DETERMINATION IN MERGER NOTIFICATION M/08/011 – HEINEKEN/SCOTTISH & NEWCASTLE

Section 22 of the Competition Act 2002

Proposed acquisition by Heineken N.V. of the assets relating to the business operated by S&N in Ireland, namely, Beamish & Crawford plc

Dated: 03/10/2008

The Competition Authority
An tÚdarás Iomaíochta

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SECTION ONE: INTRODUCTION

Introduction

1.1 On 12 February 2008 Heineken N.V. ("Heineken") notified the European Commission (the "Commission") of the proposed acquisition by Heineken of certain assets (including brands) relating to the businesses operated by Scottish & Newcastle plc ("S&N") in Belgium, Finland, Ireland, Portugal and the United Kingdom (Case No. COMP/M.4999, *Heineken/Scottish & Newcastle*).

1.2 The Competition Authority (the "Authority") received a copy of the notification by Heineken to the Commission on 14 February 2008. By letter dated 29 February 2008 to the Commission, the Authority, as the Irish competent authority, requested the referral of the part of the concentration concerning Ireland, pursuant to Article 9(2)(a) and (b) of the Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the "ECMR").

1.3 On 3 April 2008, the Commission made a partial referral of Case No. COMP/M.4999, *Heineken/Scottish & Newcastle*, to the Authority[1]. In particular, the referred transaction is the proposed acquisition by Heineken of the assets relating to the business operated by S&N in Ireland, namely, Beamish & Crawford plc ("B&C") (the "Proposed Transaction"). The remaining part of the transaction notified to the Commission was cleared on the same date.

1.4 In accordance with section 18 (13) of the Competition Act, 2002 (the "Act"), the referral of the Proposed Transaction to the Authority by the Commission constitutes a notification under Section 18 (1) of the Act. Section 18(14) provides that the date on which the Authority receives the referral from the Commission shall; be deemed to be the date of the notification. The Authority received the referral on 3 April 2008. On 29 April 2008, Heineken made a submission to the Authority setting out the pertinent Irish aspects of the case using a format similar to an Irish merger notification.

Background

1.5 The Proposed Transaction is part of a wider transaction which involved the following steps:

(i) the acquisition (through a public offer) of all the shares of S&N by Sunrise Acquisitions Limited ("Bidco"), a company jointly controlled by Heineken and Carlsberg A/S ("Carlsberg") and created for the purposes of this transaction; and,

1 The Commission's referral decision may be accessed at: www.ec.europa.eu/comm/competition/mergers/cases/decisions/m4999_20080403_20230_en.pdf. This will be referred to as "the Referred Decision."

(ii) the subsequent division of the S&N's businesses between Heineken and Carlsberg according to the terms of an agreement between Heineken and Carlsberg.

1.6 Pursuant to Commission *Consolidated Jurisdictional Notice* under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the "Jurisdictional Notice"), each of Heineken and Carlsberg's proposed acquisitions of the S&N businesses constituted a separate concentration[2]. Therefore, Heineken and Carlsberg's proposed acquisitions were notified separately to the Commission.

1.7 The proposed acquisition by Carlsberg of certain assets relating to the businesses operated by S&N in Estonia, France, Greece, Latvia and Lithuania, Belarus, China, Kazakhstan, Russia, Ukraine, Uzbekistan and Vietnam was notified by Carlsberg to the Commission on 1 February 2008 and was cleared on 7 March 2008 (Case No. COMP/M.4952, *Carlsberg/Scottish & Newcastle*).

1.8 The proposed acquisition by Heineken of the remaining assets relating to the businesses operated by S&N in Belgium, Finland, Ireland, Portugal and the United Kingdom was notified separately by Heineken to the Commission on 12 February 2008 (Case No. COMP/M.4999, *Heineken/Scottish & Newcastle*). On 3 April 2008, the Commission referred the Proposed Transaction to the Authority and cleared the remaining part of the transaction (see paragraphs 1.1 to 1.3 above).

1.9 The Commission's referral of the Proposed Transaction to the Authority had some implications with regard to the first step of the wider transaction (i.e. the acquisition by Bidco of S&N). Under the Act, the acquisition by Bidco (company jointly controlled by Carlsberg and Heineken) of S&N (and therefore B&C) before a determination was made by the Authority with regard to the Proposed Transaction would have resulted in an unlawful implementation of the Proposed Transaction. To avoid this undesirable scenario, Heineken, S&N, B&C and Credit Suisse Securities (USA) LLC (the "Bank") entered into an agreement prior to the acquisition by Bidco of S&N (the "Subscription and Option Agreement").

1.10 Under the Subscription and Option Agreement, S&N ceased to have control over B&C. One new voting share in the capital of B&C was issued and allotted to the Bank and the shares formerly held by S&N in B&C were reclassified as non-voting shares. Consequently, at the time of completion of the acquisition by Bidco of S&N, control of B&C did not pass to Heineken. The Bank undertook to hold the voting share pending the decision of the Authority.

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[2] According to paragraphs 30-32 of the Jurisdictional Notice, where the subsequent break-up of assets is agreed between the parties in a legally binding way (i.e., division of S&N assets between Heineken and Carlsberg) and is certain to take place within a short time period after the first step (i.e., acquisition by Bidco of S&N), "only the acquisitions of the different parts of the undertaking in the second step will constitute concentrations, whereby each of these acquisitions by different purchasers will constitute a separate concentration" (paragraph 32).

The Transaction

1.11 The Proposed Transaction consists of the acquisition of sole control by Heineken of B&C. The assets to be acquired include the brewery and the brands of B&C.

The Undertakings Involved

The Acquirer: Heineken

1.12 Heineken is the holding company of the Heineken group. Heineken is listed on the Euronext Amsterdam Stock Exchange. The shares in Heineken are held for 50.005% by Heineken Holding N.V., which is also listed in the Euronext Amsterdam Stock Exchange. The shares in Heineken Holding N.V. are held for 58.78% by L'Arche Green N.V., which is 88.42% owned by the Heineken family.

1.13 In Ireland, Heineken is active through its 100% subsidiary Heineken Ireland Ltd ("Heineken Ireland"). Heineken Ireland has its head office in Cork, where it also operates its only Irish brewery (formerly known as Murphy's Brewery Ireland) with a capacity of 1,030,000 hectolitres ("hl"). Heineken acquired the former Murphy's Brewery in 1983.

1.14 In Ireland, Heineken is involved in the manufacture and supply of beer products. Details of Heineken's activities in Ireland are discussed in section 2 below.

The Target: B&C

1.15 Up to 28 April 2008, B&C was a wholly owned subsidiary of S&N. B&C was acquired by S&N in 1995. B&C operates a brewery in Cork with a capacity of 600,000 hl. The head office of B&C is also located in Cork.

1.16 In Ireland, B&C is involved in the manufacture and supply of beer products. Details of B&C's activities in Ireland are discussed in section 2 below.

Rationale for the Notified Transaction

1.17 Heineken submitted that through the acquisition of S&N, it intends to further develop its business in a number of national markets where, up to the present time, it had no or only negligible business. The acquisition is also expected to result in a more efficient production process and distribution.

1.18 With regard to the Proposed Transaction, Heineken claims that the acquisition of B&C will allow it to compete more vigorously with the significantly larger Diageo.

Phase 1: Preliminary Investigation

Contacts with the notifying parties

1.19 At a very early stage of the Authority's investigation, a copy of the Form CO and the annexes part of the notification of Case No. COMP/M.4999, *Heineken/Scottish & Newcastle* to the Commission, was provided to the Authority by the legal representatives of Heineken and S&N in Ireland.

1.20 On 28 April 2008, an economic report by RBB Economics ("RBB"), commissioned on behalf of Heineken, was submitted to the Authority ("RBB Report #1").[3]

1.21 On 29 April 2008, Heineken made a submission to the Authority setting out the pertinent Irish aspects of the case using a format similar to an Irish merger notification. This document was referred to by Heineken as the "QIN" or "Quasi Irish Notification".

1.22 On 1 May 2008, the Authority issued a requirement for further information ("RFI"), in accordance with section 20(2) of the Act, to both Heineken and B&C. The deadline for both parties to provide the requested information was midday on Friday, 6 June 2008.

1.23 On 5 June 2008, the Authority accepted Heineken's request to extend the RFI deadline from midday on Friday, 6 June 2008 to midday on Friday, 13 June 2008. On the same date, the Authority also accepted B&C's request to extend the RFI deadline from midday on Friday, 6 June 2008 to midday on Wednesday, 2 July 2008.

1.24 On 10 June 2008, Heineken submitted a note by RBB in consultation with Dr. Francis O'Toole ("RBB Report #2) in response to a series of queries raised by the Authority in correspondence dated 21 May 2008.[4]

1.25 On 30 June 2008, the Authority accepted B&C's second request to extend the RFI deadline from midday on Wednesday, 2 July 2008 to midday on Friday, 4 July 2008.

1.26 Heineken complied with the RFI on 13 June 2008 and B&C complied with the RFI on 4 July 2008. The new appropriate date, in accordance with section 19(6)(b)(i) of the Act, was 4 July 2008. The new deadline for a Phase 1 Determination was 3 August 2008.

1.27 The documentation submitted by Heineken in response to the RFI was numbered sequentially, 1, 2, 3, and so on. In referring to this documentation below, reference will be made to these page numbers.

1.28 B&C's response to the RFI included an economic report by Compecon Limited ("Compecon Report #1").[5]

1.29 On 14 July 2008, Heineken made an additional submission, in writing, to the Authority ("Second Submission to the Competition Authority by Heineken N.V.").

1.30 On 25 July 2008, the Authority visited the brewing facilities of each of Heineken and B&C in Cork. These site visits were carried out

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[3] RBB, "Heineken Ireland/Beamish & Crawford: Assessment of the impact on competition in the Irish On-Trade Market", 25 April 2008.
[4] RBB, "Case M/08/011-Heineken/S&N-Response to the Competition Authority's Questions", 10 June 2008.
[5] Compecon, "Economic Assessment of the proposed acquisition of Beamish & Crawford plc by Heineken N.V.", 3 July 2008.

mainly to inform the Authority's understanding of the possibility of switching production between the different types of beer products in the same brewery. PowerPoint presentations were made separately to the Authority by both parties.

1.31 During the Phase 1 investigation, the Authority also attended various meetings and held various conference calls at the request of the parties to discuss issues relevant to the investigation of the Proposed Transaction.

Contacts with third parties

1.32 During the Phase 1 investigation the Authority contacted various third parties. These contacts with third parties included: (i) circulation of questionnaires and face-to-face interviews (administered by TNS MRBI on behalf of the Authority) to wholesalers/retailers and publicans; (ii) circulation of questionnaires by the Authority to competitors; and, (iii) telephone interviews by the Authority with third parties.

Questionnaires to wholesalers/retailers and publicans

1.33 Questionnaires were issued to 46 wholesale/retail customers of Heineken and B&C. The contact details of 44 of those were obtained from the Commission and the Authority added two more customers to the list. These 46 wholesale/retail customers were significant customers of the parties. Thirty five out of 46 (or 76%) of the customers contacted by TNS MRBI responded to the questionnaire survey. Customers from 17 counties across the State responded to the questionnaires. The majority of customers are located in Dublin followed by Cork and Clare.

1.34 The Authority obtained the contact details of 110 on-trade customers of Heineken and B&C from the Commission and the parties (i.e. the top 50 pub customers of each of Heineken and B&C and 10 golf clubs). Questionnaires were circulated to 92 on-trade customers due to common customers between Heineken and B&C. 58 out of 92 (or 63%) of the customers contacted by TNS MRBI responded to the questionnaire survey. Customers from nine counties across the State responded to the questionnaires. The majority of customers are located in Dublin followed by Cork.

Questionnaires to competitors

1.35 Questionnaires were circulated by the Authority to seven competitors of Heineken and B&C (i.e., two beer brewers, four wholesalers and one cider manufacturer). The Authority received responses from four out of seven (or 57%) of the competitors contacted.

Telephone interviews with third parties

1.36 The Authority obtained information relevant to the investigation of the Proposed Transaction in the course of telephone interviews with third parties. In particular, telephone interviews were held with;

(i) the two main representative bodies for publicans in Ireland: the Licensed Vintners Association ("LVA") and the Vintners' Federation of Ireland ("VFI");

(ii) the two main competitors of the parties in Ireland: Diageo plc ("Diageo") and InBev N. V. ("InBev"); and,

(iii) the owner of the Miller brand currently licensed to B&C, SABMiller plc ("SABMiller").

Contacts with expert economist

1.37 During the Phase 1 proceedings, the Authority retained the expert economic services of Professor Bruce Lyons of the University of East Anglia in the UK.

1.38 The Authority conducted analysis of pricing data provided by the parties and obtained from the Central Statistics Office ("CSO"). The results are reported in section three below.

Third party submissions

1.39 The Authority received third party submissions, in writing, from the [..], the [..] and two importers/wholesalers of drinks, including beer, in Ireland: [..] and [..].

1.40 All of these third parties raised competition concerns with regard to the Proposed Transaction in their submissions. The issues raised by third parties with regard to the Proposed Transaction will be dealt with in sections 5 and 6 below.

Other

1.41 The Authority retained the expert corporate law services of Mr. Sean Ryan, Solicitor for O'Donnell Sweeney Eversheds, to review the Subscription and Option Agreement referred to in paragraphs 1.9 and 1.10 above.

Phase 1 Determination

1.42 Having considered the notification, the economic reports, the information submitted by the parties in response to the RFI and also the information provided by third parties, the Authority was unable to form the view at Phase 1 that the result of the proposed acquisition would not be to substantially lessen competition in markets for goods and services in the State.

1.43 As a result, on 1 August 2008, the Authority determined, in accordance with section 21(2)(b) of the Act, to carry out a full investigation under section 22 of the Act.

Phase 2: Full Investigation

Contacts with the notifying parties

Requirement for further information

1.44 On 5 September 2008, the Authority issued an RFI to B&C, in accordance with section 20(2) of the Act. The deadline to provide the requested information was midday on Thursday, 11 September 2008. As this RFI was issued later than one month from the date of receipt of the Commission's referral decision, there was no change to the "appropriate date" (i.e., 4 July 2008).

1.45 A letter from B&C requesting an extension of the RFI deadline was received on 8 September 2008. The Authority accepted B&C's request to extend the RFI deadline from midday on Thursday, 11 September 2008 to midday on Monday, 15 September 2008.

Further contacts

1.46 Heineken made additional submissions and provided a PowerPoint presentation to the Authority on 2 September 2008 and 3 September 2008, respectively. These documents deal with specific issues relevant to the Proposed Transaction. Subsequently RBB in collaboration with Dr. Francis O'Toole submitted a further note dated 18 September 2008 ("RBB Report #3"). [6]

1.47 B&C also provided a PowerPoint presentation and additional submissions to the Authority on 17 September 2008 and 19 September 2009, respectively. These documents deal with specific issues relevant to the Proposed Transaction. The documents included Compecon Report #2, dated 12 September 2008.[7]

1.48 The Authority held various further meetings and conference calls with economic, legal and company representatives of the parties, at which the competition concerns of the Authority were presented and discussed. The parties and their representatives also updated the Authority on recent developments in the markets affected by the Proposed Transaction and made further submissions in response to specific questions raised by the Authority.

Deferring the Assessment

1.49 According to the Authority's Revised Procedures for the Review of Mergers and Acquisitions, if the Authority is not satisfied that the result of the merger will not be to substantially lessen competition, it will, within eight weeks of the date of the determination to conduct a full investigation, furnish an assessment (the "Assessment") of the proposed merger or acquisition to the undertakings involved.

1.50 The Assessment must set out the Authority's concerns regarding the effect of the proposed merger on competition in the relevant markets. The eight week time period may be adjusted following consultation and agreement between the undertakings involved and the Authority.

1.51 In the instant case, the initial deadline to issue an Assessment, if the Authority considered that an Assessment was required, was Friday 26 September 2008. However, on 25 September 2008 both

[6] RBB, "Heineken Ireland/B&C: The Elimination of B&C is Unlikely to Restrict Competition in the Stout Market", 18 September 2008.
[7] Compecon, "Replies to Competition Authority RFI", 12 September 2008.

Heineken and B&C agreed to the Authority's request to extend this deadline to close of business on Friday, 3 October 2008.

1.52 The Authority decided not to issue an Assessment on 3 October 2008 and instead made a determination under section 22(3)(a) of the Act clearing the merger.

Proposals

1.53 The parties made no proposals either informally or formally to the Authority.

Contacts with expert economist

1.54 During the Phase 2 of the investigation, the Authority continued to discuss relevant issues with Bruce Lyons.

Third Party Submissions

1.55 Interested parties were invited to make written or oral submissions by no later than 5.00pm on 21 August 2008.

1.56 The Authority received a second third party submission, in writing, from [..]; [..] and the [..]. The Authority also received written submissions from eight publicans and a consultant with experience in the international and Irish beer markets.

1.57 All of these third parties raised arguments against the Proposed Transaction. Issues raised in the third party submissions (received during Phase 1 and Phase 2) were investigated as part of the review process. The specific arguments raised by third parties with regard to the Proposed Transaction will be presented and assessed in sections 5 and 6 below.

[..]

1.58 [..] is a company involved in the manufacture and distribution of alcoholic and non-alcoholic beverages in Ireland and abroad. [..]. It deals with all the major breweries (Diageo Ireland, Heineken Ireland and B&C). [..].

1.59 [..] submits that the proposed transaction will lead to greater control by Diageo Ireland and Heineken Ireland of the beer drinks industry in Ireland and will facilitate the increase in prices. According to [..], the Proposed Transaction:

(i) will reduce the number of breweries in Ireland from 3 to 2;

(ii) will give Heineken Ireland control of 50.30% of the total lager market and will bring together the three leading packaged beer brands (Heineken, Miller and Coors);

(iii) will have an impact on the stout market:

- the Proposed Transaction will bring together the number two and three brands in the stout market (i.e. Beamish and Murphy's) with a combined market share > 50% in the Munster region;

- The Muster region is an area where there is very strong loyalty to the local brands and switch rate between the local brands and Guinness would be negligible;

- Murphy's is sold on full price premise identical with Guinness while Beamish is sold at a discount of 20-50 cents per pint.

1.60 Finally, [..] argues that Heineken will always follow Diageo in any price increase as it has done in the past. Diageo is taking a price increase of its product from 15 September 2008 which will be followed by Heineken in October. B&C has stated that they will not be taking price increases.

[..]

1.61 [..] Expressed concerns in respect of the stout market. [..] submits that Beamish brings some competition to the stout market in Ireland. Diageo sets the price and Heineken follows. Guinness and Murphy's stouts have not been available for retail sale at significantly discounted prices. In the on-trade, if Diageo and Heineken are the only two producers, the price of a "pint" will increase.

[..]

1.62 [..]main concern is the likely impact of the proposed acquisition on the Brewing and Dublin Vintner Investment ("BDVI") Company, a joint venture between the LVA and Beamish & Crawford in relation to the Dublin market. The principal objective of BDVI is to bring greater competition in the draught beer category. [..] argues that B&C has injected real price competition in the lager and stout categories.

[..]

1.63 The [..] submits that the Proposed Acquisition has the effect of significantly affecting competition, particularly in the Cork and Munster region where B&C is a strong competitor. B&C adopts a marketing strategy that is primarily price based and it has proved to be very competitive in the marketplace in which they operate. The […] would be concerned if, post-acquisition, this level of competitiveness were to be diluted.

Publicans

1.64 Eight publicans made individual submissions to the Authority. The key points of their submissions with regard to the Proposed Transaction are the following:

(i) B&C brand portfolio coming from a small brewer creates great competition in the market place;

(ii) B&C have resisted to price increases for their products when Diageo and Heineken have put up prices simultaneously. On occasions, B&C have absorbed the cost increases and not passed on any increased to the publicans who has then been in a position to hold down the price of their products to the benefit of the customer[8];

(iii) B&C is the only viable alternative supplier to the two main dominant players in the stout market and the transfer of the Beamish brand to the portfolio of one of those two dominant players is not in the interest of the publican or consumer; and,

(iv) B&C, through the BDVI, have enabled publicans to sell some of their products as mush as 50 cent cheaper than products from the other two main rivals in the trade. The BDVI partnership will be terminated if the Proposed Transaction is implemented.

Consultant with experience in the International and Irish beer markets

1.65 This consultant submits that the Proposed Acquisition does not promote a healthy competitive environment in Ireland for the following reasons:

(i) it will create a duopoly in the Irish beer market (Diageo and Heineken);

(ii) it will restrict access for third companies to the Irish market (B&C is a strategic option for third party companies to partner with to brew, distribute and market their brands);

(iii) it will demise the Murphy's or Beamish stout brands since Heineken Ireland has demonstrated that it lacks the strategic ability to build a successful stout brand;

[8] One publican submits that Beamish is sold in Dublin pubs at a €1 discount to Guinness. The same applies to Fosters lager which retails at €1 less than other lagers. Beamish and Fosters are must have brands particularly in the suburbs.

SECTION TWO: BACKGROUND

Introduction

2.1 Both Heineken and B&C are involved in the manufacture and distribution of beer products in the State.

2.2 This section provides background information on the following issues:

(i) the key features of the Irish beer market drawn mainly from the Canadean Report dated May 2007[9];

(ii) the activities of the parties in the Irish beer market; and

(iii) the activities of the parties' main competitors in the State.

Key Features of the Irish Beer Market

Brewers

2.3 There are three major firms in the Irish beer market: Diageo, Heineken and B&C. InBev is ranked fourth followed by a significant number of local wholesalers and importers. At present there are approximately eleven microbreweries in the State.

2.4 Diageo, Heineken and B&C all brew in the State. InBev, after the closure of the old Bass Brewery in Belfast in 2004, no longer has a brewery presence on the island of Ireland. InBev currently uses its brewery facilities in Great Britain to supply the Irish market.

2.5 Information on the brands of beer supplied by the parties and their main competitors in the Irish market is provided in paragraphs 2.27 to 2.40 below.

Imports and Exports

2.6 Beer imports into the State come primarily from the EU, particularly Great Britain, the Netherlands and Northern Ireland.

2.7 The bulk of beer exports from the State are stouts with Guinness stout being the largest. Exports to Northern Ireland are primarily Diageo beer products since Diageo has no brewing facilities in Northern Ireland. Exports to Northern Ireland and Great Britain by Diageo increased substantially following the closure of the Guinness brewery in Park Royal, London in July 2005.

Segmentation

2.8 The Irish beer market is divided into four distinct segments: lager, stout, ale and no alcohol/low alcohol ("NAB/LAB") beer.

2.9 While the market share for lager has increased over the years, the market share for stout has declined reflecting changes in beer consumption over the years and the appeal of continental and

[9] "The Beer Service Annual Report – 2007 Cycle Ireland", May 2007.

American beer as more fashionable beers, particularly amongst younger drinkers. In 2006, the lager segment had a market share of 63% while the stout segment had a market share of 32%, a much lower figure for stout compared with a market share of approximately 70% in the early 1970s.

2.10 The ale segment like stout has also suffered from the trend towards lager consumption. A lack of any real innovation and absence of a "real ale" culture has limited development in ale.

2.11 NAB/LAB has a very small market share with little innovation in recent years.

Distribution

2.12 For the distribution of beer, a distinction is made between the on-trade and the off-trade channel.

On-trade channel

2.13 The on-trade channel consists of pubs, clubs, restaurants and hotels. In 2006, around two thirds of beer consumed was via the on-trade channel. In this year, there were 9,949 pub and club licences in operation of which approximately 7,000 were stand alone pubs. Over the period 2000 to 2007 the number of on-trade premises decreased by almost 14.5%.[10]

2.14 Pubs are almost entirely freehold and owned by individuals. However, several small groups have emerged in recent years, the most important of which is Capital Bars. Others include Paul Connolly, Louis Fitzgerald and the Molloy Taverns chain.

2.15 The two main publicans associations in the State are the LVA and the VFI. The LVA is the trade association and representative body for the publicans of Dublin. The LVA has over 700 members and collectively represents over 90% of all publicans in Dublin. The VFI is a national trade organisation, has approximately 5,500 members throughout the State.

Off-trade channel

2.16 The main retail customers in the off-trade channel are large supermarkets (e.g. Tesco and Dunnes) and discounter chains (e.g. Aldi and Lidl).

2.17 Off-licences and petrol stations are starting to become important off-trade channels, given the growing trend towards more in-home consumption of beer. Most off-licences are one-person operations, and very few players own more than two or three stores. Over the period 2000 to 2007 the number of off-trade premises has increased by 150%.[11]

Decline of the on-trade channel

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[10]Competition Authority, 2008, *Government Alcohol Advisory Group. Submission of the Competition Authority*. Dublin: Competition Authority, January, paragraph 3.5. Hereinafter referred to as the Authority's *Alcohol Submission.* It may be accessed at: www.tca.ie.
[11] Authority's *Alcohol Submission*, paragraph 3.4.

2.18 Despite the importance of the on-trade channel and its significance in the Irish culture, beer consumption in the on-trade channel has been declining in recent years. Between 2003 and 2007 the on-trade share of total volume fell from 79% to 67%[12]. The main reasons for the decline of on-trade sales and the increase in off-trade sales are:

(i) The smoking ban in pubs, introduced on 29 March 2004;

(ii) Government efforts to limit alcohol consumption, with special attention for binge drinking and underage drinking;

(iii) Introduction of random breath testing since the summer of 2006; and,

(iv) Multi-pack offers by the large retailers, such as Tesco, Dunnes, Superquinn, Aldi and Lidl. These offers were facilitated by the abolition of the Groceries Order in March 2006. The Order discouraged price competition[13].

Activities of the parties in the Irish beer market

Manufacture of beer by the parties in the State

2.19 Heineken is active in the production of beer in the State through its brewery located in Cork (formerly known as Murphy's Brewery Ireland). Heineken's brewery has a capacity of 1,030,000 hl. Heineken acquired the former Murphy's Brewery in 1983. Heineken's brewery produces draught lager and stout beer. Packaged lager beers (bottles and cans) are imported from the Netherlands.

2.20 B&C operates a brewery in Cork with a capacity of 600,000 hl. B&C's brewery produces draught lager and stout beer. B&C's brewery has packaging (kegging and bottling) facilities. B&C uses Diageo's packaging premises in Northern Ireland for the can format.

Distribution of beer by the parties in the State

2.21 Both Heineken and B&C distribute their products in a very similar manner. The kegs of beer for the on-trade are sold directly by the brewers to the publicans. The sales representatives collect orders from individual publicans and the beer is distributed by the brewers. The contract is between the brewer and the publican.

2.22 The bottled and canned beer for the on-trade is sold to the publicans through wholesalers. Thus the contractual relationship is between the publican and the wholesaler.

2.23 The bottled and canned beer for the off-trade channel is partly sold directly by the brewers to the larger retailers (supermarket and discounters) and partly to wholesalers that sell to the smaller retailers.

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[12] Heineken's presentation to the Authority dated 11 September 2008.

[13] For a discussion see Department of Enterprise, Trade and Employment, 2005, *Restrictive Practices (Groceries) Order 1987. A Review and Report of Public Consultation Process*. Dublin: the Department. This report may be accessed at http://www.entemp.ie/commerce/consumer/groceriesorderreport.htm.

2.24 Heineken is also active on the wholesale level of the market. Heineken owns 100% of Western Beverages and West Cork Bottling and 50% of Nash Beverages. Western Beverages, West Cork Bottling and Nash Beverages are multi-brand wholesalers that are active in the West of Ireland. They distribute beer and other alcoholic and non-alcoholic beverages of a wide range of brands, including all competitor brands. They are active in the on-trade as well as the off-trade, but they are stronger in the on-trade channel.

2.25 B&C does not have any wholesale operation in the State.

Brewing & Dublin Vintners Investment Co. Plc ("BDVI")

2.26 The BDVI was established in 1991 as a partnership between the LVA and B&C. The objectives of the BDVI are twofold: (i) to offer substantial rewards to its investors and (ii) to create a healthier, more competitive environment in the marketplace whilst increasing sales and market shares for B&C. The BDVI shareholders are mainly Dublin publicans that are members of the LVA. Through this mechanism B&C seeks to provide incentives for publicans to purchase B&C products, notably Beamish Stout by offering significant volume related rebates. It also seeks to encourage publicans to pass on the benefits of cost reductions to their customers in the form of lower prices. In 2007, almost 500 of the LVA members subscribed to the BDVI.

The products and brands of the parties

2.27 Both Heineken and B&C are active on the Irish beer market each with its own brands, licensed brands or brands imported from outside the State. The brands (by type of beer product) distributed by the parties in the State are set out in Table 2.1 below.

Table 2.1
Heineken and B&C Brands, by Beer Type, 2008.

PRODUCT	BRANDS	
	HEINEKEN	**B&C**
Lager	Heineken	Miller
	Coors Light	Foster's
	Amstel	Carling
	Specialties (Sol, Affligem, Zywiec, Paulaner, Moretti)	Kronenbourg 1664
Stout	Murphy's	Beamish
Cider	-	Scrumpy Jack
Ale	_	_

Source: The Competition Authority

2.28 Heineken's brand portfolio in the State includes the following brands of beer:

- *Heineken*: This is a lager beer of Dutch origin. Heineken Ireland produces Heineken draught in its brewery in Cork and imports bottled and canned Heineken beer from the Netherlands. The Heineken brand represents in volume approximately 78% of the sales of Heineken in the State.

- *Coors*: This is a lager beer of US origin, of which the brand is licensed from Molson Coors Company (US/Canada). Heineken produces Coors beer in kegs (in Cork) and imports bottled and canned Coors beer from the Netherlands. The Coors brand represents in volume approximately 13% of the sales of Heineken in the State.

- *Murphy's*: This is a stout of Irish origin. Murphy's represents in volume approximately 7% of the sales of Heineken in the State. All Murphy's stout is produced in Cork, but canning is out-sourced to the UK, i.e. Murphy's is produced in Cork, exported to the UK, packaged appropriately and imported into the State.

- *Amstel*: This is a lager beer of Dutch origin. Heineken Ireland produces Amstel draught in its brewery in Cork and imports bottled and canned Amstel beer from the Netherlands. The Amstel brand represents in volume approximately 2% of the sales of Heineken in the State.

- *Specialties*: Since 2006, Heineken sells in the State a range of brands which are imported from different countries including Sol (Mexico), Affligem (Belgium), Zywiec (Poland), Paulaner (Germany) and Moretti (Italy).

2.29 B&C's brand portfolio in the State includes the following brands of beer:

- *Miller*[14]: This is a lager beer of US origin. The Miller brand is not owned by S&N, but licensed from SABMiller (since 1996). B&C produces Miller beer in kegs (Miller Genuine Draft or MGD) as well as in bottles under the MGD name. The Miller brand represents in volume approximately 47% of the sales of B&C in the State.

- *Foster's*[15]: This is a lager beer of Australian origin. S&N formerly owned the European rights on the Foster's brand. However, following the implementation of the transaction relevant to Case No. COMP/M.4999, *Heineken/Scottish & Newcastle*, Heineken acquired the European rights of the Foster's brand. B&C currently produces Foster's beer for the Irish market. However, there is no licence agreement between Heineken and B&C for the production of Foster's in the State. The Foster's brand represents in volume approximately 20% of the sales of B&C in the State.

- *Beamish*: This is a stout of Irish origin. Beamish represents in volume approximately 23% of the sales of B&C in the State. For kegged and bottled formats Beamish is brewed, kegged and bottled in B&C's Cork facility. With respect to cans it is

[14] MGD is brewed, kegged, and bottled in B&C's Cork facility.
[15] Foster's is brewed, kegged, and bottled in B&C's Cork facility.

tanked to Diageo's facility in Belfast where it canned and shipped back to the State.

- *Carling*: This is a lager beer of Canadian origin, of which the brand is licensed from Molson Coors Company (US/Canada). B&C produces Carling beer in kegs as well as in bottles. The Carling brand represents in volume approximately 9% of the sales of B&C in the State.

- *Kronenbourg 1664*: This is a French lager brand formerly owned by S&N. However, the ownership of Kronenbourg 1664 was transferred to Carlsberg after the implementation of the transaction relevant to Case No. COMP/M.4999, *Heineken/Scottish & Newcastle*. B&C currently produces Kronenbourg beer for the Irish market. However, there is no licence agreement between Carlsberg and B&C for the production of Kronenbourg in the State. Kronenbourg has only been sold in the State since 2006 and represents less than 1% of the sales of B&C in the State.

- *Scrumpy Jack*: This cider is of UK origin. Scrumpy Jack is only sold in negligible volumes in the State.

2.30 While B&C distributes a negligible quantity of cider in the State, neither party is involved in the production or distribution of ale in the State. Since there is no overlap between the undertakings involved in ale and cider, the competitive effects of the proposed transaction for these two markets need not be addressed further.[16]

The activities of the parties' main competitors in the State

2.31 The competitors of Heineken and B&C on the Irish beer market include two large brewers, Diageo and InBev, and a number of wholesalers that import beer from outside the State such as Comans Wholesale, Barry Fitzwilliam Maxxium and C&C.

Diageo

2.32 The market leader and by far the largest brewer in the State is Diageo Ireland, which is part of the Diageo group. Diageo owns the No. 1 Irish beer brand, Guinness, and produces other important brands under licence. Moreover, it also has a very significant position in the spirits sector and sells wines and other alcoholic beverages.

2.33 The head office of Diageo Ireland is located in Dublin and Diageo's breweries, with a capacity of 6,000,000 hl, are located in Dublin, Dundalk, Kilkenny and Waterford.

2.34 Diageo is active on the Irish beer market with different brands, which are partly owned and partly licensed brands. Diageo sells the following brands in the State:

[16] This anticipates the discussion in section three below which concludes that ale and cider are separate markets.

- *Guinness*: This is a stout of Irish origin. Guinness is the largest beer brand in the State and represents in volume approximately 51% of the beer sales of Diageo in the State.

- *Budweiser*: This is a lager beer of US origin of which the brand is licensed from Anheuser-Busch (USA). Diageo produces Budweiser beer in kegs as well as in bottles and cans. The Budweiser brand represents in volume approximately 24% of the beer sales of Diageo in the State.

- *Carlsberg:* This is a lager beer of Danish origin of which the brand is licensed from Carlsberg A/S (Denmark). Diageo produces Carlsberg beer in kegs as well as in bottles and cans. The Carlsberg brand represents in volume approximately 11% of the beer sales of Diageo in the State.

- *Smithwicks:* This is an ale beer of Irish origin. Smithwicks is the largest ale brand in the State and represents in volume approximately 9% of the beer sales of Diageo in the State.

- *Harp*: This is a lager beer of Irish origin. Harp represents in volume approximately 2% of the beer sales of Diageo in the State.

- *Tuborg*: This is a lager beer of Danish origin of which the brand is licensed from Carlsberg A/S (Denmark). The Tuborg brand is only sold in cans and represents in volume approximately 2% of the beer sales of Diageo in the State.

- *Satzenbrau*: This is a lager beer of German origin. Satzenbrau is only sold in bottles and cans and represents in volume approximately 0.4% of the beer sales of Diageo in the State.

- *McCardles Ale*: This is an ale beer of Irish origin. McCardles Ale represents in volume approximately 0.3% of the beer sales of Diageo in the State.

- *Warsteiner*: This is a lager beer of German origin of which the brand is licensed from the Warsteiner group (Germany). Warsteiner brand represents in volume approximately 0.2% of the beer sales of Diageo in the State.

- *Kilkenny*: This is an ale beer of Irish origin. Kilkenny represents in volume approximately 0.2% of the beer sales of Diageo in the State.

- *Kaliber*: This is a no alcohol beer of Irish origin. Kaliber represents in volume approximately 0.1% of the beer sales of Diageo in the State.

InBev

2.35 InBev Ireland Ltd is part of the international InBev N. V. which is currently the largest brewer in the world. InBev acquired substantial activities on the Irish beer market through the acquisition of the UK brewer Bass in 2000. InBev closed the former Bass brewery in Northern Ireland in 2004 and currently supplies its beers (including its kegged beer) from the UK and other countries. The head office of InBev Ireland is located in Dublin.

2.36 The main brands sold by InBev on the Irish market are:

- *Stella Artois*: This is a lager beer of Belgium origin. Stella Artois represents in volume approximately 32% of the sales of InBev in the State.
- *Tennents*: This is a lager beer of UK origin. Tennents represents in volume approximately 19% of the sales of InBev in the State.
- *Beck's*: This is a lager beer of German origin, which is sold in the varieties Beck's, Beck's Bier and Beck's Non-Alcoholic. Beck's represents in volume approximately 17% of the sales of InBev in the State.
- *Castlemaine*: This is a lager beer of Australian origin. Castlemaine represents in volume approximately 12% of the sales of InBev in the State.
- *Bass*: This is an ale beer of UK origin. Bass represents in volume approximately 6% of the sales of InBev in the State.
- *Labatt Ice*: This is a lager beer of Canadian origin. Labatt Ice represents in volume approximately 6% of the sales of InBev in the State.
- *Rolling Rock*: This is a lager of US origin. Rolling Rock represents in volume approximately 3% of the sales of InBev in the State.
- *Staropramen*: This is a lager of Czech origin. Staropramen represents in volume approximately 2% of the sales of InBev in the State.
- Belgium specialty beers, including Hoegaarden (white beer), Leffe Blond and Leffe Brun (abbey beers). The Belgium specialty beers represent in volume approximately 1% of the sales of InBev in the State.

Comans Wholesale

2.37 Comans Wholesale Ltd ("Comans") is a drinks wholesaler and distributor that sells beers and other alcoholic and non-alcoholic drinks. Comans does not brew beer but is a significant competitor by virtue of being able to import brands from overseas. The head office of Comans is located in Dublin.

2.38 Comans owns the Dutch Gold and Prazsky brands in the State, which it sources from different brewers on the continent. Dutch Gold is a successful off-trade lager brand (with a share of 7% of the off-trade lager market).

Barry Fitzwilliam Maxxium

2.39 Barry Fitzwillliam Maxxium ("BFM") is a drinks wholesaler and distributor that sells beers and other alcoholic and non-alcoholic beers in the State. BFM acts as agent for different foreign brewers that are not active in the State themselves. The head office of BFM is located in Cork. The main brands imported and sold by BFM are Corona Extra (Mexican), Kingfisher (Indian) and San Miguel (Filipino).

C&C

2.40 C&C Group Plc ("C&C") is a manufacturer and an independent wholesaler of alcoholic drinks in the State. C&C distributes beer and other alcoholic drinks of different brands in on- and off-trade. C&C owns the No 1 Irish cider brand Bulmers. C&C imports the Dutch lager Grolsch. The head office of C&C is located in Dublin.

SECTION THREE: RELEVANT PRODUCT AND GEOGRAPHIC MARKETS

Introduction

3.1 In this section, the relevant market is defined in terms of its product and geographic dimensions. First, the Authority presents the Commission's preliminary views of the relevant market[17], then the views of Heineken and B&C are summarised, and finally, the Authority's investigation is explained and its analysis and conclusions set out.

Relevant Product Market

The Commission's View

3.2 In its Referral Decision, the Commission followed its own precedent and ECJ case law and suggested that the relevant market "is that for the production and distribution of beer which is to be distinguished from other beverages."(p.5)

3.3 The Commission considered that it is relevant to make a distinction between "on-trade" distribution (that is, beer sold by pubs, bars, restaurants, etc.) and "off-trade" distribution (retail outlets). (p.6). The Commission's market investigation does not support the view that cider should be considered as part of the relevant product market with beer. The Commission's market investigation revealed that: (i) there is limited interaction between the price of beer and that of cider; and (ii) a 10% increase in the price of lager would not be sufficient to cause enough consumers to switch to cider.

3.4 The Commission's investigation indicated that, in assessing the beer market in the State, it would be appropriate to look at each of lager, ale and stout as separate markets.

Submissions of the Undertakings Involved

Heineken

3.5 Heineken provided two economic reports prepared by RBB Economics in consultation with Dr. Francis O'Toole to support its view that it is not appropriate to define separate markets for each of lager, stout and ale.

3.6 In RBB Report #1, RBB agrees with the Commission's view that the market should be distinguished by channels of distribution, that is, on-trade and off-trade. However, RBB disputes the Commission's view that the different types of beer (that is, lager, stout and ale) each constitute a distinct product market. RBB submits that the different beer types and cider belong to one and the same market. RBB submits that: (i) the Commission's Referral Decision relies on a "loose "opinion poll" approach to market definition based on responses from third parties who may have a clear commercial interest to cause problem for the transaction" (p. 3); (ii) there are both supply side and demand side substitutability. On the supply

[17] These were set out in the Referral Decision. For details see footnote 1 above.

side, RBB submits that there is substitutability in the manufacture of cider and other beers. On the demand side, a substantial amount of customers drink all types of beers as well as cider, which supports the view that those customers are likely to switch following a price increase in one type of beer; and, (iii) there is high price correlation across products.

3.7 Pursuant to the Authority's critique of RBB Report # 1, Heineken provided RBB Report #2, which it claimed provides data to support the view that there is a single on-trade beers and cider market in Ireland. Using AC Nielsen on-trade data on volume and value of the main lager, cider, ale and stout brands, RBB estimated weighted average prices for each category of beer and cider for the period November 2002 – February 2008. RBB confirmed that the price series are non-stationary. In order to establish the scope of the product market, RBB carried out a correlation analysis and Granger Causality test using first differences of the constructed weighted average price series. These are discussed in more detail below.

B&C

3.8 Pursuant to a formal request for information issued to B&C, B&C provided an economics report, Compecon Report #1, which came to the following conclusions concerning the relevant product market: (i) on-trade and off-trade constitute separate markets; (ii) the fact that a group of consumers consume different products at different times in different settings cannot be interpreted as indicating that products are substitutes and are part of the same market[18]; (iii) cider is in a separate market based on B&C's analysis of pricing data, analysis of an event study concerning the impact on the sale of beer due to the increase in excise duty on cider and B&C's internal documents; and (iv) each of stout and lager constitute a separate product market.

3.9 In summary, while Heineken and B&C agree that the on- and off-trade should be distinguished, they disagree on whether there is a broad or narrow market. Heineken takes the view that the relevant market is beer and cider, while B&C's view is that there are four separate markets: stout, ale, lager and cider.

Authority's Investigation

3.10 In its assessment of the appropriate relevant product market for purposes of assessing the proposed transaction, the Authority considered information obtained from various sources: (i) the parties' internal documents; (ii) the Authority's survey of competitors and customers; (iii) an analysis of drinking habits and occasion; (iv) an application of the SNNIP test; and, (v) statistical analysis of CSO price data referred to in section one above.

Review of Parties' Internal Documents

3.11 A review of the internal documentation submitted by both Heineken and B&C indicates that while consumers may have a repertoire of drinks that they consume on different occasions, competition in beer markets takes place mainly within a particular beer segment.

[18] The Competition Authority, *Irish Distillers/Cooley 1994,* Decision no. 285 at para 75.

Heineken

3.12 A number of documents obtained from Heineken pursuant to a formal request for information by the Authority indicate that there is a separate market for the different types of beer. The following document extracts recognised the distinction between lager and stout markets.

- "to increase profitability by increasing volume and market share in the lager market and Murphy's holding its own in the stout market".[19]
- "The Company strategy is aimed at: Increase market share to […]-to be […] in lager and […]% ENP growth p.a."[20]

3.13 In respect of lager, Heineken internal documents show that its lager brands mainly compete with other lager brands. For example, the following document extract shows that Coors Light Draught competes only against other lager brands: "Coors Light Draught Quantitative study 2003", states "Key competitors for Coors Light Draught Drinkers in Order are Budweiser, Heineken, Miller, and Carlsberg"[21]

3.14 Similarly, in respect of Heineken lager, the following document: "Heineken: Qualitative Exploration Brand Loyalty and Thematic Evaluation, 2 March 2006" indicates that in the on-trade channel, customers switch out of Heineken lager into other lager brands, namely, Corona, Miller Genuine Draft, Carlsberg and Budweiser.[22] Likewise, Heineken takes shares from Budweiser and Carlsberg.[23]

3.15 In respect of stout, Heineken's internal documents indicate that its stout brand - Murphy's - competes mainly with other stout brands. The following documents demonstrate that Murphy's tracks Beamish and Guinness:

- "[…]".[24]
- "long Term (2005 and beyond) commercial goal for Murphy's is to Become the […] off trade Stout in Cork City and County. In 2004 "Become […] National off Trade Stout Brand-by value and volume."[25]
- "Whilst we have seen some large and impressive lifts for the Murphy's brand amongst stout drinkers in Munster, […]. This reflects the size of the challenge for Murphy's and […]."[26]

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[19] Page 200155, "Ireland Beer Market Overview", undated document.
[20] Page 260209, Heineken General Managers Overview.
[21] See pages 050065, 050073 and 050073.
[22] See pages 080376 and 080377.
[23] See page 080321.
[24] Page 170269, "Murphy's On Trade forward Planning", 2004.
[25] Page 180011, "Section 3-Strategic Objectives for HIL and Brands in the Off Trade", 2004.
[26] Page 060396, "Murphy's Monthly Report by Hall and Partners", 2005.

- "many Cork drinkers also believe that Murphy's actually has a nicer taste than Guinness…". "[…]."[27]

- "there is a strong Cork skew to Murphy's penetration (not however the rest of Munster). Again in Page 080214, "Stout drinkers in Cork/muster skew to be more loyal to Murphy's both on and off trade. Encouragingly Murphy's target skew heavily towards drinking stout."[28]

3.16 In sum, Heineken's internal documents provide evidence that stout and lager belong to separate markets.

<u>B&C</u>

3.17 A number of B&C's internal documents indicate that lager is a separate market from stout. In respect of its lager brands, B&C monitored other lager brands in terms of pricing, market share, advertising and growth:[29]

- "The new brands of lager continue to establish themselves, with lager drinkers in no doubt as to the growing range available to them. Budweiser should be a key target for Miller to steal share/encourage switching for a number of reasons- Miller bottled drinkers currently leave the brand to drink Budweiser pints. As Budweiser becomes less appealing it offers the opportunity to encourage them to stay with the brand. – the core image of Budweiser and Miller has many similarities which make Miller an ideal alternative for Bud drinkers. Carlsberg also offers potential to encourage switching to Miller as the brand performs well in a forced choice situation and Carlsberg drinkers are less loyal than Heineken drinkers, who are potentially the most difficult to appeal to as they are the most satisfied with their brand." [30]

- "Miller draught remains a comparatively weak alternative resulting in Miller drinkers recently increasingly choosing Carlsberg and Heineken draught."[31]

- "Competitor preference point- We wish to be considered a credible alternative to Bud. Both American brands- Want Bud to stand for brash America and Miller to stand for urban cool America. Competitor set – Bud, Heineken and Carlsberg."[32]

- "Fosters target brands- Amstel and Carlsberg"[33]

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[27] Page 070195, "Channel and Brand Research On Trade" 2004.
[28] Page 800140, "Bible of Usage Findings for Ireland Alcohol Market", 2006
[29] "Miller Quarterly Review", January 2003
[30] Lansdowne Market Research, "Dublin & Cork Satellite Lager Tracking", September 2005.
[31] Lansdowne Market Research, "Brand & Advertising Study 2005-2006", August 2007.
[32] Beamish & Crawford, "Miller Genuine Draft ROI- Business Plan 2005 – 2009".
[33] Package Sales Team Meeting – Cork.

3.18 Similarly, the B&C documents clearly demonstrate that stout is a distinct market. Beamish's main competitors are Guinness and Murphy's.[34] For example:

- "The off trade stout segment is small but growing. Beamish is the fastest growing stout in the segment and becoming a clear number 2. .. The plan is to be bigger than Murphy's and stay ahead. Having already reached 10K barrels, the aim is to reach 15k barrels by 2008."

3.19 This document goes further:

(i) Showing that gains/losses from Beamish in specific stores are benchmarked against gains/loss from Murphy's and Guinness;

(ii) Outlining B&C's aspiration to "Become the number 2 beer supplier - Main target for Beamish Draught can is Guinness - refocus on distribution & ensure increased space and prime positioning (Beside Guinness)"; and,

(iii) Reproduces a table showing B&C's core competitors in the off-trade: (a) Miller Genuine Draught's key competitors are Heineken, Bud, Coors Light & Carlsberg; (b) Fosters' key competitors are Amstel, Carlsberg, Tuborg, Dutch Gold and Prazsky; Beamish's main competitors are Guinness and Murphy's; and, (d) Carling's main competitors are Harp, Tennents and Amstel. [35]

3.20 In sum, the B&C internal documents provide evidence that stout and lager belong to separate markets.

Authority Survey of Competitors and Customers

3.21 The Authority surveyed both customers of and competitors to Heineken and B&C. On-trade customers are used as a proxy for consumer tastes and preferences. The demand of the on-trade customers for the products considered in this document is a derived demand – the on-trade customers' opinions are based on their perception of the demand of end consumers.

3.22 Questionnaires were circulated to seven competitors of Heineken and B&C (i.e. two beer brewers, four wholesalers and one cider manufacturer). The Authority received responses from four of the seven competitors contacted. As noted in paragraphs 1.36 above the Authority supplemented the questionnaire to competitors with telephone interviews with the parties' two main competitors – Diageo and InBev.[36]

3.23 Questionnaires were also issued to a total of 46 wholesale/retail customers of Heineken and B&C. 35 of the customers contacted

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[34] Ibid, p. 18

[35] Package Division Sales, "Impact of "Beamish specific promotions", Conference 23 August 2007.

[36] The Authority also conducted a telephone interview with the owner of the Miller brand currently licensed to B&C, SABMiller.

responded to the questionnaire survey. In addition the Authority issued questionnaires to 92 on-trade customers of which 58 responded. This was augmented with telephone interviews with the LVA and the VFI.

3.24 Regarding the issue of market definition a number of questions were asked to competitors, on-trade and off-trade customers. The questions posed and a summary of the responses received are discussed below.

<u>On-trade v Off-trade</u>

3.25 In order to determine whether it is appropriate to make a distinction between the supply of beer to on-trade and off-trade channels, the Authority asked the following question:

- Do you consider that it is appropriate to make the distinction between the supply of beer to the on-trade and off-trade channels in Ireland?

3.26 In response to this question:

- The vast majority of on-trade customers, 82%, stated yes while only 12% stated no.

- A similar sentiment was expressed by the majority of wholesale/retailers - 71% answering yes compared to 23% answering no.

- Three out of the four competitors who responded said it is appropriate to distinguish between on-trade and off-trade channels while one did not provide an opinion.

3.27 Therefore, the Authority's survey indicates that in defining the relevant market it is appropriate to make a distinction between supply to the on-trade channel and supply to the off-trade channel.

<u>Beer by Type</u>

3.28 The Authority also enquired whether customers strategically categorise beer products by type of product. In this regard the Authority asked the following question:

- In your commercial and strategic behaviour (procurement, pricing, presentation in your pub etc.), do you categorise beer products into further sub-segments?
  - ☐ Yes, I categorise according to the <u>type of beer</u> (e.g., lager, stout, ale etc.) and I use the following categories:
  - ☐ I do not categorise by type of beer but rather according to the following criteria:
  - ☐ No, I do not use specific sub-segments.

3.29 In response to this question:

- 78% of on-trade customers said they categorise beer products by type of beer, i.e., lager, stout, ale, etc.

- The response is more mixed for wholesale/retailers: 49% answered yes and 51% replied that they do not categorise by type of beer.

- Two out of four respondent competitors said they do not categorise by type. A third did not provide an opinion and the fourth replied that it did categorise according to the type of beer.

3.30 Therefore the results of the survey are somewhat equivocal as to whether or not there are separate markets by beer type. While the on-trade are very definitely of the view that there are separate markets, the wholesales/retailers are mixed and the competitors of the view that there were not separate markets.

<u>Relative Prices of Beer and Cider</u>

3.31 The Authority enquired whether there is any interaction between price of beer and the price of cider. The Authority asked the following question:

> In your experience, are beer prices constrained by cider prices?
> ☐ Yes
> ☐ No
> ☐ Cannot say

3.32 In response to this question:

- 78% of the on-trade customers replied that beer prices are not constrained by cider prices. Only 13% of on-trade customers stated that beer prices are constrained by the price of cider.

- 94% of wholesalers/retailers stated that beer prices are not constrained by cider prices. The remaining 6% replied "cannot say".

- Two out of the four competitors who responded replied yes. A third did not provide an opinion and the fourth said no.

3.33 Therefore the Authority's survey clearly pointed towards separate markets for beer and cider.

3.34 In sum, the responses provided by on-trade customer, off-trade customer and competitors support the view that:

- The on-trade and off-trade constitute separate markets;

- There is some equivocation to whether or not there are separate product markets by type of beer, i.e., for ale lager and stout; and,

- Beer and cider are not in the same market - there is very limited evidence to support the view that there is significant interaction between the price of cider and beer.

Drinking habits and occasions

3.35 As noted above RBB argues that the drinking habits and preferences of consumers are consistent with the view that there is one market for beer and cider. This view is based on:

- Data provided in RBB Report #1 on the brands that are drunk regularly by different groups of consumers defined by their preferred drink (Figure 9, p.26). This data shows that the majority of consumers surveyed, over 75%, drink lager. Of the lager drinkers, 8% drink cider and 16% drink stout. In addition RBB specifically notes that among cider drinkers 47% of respondents declared they drank lagers on a regular basis (14% for stout).

- Information provided in RBB Report # 1 on occasions when consumers tend to drink a certain brand (Table 7, p. 27). This shows that different brands are drunk at the same occasion and indicates whether that brand is the "most frequent" choice of the respondent or a "secondary" choice. RBB specifically note that lager and cider brands show a very similar pattern of drinking; Bulmers is particularly strong as a "second choice" on all occasions when beer is drunk; and Guinness is also drunk on the same occasions as lagers but is less often chosen "at a club" and when "celebrating a special occasion".

3.36 The Authority does not find this data compelling evidence that lager, stout and cider are in the same market: while individuals may drink stout at lunchtime, lager with meals and cider on hot days, this does not provide any additional information on the substitution likely between different categories of beers or occasions than between lager and, say, bread which most lager drinkers also consume.

3.37 While RBB Report #2 continues to assert that customers tend to drink several types of beer and/or cider and that stout, lager, ale and cider are generally drunk on similar occasions it does "recognise that surveys of consumer drinking habits do not provide definitive evidence on market definition." (p. 23).

The SSNIP Test

3.38 Both the Authority and RBB are in agreement that the SSNIP test is the most appropriate test for defining the relevant market. The Authority's *Merger Guidelines*[37] states that the product market is delineated as a product or group of products such that a hypothetical monopolist of that product would impose a "small but significant and non-transitory increase in price" ("SSNIP") above the prevailing level, when the conditions of sale of all other products remain constant.

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[37] Competition Authority, 2004, *Notice in Respect of Guidelines for Merger Analysis*, Decision No. N/02/004, hereinafter referred to as the *Merger Guidelines*, which are available on the website, www.tca.ie.

3.39 The SSNIP test is used to identify the narrowest relevant product market within which a hypothetical monopolist is capable of raising price profitably. The SSNIP test estimates how a price change affects the demand for the hypothetical monopolist's product. This test is carried out by comparing the pre-merger elasticity of demand to the critical elasticity.[38] If the former exceeds the latter, it implies that a post merger price increase will be unprofitable due to the substantial decline in sales. Therefore, the product concerned does not constitute a relevant product market.

3.40 An alternative method for applying the SSNIP test involves estimating the maximum sales loss that could be sustained as a result of the price increase without making the price increase unprofitable. This is done by comparing the profit in the current pre-merger situation to the profit post merger where the merged entity raises the price post merger. If the latter is greater than the former then the product concerned constitutes a distinct market. Otherwise, the investigation should continue by adding more products which are likely to be substitutable for the product concerned.

3.41 Due to lack of data on elasticities, the Authority applies the SSNIP test using the profitability test described in the preceding paragraph. In order to estimate the percentage of customers that will switch as a result of a SSNIP by a hypothetical monopolist, the Authority survey (described in paragraphs 1.33 and 1.34 and referred to in paragraphs 3.21 to 3.24 above) asks the following questions to on-trade customers and wholesale/retailers:

3.42 In respect of a hypothetical monopolist raising the price of lager, the Authority asked the following question:

> If the price of lager were to increase by 10% whilst other prices remained constant, would you switch to other types of beer such as ale or stout and/or other alcoholic beverages such as cider? If yes, please estimate the percentage of consumers that would switch and to which other beverages.
>
> ☐ No, this price increase is not significant enough to spark changes of consumption.
>
> ☐ Yes, _______% of lager consumers would switch to the following types of beer _______.
>
> ☐ Yes, _______% of lager consumers would switch to cider.

3.43 In response to this question:

- 29% of wholesale/retailers stated that customers would switch from lager to stout as a result of a 10% increase in the price of lager. Wholesale-retailers on average estimated that 6% of customers would switch.

[38] The critical elasticity is that elasticity of demand that is just high enough to prevent a hypothetical monopolist from profitably increasing price by a threshold "small but significant" amount. See, M. G. Baumann and P. E. Godek, 2006, "A new look at critical elasticity", *Antitrust Bulletin*, June.

- A similar percentage, 23%, of on-trade customers stated that customers would switch from lager to stout. However, on-trade customers on average estimated that a lower percentage of customers, only 2.8%, would switch from lager to stout.

- In respect of a switch to cider, only c.17% of wholesale/retailers stated that customers would switch from lager to cider as a result of a 10% increase in the price of lager. Wholesale/retailers on average estimated that 3% of customers would switch from lager to cider.

- 14% of on-trade customers expressed the view that customers would switch from lager to cider. However, on-trade customers on average estimated that only 1.7% of customers would switch from lager to cider.

3.44 Table 3.1 below illustrates the SSNIP test using the above on-trade customers' estimate of the number of customers that would switch as a result of a SSNIP by a hypothetical lager monopolist. The Authority also used the following hypothetical figures: (i) a pre-merger price = €100 per 50L keg, (ii) variable cost = €30 per 50L keg, and (iii) Gross sale of 1000 units of 50L keg.

3.45 This implies a gross margin of 70% (i.e., 100-30)/100). This is somewhat lower than the gross margin reported in RBB Report # 1 (Table 5, p. 20) for Heineken across all of its beers over the period 2002 to 2007 of between […] and […]. These margins related to the on-trade. It is likely that the off trade is more competitive and margins are likely to be lower.

3.46 A change in these absolute values of hypothetical figures applied by the Authority does not affect the SSNIP test. What matters is the amount of consumers that will switch as a result of a 10% increase in the price of the product. This figure is obtained from the results of the Authority's survey discussed in paragraph 3.23 above.

Table 3.1
SSNIP Analysis of a 10% Increase in the Price of Lager

	Current price	**10% Price Increase and 2.8% Switch to Stout***	**10% Price Increase and 1.6% Switch to Cider***	**10% Price Increase, 2.8% Switch to Stout and 1.6% Switch to Cider**
Assumed unit price (€)	100	110	110	110
Assumed Gross Sale (number)	1000	972	984	956
Assumed variable costs (€)	30	30	30	30

Gross Profit (€)	70,000	77,760	78,720	76.480

*Average percentage of customers that will switch as stated by on-trade customers who responded to the Authority
Source: The Competition Authority

3.47 In the illustration in Table 3.1 above, a hypothetical 10% increase in the price of lager by a hypothetical monopolist does not result in a sufficient substitution to either stout or cider to make the price increase unprofitable. In fact the 10% increase in the price of lager is profitable suggesting that lager constitutes a separate market.

3.48 The Authority considers that using the wholesale/retailers' estimate of the number of customers that would switch as a result of a SSNIP by a hypothetical monopolist does not affect the result of the SSNIP test in paragraph 3.23 above. The estimated percentage of customers that would switch is not large enough to make the price increase unprofitable.

3.49 In respect of a hypothetical monopolist raising the price of stout, the Authority asked the following question:

> From your experience, if the price of <u>stout</u> were to increase by 10% whilst other prices and quality of other beers remained constant, would your customers switch to other types of beer such as ale or lager and/or other alcoholic beverages such as cider? If yes, please estimate the percentage of consumers that would switch and to which other beverages.
>
> ☐ No, this price increase is not significant enough to spark changes of consumption
> ☐ Yes, _______% of stout consumers would switch to the following types of beer
> ☐ Yes, _______% of stout consumers would switch to cider

3.50 In response to this question:

- 32% of wholesale-retailers said customers would switch to other beer, such as lager, as a result of a 10% increase in the price of stout. Wholesalers on average estimated that 6.9% of customers would switch from stout to lager.

- An almost identical view was expressed by the on-trade: 36% said customers would switch to other beer, such as lager and on average estimated that 6% of customers would switch from stout to lager.

- 15% wholesale-retailers said customers would switch from stout to cider as a result of a 10% increase in the price of stout and on average estimated that 3% of customers would switch from stout to cider if the price of stout were to rise by 10%.

- 18% of on-trade respondents said customers would switch from stout to cider. However on-trade respondents on average estimated that only 1.4% of customers would switch from stout to cider.

3.51 Table 3.2 below illustrates the SSNIP test using the above on-trade customers' estimate of the number of customers that would switch as a result of a SSNIP by a hypothetical stout monopolist. Again, the Authority used the following hypothetical figures: (i) a pre-merger price = €100 per 50L keg, (ii) variable cost = €30 per 50L keg, and (iii) Gross sale of 1000 units of 50L keg.

3.52 As stated in paragraph 3.46 above, a change in these absolute values of hypothetical figures applied by the Authority does not affect the SSNIP test. What matters is the amount of consumers that will switch as a result of a 10% in crease in the price of the product. These figures are obtained from result of the Authority's survey discussed in paragraph 3.23 above.

Table 3.2
SSNIP Analysis of a 10% Increase in the Price of Stout

	Current price	**10% Price Increase and 5.9% Switch to Lager***	**10% Price Increase and 1.4% Switch to Cider***	**10% Price Increase, 5.9% Switch to Lager and 1.4% Switch to Cider**
Assumed unit price (€)	100	110	110	110
Assumed Gross Sale (number)	1000	941	986	927
Assumed variable costs (€)	30	30	30	30
Gross Profit (€)	70,000	75,280	78,880	74,160

* Average percentage of customers that will switch as stated by on-trade customers who responded to the Authority.
Source: The Competition Authority

3.53 Table 3.2 above shows that a hypothetical 10% increase in the price of stout by a hypothetical monopolist does not result in sufficient substitution to either lager or cider to make the price increase unprofitable. In fact, the 10% increase in the price of stout is profitable suggesting that stout constitutes a separate market.

3.54 As stated in paragraph 3.46 above, using the wholesale/retailers' estimate of the number of customers that would switch as a result of a SSNIP by a hypothetical stout monopolist does not affect the result of the SSNIP test. The estimated percentage of customers that would switch is not large enough to make the price increase unprofitable. The Authority however notes that these SNIPP tests take no account of the presence of the same brewers across market segments.

3.55 In sum, the SSNIP test discussed above clearly shows that: (i) cider is not in the same market with either stout or lager, and (ii) each of stout and lager are in a separate market. Our elasticity estimates are based on expert opinions rather than evidence of actual switching behaviour in response to actual price changes. As such they should be seen as orders of magnitude in a SNIPP analysis to be interpreted in the context of other evidence.

Statistical Analysis of Price Series

<u>Price correlation</u>

3.56 Price correlation measures the degree of correlation between two price series. The higher the price correlation coefficient, the more likely that the two products lie in the same market. The economic intuition is that if products are very close substitutes their prices cannot move too far apart, since consumers will shift between them in such a way as to eliminate the more expensive one from the market.

3.57 The price correlation analysis is not a determinative test for market definition. The result of a price correlation analysis is only credible if it can be confirmed by other evidence or observations (which were examined in detail above). In RBB Report # 2 it is stated that, "While we recognise that correlation analysis does not provide conclusive evidence for the purpose of market definition, it is nevertheless a useful indicator." (p.14).

3.58 RBB Report #1 contains price correlations for selected brands over the period 2002 to 2008, which were subsequently updated. These are reproduced in Table 3.3 below. The results reported wide disparities between the correlation coefficients for different brands of beer, ranging from 0.0819 between Bulmers and Fosters to 0.8945 between Guinness and Smithwicks.

3.59 While there is no generally agreed level or threshold which defines whether series are moving sufficiently closely together for them to be considered in the same market this can be addressed through the use of benchmarking techniques. As a benchmark against which to compare other correlations, one can use the correlation coefficient between two series which on *a priori* grounds lie in the same relevant market. If the correlation coefficient between the two other products lies above the benchmark this can be interpreted as meaning that these two products lie in the same relevant market.

3.60 Instead of using an absolute value for the benchmark RBB present the correlation coefficients in order of decreasing magnitude arguing that *a priori* one would expect lager brands to be in the same market and thus to be more highly correlated. Consequently if correlation coefficients exist across segments (i.e. between brands of stout and brands of cider) are greater than those between lagers then this may support a view that stout and cider are in the same market.

Table 3.3
Price Corrections, Selected Beer Brands, the State, November 2002 – February 2008.

Heineken (lager)		Bulmers (cider)		Guinness (stout)	
Guinness	0.8114	Guinness	0.8314	Smithwicks	0.8945
Carlsberg	0.7915	Budweiser	0.8146	Bulmers	0.8314
Budweiser	0.7878	Smithwicks	0.8049	Budweiser	0.8243
Smithwicks	0.7741	Carlsberg	0.7563	Heineken	0.8114
Bulmers	0.7311	Heineken	0.7311	Carlsberg	0.7812
Murphy	0.6327	Beamish	0.5794	Beamish	0.5930
Beamish	0.4722	Murphy	0.4990	Murphy	0.5048
Coors	0.4548	Coors	0.4182	Miller	0.5000
Miller	0.3852	Miller	0.4151	Coors	0.4345
Fosters	0.1468	Fosters	0.0819	Fosters	0.0881

Note: Correlation coefficients between first differences of retail prices, on trade draught products.
Source: RBB's analysis of AC Nielsen data

3.61 The high correlation coefficients reported by RBB may suggest that the market should be broadly defined. However, the coefficients may be spurious and hence meaningless for a variety of reasons.[39]

3.62 One element that will affect price correlation results is the existence of common factors which influence the price series of both products. The Authority notes that the price correlation analysis presented by RBB does not appear to have controlled for common factors, such as similar changes in costs across beers, common ownership and common price changes across beers owned by the same brewers. All of these factors may lead to biased correlation coefficients which may mean that they are unreliable for purposes of market definition. For example, the highest correlation in Table 3.3 is between Guinness (a stout) and Smithwicks (an ale) which are both owned and produced by Diageo. Thus, the Authority requested Heineken to ask RBB to conduct a co-integration analysis by controlling for common factors and assess how this analysis affects Heineken's view of the relevant product market.

3.63 RBB Report #2 presents the results of this co-integration analysis concluding:

- That the weighted average prices of draught lager, stout, ale and cider are non stationary;

- Using a Granger Causality Test[40] which controlled for a number of common factors (that is, CPI, average temperature monthly temperature and dummies for seasonality[41]):

    - Stout price granger causes cider price and, *vice versa*, cider price granger causes stout price; this

[39] For further discussion see S. Bishop & M. Walker, 2002*, The Economics of EC Competition Law: Concepts, Application and Measurement,* 2nd Edition. London: Sweet & Maxwell ("Bishop & Walker"), pp. 378-394. Spurious correlation occurs when two series seem to be correlated but in fact they are not. The correlation in this case is a 'coincidence' and is not the result of any interrelation between the two products or price series.
[40] A time series X is said to Granger-cause Y if it can be shown that the X values provide statistically significant information about future values of Y. For further discussion see Bishop & Walker, pp. 442-454.
[41] The controlling factors do not include common ownership of brands.

might suggest that stout and cider belong to the same product market;

  - Ale price granger causes cider price and, *vice versa*, cider price granger causes ale price; this might suggest that ale and cider belong to the same product market;

  - Stout price granger causes lager price. However there was not statistically significant evidence that lager price Granger causes stout price; and,

  - There is no statistically significant evidence Granger causality between lager and cider.

- "Overall these results provide partial (but not conclusive) evidence that stout, ale, cider and lager may well belong to the same relevant market". (p. 23).

<u>Granger-Causality Test</u>

3.64 The Authority requested the RBB data and do-files. The Authority ran these files and verified the RBB results. The Authority observes however, that there is a limitation in the price series data used by RBB. The price used are not actual retail prices obtained at the pubs but prices constructed by weighted volumes and values.[42]

3.65 To compensate for this the Authority obtained CSO data on average monthly price series of a pint for the various products under consideration for the period December 2001 – June 2008. The data relate to the retail prices for these products in pubs. Using the CSO data for lager, stout and ale, together with the RBB price for cider,[43] the Authority undertook the Granger-Causality test using the model specified by RBB, in order to establish whether the improved data quality would provide more conclusive evidence in respect of the market definition.

3.66 The results of the Authority's tests are presented in Table 3.4 below.

Table 3.4
Granger Causality Test (OLS regression of first difference of average prices)

	d_cider	d_stout	d_lager	d_ale
L1.d_cider		0.28 (3.17)*	0.32 (3.16)*	0.10 (0.40)
L1.d_stout	0.03 (0.16)		0.44 (1.36)	0.48 (1.44)
L1.d_lager	-0.02 (-0.11)	0.01 (0.04)		0.60 (1.85)
L1.d_ale	-0.02 (-0.25)	-0.11 (-0.24)	0.003 (0.06)	

[42] The Authority also notes the limitations of Granger Causality in defining markets. Even a correctly specified Granger-Causality test may fail to correctly delineate the scope of the relevant product market where for example it statistically rejects the hypothesis that product A Granger-causes product B when in fact both products are in the same market.
[43] The CSO Cider price series only covers 19 months.

Note: Monthly data 2001 to 2008. d_cider refers to first difference of cider. L1.d_cider refers to lagged first difference of cider. Similarly for stout, lager and ale.
Source: The Competition Authority based on CSO and RBB price data.

3.67 Table 3.4 shows the following:

- There is statistically significant evidence that the RBB average price of cider granger causes the average pint price of stout. However, there is no statistically significant evidence that the average pint price of stout granger causes the RBB average price of cider.

- There is no statistically significant evidence that the average pint price of ale granger causes the RBB average price of cider. Likewise, there is no statistically significant evidence that the RBB average price of cider granger causes the average pint price of ale.

- There is no statistically significant evidence that the average pint price of stout granger causes the average pint price of lager. Likewise, there is no statistically significant evidence that the average pint price of lager granger causes the average pint price of stout.

- There is statistically significant evidence that the RBB average price of cider granger causes the average pint price of Lager. However, there is no statistically significant evidence that the average pint price of lager granger causes the RBB average price of cider.

- There is no statistically significant evidence that the average pint price of stout granger causes the average pint price of ale. Likewise, there is no statistically significant evidence that the average pint price of ale granger causes the average pint price of stout.

- There is no statistically significant evidence that the average pint price of ale granger causes the average pint price of lager. Likewise, there is no statistically significant evidence that the average pint price of lager granger causes the average pint price of ale.

3.68 In sum, the Granger-Causality tests undertaken by the Authority do not provide conclusive evidence that there is a single on-trade market for beers and cider.

<u>Stationarity of Relative Prices</u>

3.69 It is established in the statistical econometric literature and precedent cases that if two products or geographic areas belong to the same market, their relative prices must be stationary[44]. In other words prices must not be drifting apart over time.

[44] It is important to note that the stationarity testing reported in the RBB Report # 2 was undertaken separately for each brand using the individual price series in first differences to ensure the integrity of the correlation analysis. This is different to the stationarity testing

3.70 Given that neither the Granger-Causality tests of RBB nor those of the Authority provided conclusive evidence on the product market definition, the Authority tested the stationarity of the relative prices of stout, cider, ale and lager in order to establish whether this test could provide further evidence on the product market definition. [45]

3.71 The Authority obtained the log of the ratio of pairs of cider, ale, stout and lager. The log ratio series were graphed and finally an Augmented Dickey Fuller ("ADF") test for stationarity was performed on each log ratio series.

3.72 The charts in Figure 3.1 present the results of the stationarity testing carried out by both RBB and the Authority. On the vertical axis analysis is the log of the ratio of the prices of the two beer types in the panel. For example, panel A is the log of the ratio of the price of cider to the price of stout. Two price series are used: the Competition Authority price series based on CSO data and that constructed by RBB.

3.73 The results reported by the Authority using the CSO data suggest that the relative prices are non-stationary and this was confirmed by the ADF test for stationarity. The intuition is that if two products are in the same market then we would expect the relative price between them to be stationary, i.e. the time series of the relative price between them would tend toward a constant long-run value since there is a limit to how far prices within a single market can move out of line with one another. The graphs in Figure 3.1 clearly demonstrate that the relative prices of the products are not converging towards a constant long run value.

Figure 3.1
Stationarity of Relative Prices of Categories of Beers and Cider, RBB and CSO Price Series, November 2002 – April 2008

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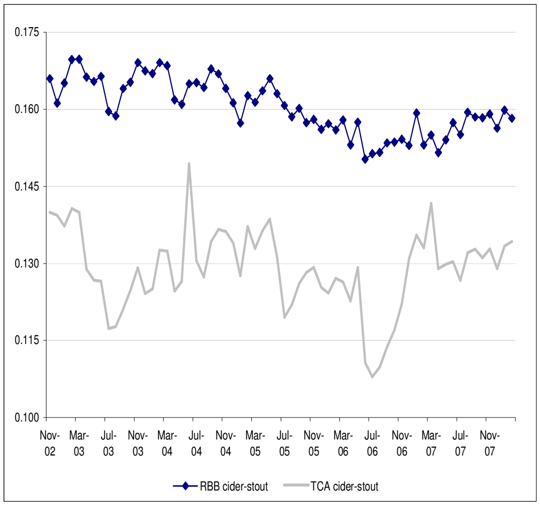
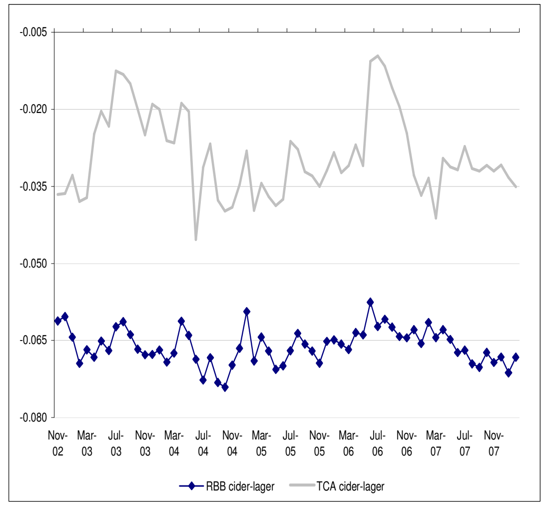
undertaken by the Authority where the relative prices of two products are tested for stationarity to provide evidence of whether two products are in the same market.

[45] See, Mario Forni, ,2002, "using stationarity tests in antitrust market definition". Also, Willem H. Boshoff, "Quantitative competitive analysis: stationarity tests in geographic market definition" undated. UK Competition Commission (2000): Nutreco Holding NV and Hydro Seafood GSP Ltd: A report on the proposed merger (CM5004).

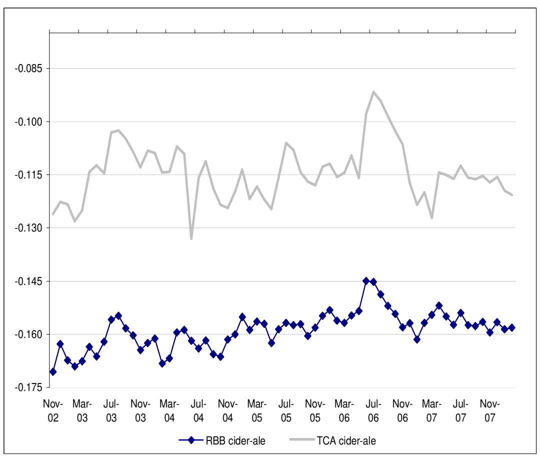
Price of Cider relative to the price of Stout



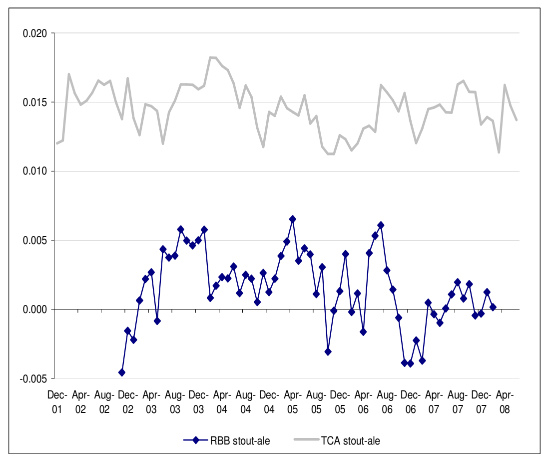
Price of Cider relative to the price of Lager



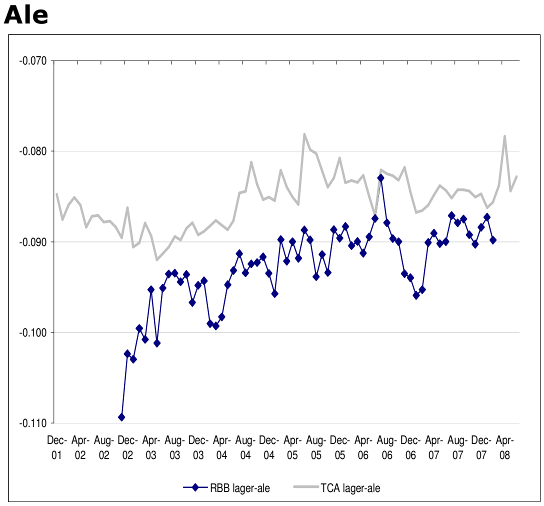
Price of Cider relative to the price of Ale



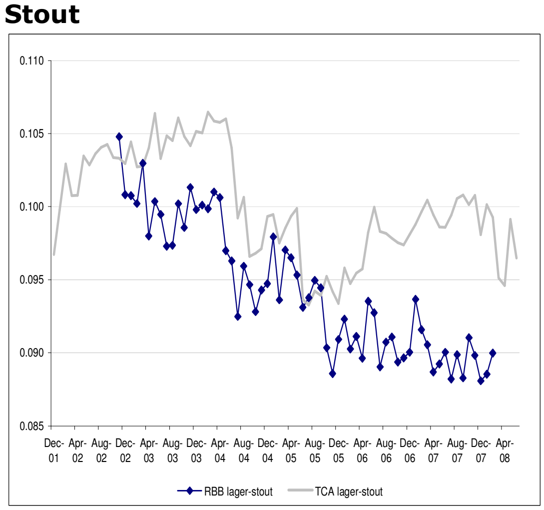
Price of Stout relative to the price of Ale



Price of Lager relative to the price of Ale



Price of Lager relative to the price of Stout



Note: See text for explanation of terms.
Source: The Competition Authority based on CSO and RBB price data.

3.74 The reported results provide strong evidence that stout, cider, ale and lager do not belong to a single market and are consistent with a view that each product constitutes a separate market.

Conclusion

3.75 On the basis of the analysis of all the evidence obtained from various sources (that is, the evidence obtained from the Commission, Heineken, B&C and the Authority's market enquiries, together with the econometric analysis) the Authority is of the view that the following product markets are relevant for purposes of assessing the proposed acquisition:

- The production and supply of lager to the on-trade channel;
- The production and supply of lager to the off-trade channel;
- The production and supply of stout to the on-trade channel; and,
- The production and supply of stout to the off-trade channel.

Relevant Geographic Market

The Commission's View

3.76 The Commission following previous decisions and ECJ case law suggests that the market for the production and distribution of beer is national in scope. This view is supported by Heineken and by the results of the Commission's market investigation. On the basis of this, the Commission concluded that the relevant geographic market is no wider than Ireland.

Submission of the Undertakings Involved

Heineken

3.77 Heineken submits that there is a national beer market. Heineken further submits that market characteristics (such as national pricing, national advertising and national distribution arrangements) do not support a narrower regional market.

B&C

3.78 B&C submits that the geographic market for each product appears to be national in scope. However, there may be separate local markets in the case of stout given the differences in consumption patterns in Cork and Munster to the rest of the State.

Authority's Investigation

3.79 In order to assist the Authority in delineating the relevant geographic market, the Authority asked customers and competitors a number of questions.

3.80 The Authority enquired whether there is regional advertising of beer products that would support a finding of a regional market. In this regard, the Authority asked the following question in its questionnaire survey:

> Is there regional advertising for any of the different types of beer (i.e., lager, stout)?

3.81 The response to this question is inconclusive:

- 44% of wholesale/retailers replied yes (c.44%) and 41% said no.
- 44% of the on-trade customers who responded replied yes with 53% replying no.
- Three out of four of the competitors who responded said no while one did not provide an opinion.

3.82 The Authority enquired whether market realities concerning the sale of beer products support a national market in scope. The Authority asked the following question:

> The European Commission understands that marketing beer requires building brand awareness and having a good distribution network, which speaks for markets that are at most national in scope. Do you agree?

3.83 In response to this question:

- 89% of wholesale/retailers agreed with a national market while 9% did not.
- 75% of the on-trade customers who responded agreed with a national market while 23% said no. (Those that said no mainly refer to Stout market being local in scope. Two referred to an international market.)
- Three out of four of the competitors who responded agreed with a national market while one disagreed.

Conclusion

3.84 On the basis of the evidence obtained from the Commission, Heineken, B&C and the Authority's market enquiries, the Authority is of the view that the relevant geographic market for each of the lager and stout markets is the State. However, while the geographic market is the State there may be regional variations or preferences where some brands are more competitive than others.

SECTION FOUR: MARKET STRUCTURE

Introduction

4.1 Market structure can be characterised as the number and size distribution of firms. The initial impact of any merger is felt on market structure as two firms pre-merger become one firm post-merger. In this section, the pre- and post-acquisition market shares in each of the relevant markets identified in section three are considered.

Measuring Concentration

4.2 Market concentration refers to the degree to which production in a particular market or industry is concentrated in the hands of a few large firms. It refers in particular to the number and size distribution of firms in the relevant market: the fewer the number of firms and/or the more disparate the firms are in terms of their sizes, the more concentrated the market. The significance of concentration in competition analysis is that in highly concentrated markets in which barriers to entry are also high, effective competition is likely to be weak.

4.3 The most commonly used measure of concentration is the Herfindahl-Hirschman index ("HHI"), which is defined as the sum of the squares of the market shares of all firms participating in the market. The higher the value of HHI the more concentrated the market. According to the Authority's *Merger Guidelines*, a HHI of above 1800 combined with a change in pre- compared to post-merger HHI of less than 50 indicates that "mergers in Zone A are less likely to have adverse competitive effect" (paragraph 3.10). Zone B mergers are those with an HHI of 1800 or above combined with a change in pre- compared to post merger HHI of between 50 and 100 indicates that such mergers "may raise significant competition concerns." (paragraph 3.10).

4.4 However, the *Merger Guidelines* notes that the Zones do not constitute a "safe harbour". It cited a number of factors, including barriers to entry, high switching costs and a merger involving a maverick firm, as factors that may determine whether mergers in Zone A might raise competition concerns (paragraph 3.11). Moreover the HHI while a useful indicator for unilateral effects in merger analysis may be less informative if the competitive concern is coordinated effects.

4.5 The *Merger Guidelines* also state that a HHI in excess of 1800, combined with a change in the pre- compared to the post-merger HHI of greater than 100, indicates a situation where "mergers occur in already highly concentrated industries and more usually be those that raise competitive concerns" (paragraph 3.10). These are categorised as Zone C mergers.

4.6 Having defined the relevant markets in section three above, the Authority now considers the structure of each of these markets in turn.[46]

Market Structure for the National Lager Markets

4.7 As explained in section three above, one of the relevant markets affected by the proposed transaction is the market for the production and supply of lager distinguished by channel of distribution in the State. In section three above, the Authority found that it is appropriate to assess the proposed acquisition in the following lager markets:

- The production and supply of lager to the on-trade channel; and

- The production and supply of lager to the off-trade channel.

4.8 Both Heineken and B&C provided market share data based on AC Nielsen scanner data. AC Nielsen scanner data is the most widely used research data in beer markets in Ireland. In Ireland, brewers rely on the AC Nielsen data in tracking the performance of their product brands as well as those of their competitors.

4.9 According to Table 4.1 below, three brewers, Diageo, Heineken and B&C, account for over 90% of lager sold through the on–trade channel in the State. Collectively, these three brewers account for almost 70% of lager sold through the off-trade channel.

Table 4.1
Market Shares, Lager Market, by Channel of Distribution, by Value, the State, 2007

Brewers	**On-trade**	**Off-trade**
Heineken	43.8%	22.3
B&C*	9.1	15.0
Combined	**52.9**	**37.3**
Diageo	41.4	32.5
BFM	2.1	2.5
InBev	2.0	6.3
Gleeson	0-1	4.9
Comans	0-1	8.2
Others	1.6	8.3

[46] While a combined market for beer (i.e., comprising lager, stout and ale) is not considered the Authority has examined the HHIs for both the on and off trade in a hypothetical beer market. In each case the proposed merger would lead to a Zone C outcome as outlined in paragraph 4.3 above.

Total	100	100
Summary of HHI Measures*		
	HHI	**HHI**
Pre-merger	3726	1985
Post-merger	4523	2654
Delta	797	669
Zone	**C**	**C**

Source: Based on RBB's Analysis of AC Nielsen Data

4.10 Table 4.1 shows the following:

- The proposed acquisition of B&C by Heineken is occurring in an on-trade lager market that is already highly concentrated with a HHI of 3726. Post-merger, the on-trade lager market will become more concentrated with a HHI of 4523 and a change in HHI of 797.

- The merger occurs in a less concentrated off-trade lager market with a HHI of 1985. However, post-merger, the off-trade lager market will become more concentrated with a HHI of 2654 and a delta of 669.

- The proposed acquisition falls into Zone C of the *Merger Guidelines* in respect of both on-trade and off-trade lager markets.

4.11 The fact that a merger falls into Zone C does not necessarily mean that it will lead to a substantial lessening of competition. As the Authority's *Merger Guidelines* point out, factors that affect whether a merger in Zone C will raise competition concerns include the degree of competition that is likely to exist between the remaining participants in the market post-acquisition. The competitive effects of the proposed acquisition in these markets are assessed in section five below.

Market Structure for the National Stout Markets

4.12 There are three major brewers, Diageo, Heineken Ireland and B&C, responsible for the brewing and distribution of stout in the State. These three brewers account for over 98% of stout sold through either distribution channels in Ireland.

Table 4.2
Market Shares, Stout Market, by Channel of Distribution, by Value, the State, 2007

Brewers	On-trade	Off-trade

Heineken	4.7	5.0%
B&C	5.4	8.5%
Combined	**10.1**	**13.5%**
Diageo	89.9	85.1%
Other	-	1.4*
Total	100	100
Summary of HHI Measures		
	HHI	**HHI**
Pre-merger	8133	7339
Post-merger	8184	7424
Delta	51.	85
Zone	**B**	**B**

*A number of suppliers including Coopers, Darcys. Finians, Sierra and O'Haras provide alternative stout brands to the off-trade. Note that the off-trade refers to 2006 and market shares are measured in volume terms. Value was not available.

Source: Based on RBB's Analysis of AC Nielsen Data for the on-trade; and, data in Form CO for the off-trade

4.13 The following conclusions can be drawn from Table 4.2:

- The merged entity will account for about 10% of the on-trade stout market with Diageo accounting for 90%%. The merger will reduce the number of producers and suppliers of stout to the on-trade channel from three to two players.

- The proposed acquisition takes place in an on-trade market that is already highly concentrated due to the market position of Diageo.

- The proposed acquisition will result in a post-merger HHI of 8184 with a change in HHI of 51 in the on-trade stout market. The proposed acquisition falls into Zone B of the *Merger Guidelines* in respect of the on-trade stout market.

- The proposed acquisition will result in a post-merger HHI of 7424 with a change in HHI of 85 in the off-trade stout market. The proposed acquisition falls into Zone B of the *Merger Guidelines* in respect of the on-trade stout market.

4.14 Over 97% of stout is sold through the on-trade in Ireland. The remainder is sold through the off-trade channel. Due to the negligible size of the off-trade stout market, it is unlikely that the proposed acquisition will raise competition concern in this market. Therefore, no further assessment of this market will be conducted.

SECTION FIVE: COMPETITIVE ANALYSIS - LAGER

Introduction

5.1. Section four above established that the proposed acquisition falls in Zone C in both the national off-trade and national on-trade lager markets. In this section, the Authority analyses the competitive characteristics of each of the off-trade and on-trade markets, to establish whether the proposed transaction will result in a substantial lessening of competition ("SLC"). The Authority assesses the likelihood of the proposed transaction resulting in a SLC within the framework of unilateral and co-ordinated effects.

The Counterfactual

5.2. In merger analyses conducted by the Authority two situations are compared, over a two-year time horizon, to determine if a merger will lead to a substantial lessening of competition.

- First, it is assumed that the merger takes place. Control of the target – B&C – passes to the acquirer – Heineken. B&C ceases to exist as a separate entity.
- Second, "the situation that would have been expected to prevail without the merger (sometimes referred to as the counterfactual) is considered".[47] Typically the counterfactual assumes that the merger does not take place and that the "existing pre-merger, competitive conditions"[48] will prevail. Heineken and B&C remain separate entities.

5.3. The competitive assessment then asks whether the merger compared to the counterfactual will lead to a substantial lessening of competition.

5.4. In considering these two situations, in certain circumstances, it may be important to take into account certain other factors which can be predicted with a reasonable degree of certainty. In the instant case, for example, none of the lager brands sold by B&C are owned by B&C. In contrast, B&C owns the rights to its stout brand, Beamish.

5.5. MGD, as noted in section two above, has been licensed by B&C from SABMiller since 1996. There is a […]. Heineken's internal documents show that Heineken when assessing the opportunities for brewery consolidation of Heineken and B&C activities post merger assumed that […].[49]

5.6. In the UK, MGD was licensed to S&N. Following the implementation of the transaction Case No COMP/M.4999, *Heineken/Scottish & Newcastle*, SABMiller did not transfer the MGD license to Heineken in respect of the UK. Instead, SABMiller markets the MGD in the UK itself, importing MGD from Italy.

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[47] UK Competition Commission, 2003, *Merger references: Competition Commission Guidelines,* London: the Commission, paragraph 1.22. These guidelines will be referred to as Competition Commission, *Merger Reference Guidelines*. They may be accessed at: http://www.competition-commission.org.uk/rep_pub/rules_and_guide/pdf/cc2.pdf

[48] Competition Commission, *Merger Reference Guidelines*, paragraph 1.22.

[49] `"Inca Phase 1 "80/20" Review of Value Gap – Supporting Materials ", 11 June 2006, updated 24 January 2008, page 020377.

5.7. It is also important to note that the licence agreement between SABMiller and B&C can be terminated for various other reasons, upon specified notice, absent any change of ownership. In the event of such a termination, SABMiller would be free to offer the licence to a third party, such as Heineken, for example. Thus, it is quite possible for Heineken to acquire the Miller's licence in circumstances where the merger does not go ahead.

5.8. In a submission to the Authority on 2 October 2008 B&C stated that MGD on draught could not be brewed and kegged in Ireland by Heineken as it brews and kegs Coors Light, this precludes Heineken from brewing and kegging any other North American lager brands. Heineken in a submission dated 3 October 2008 rejected this allegation noting that; (1) the B&C/Miller contract does not restrict B&C to selling just one North American brand (i.e., Miller). And it specifically allows B&C to sell, alongside Miller, certain Molson brands (Molson is part of the MolsonCoors Brewing Company which owns Coors); (2) Heineken had preliminary discussions with both Coors and SABMiller about […]; (3) Coors and SABMiller are already in a very significant joint venture in the USA; and, (4) this is primarily a contract issue and not a competition law issue. All such contracts are negotiated individually and the terms will vary depending on what the parties want to agree. It is perfectly possible that a brewer might be licensed in a contract to brew and distribute several North American brands just as brewers are licensed to brew and distribute several Continental European brands or other speciality brands

5.9. Even where Heineken is granted the Miller licence by Miller Brewing Company ("MBC") then it is important to note that the operation of this license agreement would be likely to act as a constraint on the ability of Heineken to market and distribute the product. Typically licensors face financial and non-financial penalties if they do not promote competitively and actively the licensed brand. This is the case in the license agreement and rolling commercial agreements between MBC and B&C which provide MBC with discretion over marketing strategy to be undertaken by B&C and which specify the advertising spend of both MBC and B&C and the sales volumes to be met. The implications of a putative license agreement on the activities of Heineken are discussed further below.

5.10. B&C has no licence agreement concerning Fosters. This was unnecessary since the brand used to be owned by S&N, the parent of B&C. However, as a result of the implementation of the transaction in Case No COMP/M.4999, *Heineken/Scottish & Newcastle*, Heineken acquired the rights of the Foster's brand for Europe including the State. Finally, the third lager brand of B&C, Kronenbourg may not transfer to Heineken post merger. Kronenbourg is currently owned by Carlsberg.

5.11. Thus, it is possible to consider a variety of scenarios as to what will happen post-merger and what the appropriate counterfactual might be. For example, [an existing licensor could purchase the B&C brewery and utilise this brewery as a brewing and bottling supply facility to supply its Irish and UK markets].[50] Alternatively it could

[50] The Authority has to examine the merger as notified. Frequently in mergers the Authority is aware that there are credible but unsuccessful firms that also bid for the target. However, it is

be argued that the appropriate counterfactual is that B&C will continue but without the Fosters brand.

5.12. The Authority has decided, however, to assume that the merged entity will control all of the lager brands currently marketed by B&C post-merger and that, should the merger not proceed, then these brands will continue to be marketed by B&C.

5.13. This approach is justified on two grounds. First, the Authority does not know which, if any, of the various alternative outcomes is likely to occur. For example, the Authority approached SABMiller concerning their future plans for the MGD licence. In response to this, SABMiller said it is weighing its options and will make a decision following the Authority's Determination in respect of the proposed acquisition**.** Hence the default is the *status quo*. Second, the approach is likely to be the worst case scenario from a competition assessment point of view. If it is concluded, on the basis of this approach, that there is no SLC, the merger can proceed. If it is concluded that this approach would produce an SLC, then various possible remedies can be explored.

National Off-trade Lager Market - Market conditions

5.14. The current market conditions that exist in the off-trade lager market are presented below and an assessment of the potential impact on these market conditions by the proposed acquisition is made.

Trend in Market Shares: by Undertakings

5.15. As stated in section two above, the national off-trade market consists of the supply of packaged lager to wholesalers and retailers (multiples, supermarkets, independents and off-licences). In 2007, this market represented 33% of the value of lager sales in the State.

5.16. Table 5.1 below presents the market shares of the leading suppliers (Diageo, Heineken, B&C, Comans, Inbev, Gleeson, Barry Fitzwilliam Maxxium ("BFM")) of lager to the off-trade in the State. It should be noted that these market shares are based on retail scanner data collected by AC Nielsen. Such data is recorded by brand and then aggregated by undertaking to form the basis of the market share estimates. However, to the extent that there are parallel imports - an issue discussed further below - this will overstate the market shares of at least some of the undertakings in Table 5.1. It appears that this is the case particularly for B&C and its MGD brand. However, reliable data is not available with which to adjust the market shares in Table 5.1.

Table 5.1
Market Shares, Lager, Off-Trade, Sales, Leading Suppliers, the State, 2004-2007

Year	Diageo (%)	Heineken (%)	B&C (%)	Comans (%)	Inbev (%)	Gleeson (%)	BFM (%)	Others (%)
2004	37.1	22.5	17.1	6.6	7.3	1.8	1.0	6.6

not the remit of the Authority to consider these alternative merger possibilities, even if they were less restrictive of competition.

2005	33.9	21.9	15.0	10.1	8.3	2.8	1.6	6.4
2006	31.8	22.4	15.3	9.3	7.9	4.4	2.2	6.7
2007	32.5	22.3	15.0	8.2	6.3	4.9	2.5	8.3
Change	**-4.6**	**-0.2**	**-2.1**	**1.6**	**-1.0**	**3.1**	**1.5**	**1.7**

Source: Based on RBB's Analysis of AC Nielsen data

5.17. For the period 2004 to 2007:

- Diageo is the market leader while the merging parties, Heineken and B&C, are ranked number two and three, respectively.

- Post-merger, the merged entity will become the market leader in the off-trade market with a combined share of 37%. The merged entity and Diageo will account for 69% of this market.

- Heineken's share of the market has remained fairly stable during the period while smaller suppliers have gained market shares at the expense of Diageo and, to some extent, B&C. Market shares for Diageo and B&C declined by 4.6% and 2.1%, respectively. The market shares lost by Diageo and B&C appear to have been captured by Comans, Gleeson, BFM and others who increased their market shares by 1.6%, 3.1%, 1.5% and 1.7%, respectively.

Trends in Market Shares: by Lager Brand

5.18. The leading lager brands supplied to the off-trade market and their ownership are presented in section two above. The market shares of the main lager brands supplied by the leading suppliers are presented in Table 5.2 below. These eight brands account for 63.5% of the off-trade lager market. Other lager brands sold by Diageo, Heineken, B&C, Inbev and BFM account for 15.1% of the off-trade lager market. The remaining 21.4% of the off-trade lager market is accounted for by brands sold by Comans, Gleeson and others. Section two above details the brands sold by the various undertakings..

Table 5.2
Market Shares, Lager, Off-Trade, Sales, Top Eight Brands, the State, 2004-2007

	Diageo		**Heineken**		**B&C**		**Inbev**	**BFM**
Year	**Budweiser (%)**	**Carlsberg (%)**	**Heineken (%)**	**Coors (%)**	**MGD (%)**	**Foster's (%)**	**Stella (%)**	**Corona (%)**
2004	25.5	5.8	16.9	3.6	11.0	3.4	4.3	0.7
2005	21.5	5.4	15.0	4.4	8.1	3.6	4.1	1.2
2006	19.7	5.0	15.2	4.9	9.5	3.0	3.7	1.9
2007	19.4	5.4	16.0	4.7	9.9	2.8	3.1	2.2
Change	**-6.1**	**-0.4**	**-0.9**	**1.1**	**-1.1**	**-0.6**	**-1.2**	**1.5**

Source: RBB's Analysis of AC Nielsen data

5.19. For the period 2004 to 2007, the Table 5.2 shows that lager brands share trends reflecting the trend in market shares of the leading suppliers in the off-trade market:

- The lager brands supplied by Diageo have witnessed declines in market share: Budweiser from 25.5% in 2004 to 19.4% in 2007; and Carlsberg from 5.8% in 2004 to 5.4% in 2007.

- The Heineken lager brand ranks second with a market share of 16% in 2007. Its market share fell to 15.2% in 2006 from 16.9% in 2004, before recovering to 16% in 2007.

- B&C's MGD is ranked third with a market share of 9.9% in 2007 down from 11% in 2004.

- Heineken will, post-merger, control three out of the top eight lager brands supplied to the off-trade market. Post-merger, Heineken will become the market leader overtaking Diageo.

Competitive Assessment

5.20. In order to assess whether the proposed acquisition will result in SLC in the national off-trade lager market, the following characteristics of this market, identified by the undertakings involved, by third parties, and by the Authority during the course of the investigation, are discussed:

- closeness of competition;
- entry and parallel imports;
- countervailing buyer power; and,
- the removal of a "maverick firm."

Closeness of Competition

5.21. In the competitive analysis of differentiated products such as different brands of lager, it is important to be able to measure the degree to which two (or more) brands are close substitutes. Where it is found that the merging parties are not close competitors, then it is likely that the merger will not lead to anticompetitive effects. However, where the merging parties are found to be close competitors then, it is necessary to consider all the competitive conditions in the market before coming to a final conclusion.

Submission of the Undertakings Involved

Heineken

5.22. Heineken submits, in its notification the Authority[51], that the closest competitors for its brands are as follows:

- Heineken and Amstel: competing brands include Carlsberg and Stella Artois.
- Coors Light and Sol: competing brands include Budweiser, Bulmers, Miller and Corona.

B&C

[51] Heineken, "Submission to the Competition Authority concerning the proposed acquisition of parts of the business of Scottish and Newcastle in the Republic of Ireland (namely, Beamish & Crawford plc)", 28 April 2008, p 22. This was referred to as the QIN or Quasi Irish Notification in paragraph 1.21.

5.23. B&C did not make a submission on which other lager brands are its closest competitors.

Review of the Parties' Internal Documents

<u>Heineken</u>

5.24. Heineken's internal documents show that the Heineken lager brand competes with B&C's MGD. For example, "Coors Light Draught Quantitative study 2003" clearly states "Key competitors for Coors Light Bottle […] are Budweiser, Heineken, Miller, and Carlsberg". Similarly, ""Key competitors for Coors Light Draught […] are Budweiser, Heineken, Miller, and Carlsberg."[52] However, it is unclear from the Heineken internal documents which other brand(s), in its view, are closest competitor(s) to its own lager brands.

<u>B&C</u>

5.25. B&C's internal documents show B&C's core competitors in the off-trade lager market as follows: (i) MGD's key competitors are Budweiser, Heineken, Coors Light & Carlsberg; and (ii) Fosters' key competitors are Amstel, Carlsberg, Tuborg, Dutch Gold and Prazsky; and, (iii) Carling's main competitors are Harp, Tennents and Amstel. [53]

5.26. In terms of the closest competitor to MGD, a number of B&C internal documents show that Budweiser is its closest competitor.

- B&C's MGD Draft Business Plan 2005 – 2009, indicates that its closest competitor is Budweiser. B&C stated that "we wish to be considered a credible alternative to Budweiser. Budweiser stands for brash America and MGD to stand for urban cool America."

- "Budweiser should be a key target for Miller to steal share/encourage switching for a number of reasons- Miller bottled drinkers currently leave the brand to drink Budweiser pints. As Budweiser becomes less appealing it offers the opportunity to encourage them to stay with the brand. – the core image of Budweiser and Miller has many similarities which make Miller an ideal alternative for Bud drinkers. Carlsberg also offers potential to encourage switching to Miller as the brand performs well in a forced choice situation and Carlsberg drinkers are less loyal than Heineken drinkers, who are potentially the most difficult to appeal to as they are the most satisfied with their brand." Dublin & Cork Satellite Lager tracking, Lansdowne Market Research, September 2005.

Discussion

5.27. The parties' internal documents show that the closest competitor to the leading lager brands of both Heineken and B&C is Diageo's Budweiser.

Authority Survey Evidence

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[52] See pgs 050065, 050073 and 050073.

[53] Package Division Sales, "Impact of "Beamish specific promotions", Conference 23 August 2007.

5.28. In order to enable the Authority to establish this, the Authority asked the following question to off-trade customers (that is, wholesale/retailers) in its survey: "For each brand listed in the following tables which other brand(s) do you view as the closest competitor and why?"

5.29. Table 5.3 presents a summary of the response of off-trade customers to this question in respect of the key lager brands supplied by Heineken.

Table 5.3
Closest Competitor, Heineken's Key Lager Brands, Off-Trade, the State, 2008

Brand	Closest Competitor	Percentage of Respondents
Heineken	Budweiser	54.3
	Carlsberg	17.1
	Budweiser and Carlsberg	5.7
	MGD	5.7
Coors Light	Budweiser	25.7
	Budweiser Light	25.7
	MGD	20.0
	Budweiser and MGD	5.7
Amstel	Harp	11.4
	Tennents	8.6

Source: The Competition Authority Survey of Wholesale/Retailers

5.30. The following conclusions can be drawn from Table 5.3:

- The lager brands of Diageo (Budweiser, Carlsberg and Harp) are closer competitors to the lager brands of Heineken than those of B&C.

- The majority of off-trade customers (54%) state that Budweiser is Heineken's closest competitor followed by Carlsberg (17%).

- The majority of customers (51%) stated that Budweiser and Budweiser Light are Coors Light's closest competitors.

- Amstel does not appear to have a clear closest competitor. Any lager brand would appear to be substitutable for Amstel.

5.31. Table 5.4 below presents a summary of the response of off-trade customers to the question in paragraph 5.27 in respect of the two main lager brands supplied by B&C.

Table 5.4
Closest Competitor, B&C's Key Lager Brands, Off-Trade, the State, 2008

Brand	Closest Competitor	Percentage of Respondent
MGD	Budweiser	28.6
	Coors Light	17.1
	Heineken	14.3
Foster's	Amstel	17.1
	Castlemaine	11.4

Source: The Competition Authority Survey of Wholesale/Retailers

5.32. The following conclusions can be drawn from Table 5.4:

- There is substantial support for the view that Budweiser is the MGD's closest competitor followed by Heineken and Coors Light.

- Fosters, like Amstel, does not appear to have a clear closest competitor. Any lager brand would appear to be substitutable for Fosters.

<u>Discussion</u>

5.33. In sum the Authority's survey finds that that the closest competitor of both Heineken and MGD in the off-trade market is Budweiser, a view consistent with the internal documents of the parties.

Entry and Parallel Imports

5.34. The Authority's *Merger Guidelines* require three conditions to be met for entry to be able to constrain the merged entity from raising prices post-merger. These conditions are cumulative; they all have to be satisfied before entry acts as a competitive constraint on the merged entity:

- Entry must be timely – entry is considered timely only if it occurs within two years;

- Entry must be likely – in other words, entry must be profitable at existing or lower prices; and,

- Entry must be sufficient – entry must return prices to their pre-merger level. For this to happen, entry must occur on a sufficient scale.

5.35. If the merged entity were to raise price post-merger, entry and/or parallel imports may constrain such a price increase due to: (i) the entry of a new brand that consumers would switch to in such numbers as to defeat the price increase; and/or (ii) parallel imports of the brands whose price was increased (or very close substitutes) such that the price increase would be unsustainable. Each alternative is considered in turn.

Submissions of the Undertakings Involved

<u>Heineken</u>

5.36. RBB Report #2 (p. 30) states that barriers to entry and expansion are low in the off-trade lager market. Referring to AC Neilsen data, RBB notes that there are examples of successful entry by Corona and other brands which have gained a substantial market share over a short period of time.

5.37. RBB claims that there are no significant barriers to entry or expansion in production since beer can be economically imported from overseas. Additionally, there are no substantial barriers to developing effective distribution throughout the country since the majority of sales are made through supermarkets and wholesalers/distributors.

5.38. RBB also notes that lager brands are easily imported into Ireland from other European countries in the so-called "parallel trade or grey market". RBB estimates that 5-20% of the lager sold in the off-trade is from the grey market.

B&C

5.39. Compecon Report #1 (p. 65) agrees with RBB that there is scope for new entrants to import lager brands directly into the State. However, Compecon contends that this will appear to occur at a disadvantage to the entrants due to high transportation cost. However, Compecon provides no evidence to verify this point. This view is inconsistent with the presence of successful wholesalers/retailers that import much of their off-trade lager products.

Discussion

5.40. New and existing brands of lager in the State are predominantly foreign. For example, all of the brands in Table 5.2 above are foreign as are virtually all of the other brands sold by brewers and wholesalers/retailers in the State, as set out in section two above. These brands are typically licensed to a brewer or wholesaler/retailer in the State, which is responsible for the marketing and distribution of the brand in the State. There may be sales and other targets as part of the licensing agreement. In the case of a brewer such as Heineken or B&C, the licensed brand might be brewed in the State, while in the case of wholesalers/retailers, the cans and/or bottles of lager are imported. Thus entry of a new brand into the State occurs through a brand owner licensing either a brewer such as the merging parties and/or a wholesaler/retailer to market the brand in the State.

5.41. The Authority's investigation confirms that neither a brewery facility nor a distribution network is required to enter the off-trade market in the State. Tables 5.1 and 5.2 above indicate that there have been successful entrants (BMF, Gleeson, Comans and others) who have taken market share from the already established brewers in the State, mainly Diageo and, to some extent, B&C. These competitors own neither a brewing facility nor their own lager brand in the State. Each owns the rights to import and sell different foreign lager brands in the State.

5.42. Post-merger, if the merged entity were to raise the price of one of B&C's or Heineken's brands, then a brand owner from outside the State could license either Diageo or one of the wholesalers/retailers. Given the multiplicity of brands listed as being already sold by these suppliers in section two above, it is likely that entry is easy.

5.43. The Authority considers that, if the merged entity did raise price post-merger, then the entry of new brands is likely and would be timely, in that it would occur within two years. The brands already exist, but in another jurisdiction, such as the US or an EU Member State. However, the Authority does not think that such entry would be sufficient. The evidence in Table 5.2 suggests that the leading brands of the undertakings involved, while declining in some instances, nevertheless maintain substantial market shares. Furthermore, it seems likely that, to the extent that close substitutes for these brands already exist, they would have already been introduced under licence to a brewer or wholesaler.

Parallel Trade

Definition

5.44. According to the European Commissions parallel trade can be described as follows:

> Trade in products, which takes place outside the official distribution system set up by a particular firm. Through their own distribution system, firms may cause differences in prices for different countries, exploiting national differences in the behaviour of consumers. Parallel traders buy products in countries where they are sold at lower prices and sell them in high-price countries. The flow of products thereby created is called parallel trade.[54]

5.45. In other words, wholesaler/retailers import lager brands from the UK or elsewhere and then these parallel trade brands are sold in competition with those sold by the licence holder in the State. Parallel trade thus will be important where there are differences in price between Ireland and other countries. Such differences may reflect currency fluctuations or different pricing policies or different competitive conditions. The parallel trade might be sponsored by retailers with operations in other EU Member States or off-trade retailers such as O'Briens etc.

Review of the Parties' Internal Documentation

Heineken

5.46. A review of the parties' internal documents clearly shows that parallel trade is an important element of the off-trade market. Heineken estimates that [0-5]% of the off-trade market is accounted for by parallel imports from the grey market. However, the severity of the problem differs from brand to brand.

5.47. Heineken continuously tracks the occurrence and prevalence of parallel imports of its own lager brand. The following documents show how Heineken attempts to address this issue:

- P 250095, Presentation Bain & Company, Management workshop December 15, 2003: this presentation explains that parallel imports are a significant threat, and this presentation also identified stores with parallel imports.
- P 260228, Three Year Plan 2006-2008, considers the issue of parallel trading and states that "Parallel trading is increasing".
- P 280037, "Heineken Ireland Packaged Pricing issues, 2003" discusses the threat of parallel trade, especially with the introduction of new EU Member States.

[54] European Commission, 20032, *Glossary of Terms used in EU Competition Policy*, Luxembourg: Office for Official Publications of the European Communities, p. 36.

- Ps 290192 and 290193, "Heineken Ireland performance 2004", discussed parallel trading and reasons for successful management in 2004.

- P 210076 David Review Presentation 2007, presents Threat of Parallel Trading from different countries due to price differences.

B&C

5.48. Similarly, B&C's internal documents show that parallel trade is a significant threat where there are significant price differentials between Ireland and other countries in Europe. B&C's internal documents show that […] of its top off-trade customers stocked parallel trade in 2006. For example, […] exclusively stocked parallel-imported MGD. Customers argued that they need to have cheaper MGD stock keeping units to compete.

5.49. The extent of parallel imports of MGD and its impact on B&C is discussed in the document "MGD Bottle Strategy - Discussion Paper" (undated, would appear to have been created in 2007). This document established that there is significant import of bottled beer both to the off-trade and on-trade. The document compares the volume of MGD sold, to the Moving Annual Total reported by AC Nielsen. In respect of the off-trade, […] barrels or […] hls were paralleled in 2006. In respect of on-trade bottled MGD, excluding […] who at the time also exclusively parallel imported MGD, […] barrels (out of […] barrels) or just over […] cases of parallel were sold in Ireland in 2006. That was [25-30]% of MGD sold in Ireland. The reason, according to this document, is simply down to economics - Miller is available from a number of sources across Europe at a significantly lower price than B&C is offering. Up to a €10 price gap can exist per 24 pack - €29.45 v €18.00. A €10 gap is not sustainable and even harder to justify.

5.50. To compete with parallel imports in the off-trade, B&C launched a 20-pack bottle for Christmas 2004 which proved to be hugely successful and, along with the 18 pack, has almost removed parallel imports from the off-trade (excluding Dunnes). B&C offered discounts of between […] per case for wholesalers to use with publicans in order to protect against parallel imports. In some outlets they may not need to discount but in some they will invest up to […] per case on returnable bottles. The total investment by B&C is near to […] per annum. B&C also put in place restrictions and sanctions for customers who buy parallel imports. For instance if a customer is buying non-B&C stock he will not be offered 18/20 pack deals. This applies to both wholesale and retail customers.

5.51. A number of strategies were suggested – […].

5.52. On 25 July 2008, at a meeting between B&C and the Authority, B&C argued that parallel trade in MGD was a problem of the past because it was produced in the UK. S&N had the sales franchise up to 2006 and had 'traded' the brand thereby resulting in 'cheap' product crossing the Irish Sea […]. B&C submits that MGD is no longer produced in the UK and therefore this source has dried up.

5.53. On 19 September 2008, in response to B&C's claim that parallel trade in MGD has been stemmed, Heineken submits that that claim is inaccurate. Heineken submits that MGD is still being parallel-traded from a variety of sources, varying from Hungary to Costa Rica to Greece. Parallel-traded MGD is sold in a variety of outlets (for example, some […] outlets). Heineken also submits that other retailers including […], only in the last few weeks, opted for 100% parallel-traded MGD. […] is also not trading with B&C for any of the B&C products. The Authority contacted […] on 26 September 2008. […] confirmed that they continue to import MGD and other lagers as parallel imports. […] claimed that imported MGD was approximately 35% cheaper than B&C-producer MGD.

<u>Discussion</u>

5.54. Parallel trade in packaged lager occurs at varying degrees for different brands. The evidence shows that a significant price differential between the price of MDG in the State and the UK induced a substantial parallel trade in MGD. The evidence suggests that parallel trade in lager brands in the off-trade market is likely and will occur in a timely and sufficient manner that will constrain any attempted rise in the price of the lager brands controlled by the merged entity.

Countervailing Buyer Power

5.55. Countervailing buyer power occurs when customers are able to counter the exercise of market power by the merged entity through their bargaining strength. The Authority's *Mergers Guidelines* states that:

> the fact that buyers are large and have a degree of bargaining power is not sufficient to conclude that market power is effectively constrained. Effective buyer power requires that buyers have alternative sources of supply, or are capable of credibly threatening to set up alternative supply arrangements. (Paragraph 4.10)

In such cases, even firms with very high market share may not be in a position to exercise market power post-merger.

5.56. Countervailing market power, in terms of alternatives, can take at least two forms. First, the customer, such as a large supermarket, may threaten to parallel import a brand if the licensed supplier in the State does not supply at the right price. Second, the customer can play one supplier of lager against another in order to get a better price. As noted above, the abolition of the Groceries Order has encouraged price competition in the off-trade, creating an incentive for customers to seek lower prices to compete with other retail outlets.

5.57. In the context of the current situation, if the merged entity were to raise price post-merger, then customers would be able to prevent such an increase by either parallel imports and/or promoting close substitutes that are available from competitors to the merged entity, including Diageo and wholesalers/retailers.

Submission of the Undertakings Involved

<u>Heineken</u>

5.58. RBB Report #2 (p. 30) submits that off-trade customers are powerful buyers who have the ability to constrain prices by exercising their substantial countervailing buying power. RBB estimates that the leading retailers (Musgraves, Dunnes, Tesco, Lidl and Aldi) account for 50% of beer sales in the off-trade sector. These customers can use shelf space to discipline suppliers' behaviour by organising tenders or by sponsoring entry or expansion of smaller players.

B&C

5.59. Compecon Report #1 (p. 66), on the other hand, submits that the majority of customers would not appear to have any degree of market power. Compecon agrees with Heineken that the multiples would be able to exercise market power but contends that the vast majority of off-licences would not be able to do so.

Discussion

5.60. The Authority takes the view that leading retailers are able to exercise a significant degree of countervailing buyer power due to:

(i) their ability to seek products supplied by the merged entity from alternative sources. As illustrated above, under the "parallel trade" heading, Dunnes and Superquinn obtained their MGD supplies exclusively from sources other than B&C. This forced B&C to reduce price and become more innovative in managing its stock keeping units for MGD;

(ii) the removal of the Groceries Order, which has created a competitive pressure for retailers to seek lager brands from the cheapest sources in order to engage in price competition; and,

(iii) the fact that wholesalers are also actively engaged in supplying the market (retailers and off-licence customers) with products obtained from the grey market. The gaining strength of the euro against the pound sterling will make it more attractive for wholesalers to source packaged lager brands from the UK.

Removal of Maverick?

Defining a Maverick

5.61. The Authority's *Merger Guidelines* state that "a maverick is a firm that has a history of cutting price or otherwise deviating from conventional market behaviour in a pro-competitive manner." (Paragraph 14.4(e)). Thus the removal of a maverick by a merger is likely to reduce competition and, depending on the strength of the maverick, may lead to a substantial lessening of competition.

5.62. Ivaldi et al,[55] state that a maverick firm can be interpreted as a firm with a drastically different cost structure, which is thus unwilling to

[55] M. Ivaldi, B. Jullien, P. Rey, P. Seabright and J. Tirole, 2003, *The Economics of Tacit Collusion*, Final Report for DG Competition, EC

participate in a collusive action. The existence of such a "maverick" tends to make collusion difficult, if not impossible, to sustain.

5.63. Baker[56] describes a maverick as a firm:

> that could be an observably disruptive force, taking the lead in starting price wars or sales, but it also could keep price from rising merely by refusing to follow rival attempts to raise price. It is possible that the maverick would not be recognisable as a holdout to the outside observer, as rivals would be expected not to attempt to increase price unless they had reason to think that industry conditions had changed in a way that would lead the maverick to go along. As long as the maverick refuses to go along, there will be no coordinated price increases, and all firms' prices will remain competitive. (p.163)

5.64. Scheffman and Coleman state that "If a maverick has been identified, it is … important to assess why the firm has been behaving like a maverick in order to determine whether the merger will change those incentives."[57]

5.65. On the basis of the above, a maverick can be understood to be a firm that is 'different' in the sense that, relative to its competitors in the potentially coordinating group, it is either: (i) less likely to coordinate on a higher price; or (ii) more likely to deviate from an existing high price. A likely impact of the existence of a maverick is that a price leader is less likely to push for higher prices and there may be little sign of overt price wars ('sales'). Nevertheless, it should be possible to be able to identify either an 'inherent, long-lasting characteristic' of a maverick (Ivaldi et al, p.55) or some evidence from price leadership and signalling behaviour (as identified in Baker above) before concluding that there exists a maverick as a significant force constraining market prices.

Submissions of the Undertakings Involved

<u>Heineken</u>

5.66. Heineken submits that B&C is not a "pricing maverick" in the off-trade lager market. B&C's prices have not been systematically lower than those of its rivals. For example, RBB Report #2 (p. 2) states that "the price of MGD has been substantially higher than the price of the main lager brands, and has increase*d* at a faster rate." Also, B&C's market shares have increased by less than those of its competitors, suggesting that B&C is not a critical source of competitive pressure in the off-trade market.

<u>B&C</u>

5.67. Compecon Report #1 (p. 66) submits that Heineken always follows a price increase announced by Diageo by the same amount. Compecon submits that B&C is a maverick, as it has a history of undercutting its competitors and it has not always followed the price

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[56] J. D., Baker, 2002, 'Mavericks, Mergers, And Exclusion: Proving Coordinated Competitive Effects Under The Antitrust Laws', *New York University Law Review,* Vol.77, April, pp.135-203

[57] D. T. Scheffman and M. Coleman, 2003, 'Quantitative Analyses of Potential Competitive Effects from a Merger', Federal Trade Commission, p. 21. The paper may be accessed at: <www.ftc.gov/be/quantmergeranalysis.pdf>

increases announced by the market leader, Diageo. For example, MGD and Foster's deviated from the price increase announced by Diageo on two out of five occasions and four out of five occasions, respectively. The proposed transaction will result, Compecon argues, in the removal of a maverick in the off-trade lager market leading to coordinated effects.

Discussion

5.68. The Authority first establishes whether B&C is a maverick in the off-trade lager market and then determines whether the proposed transaction is likely to impact this behaviour post-merger.

5.69. Although B&C claimed that it is the pricing maverick in the off-trade market, the Authority's investigation indicates that B&C's pricing behaviour is more as a result of competitive constraints from its existing competitors and countervailing buyer power of its customers due to their ability to parallel import its MGD, than as a result of a maverick strategy. For example, B&C's "MGD Draft ROI, Business Plan 2006-2010," confirms that B&C maintains a pricing parity for MGD with its competitor set (Budweiser, Heineken and Carlsberg) as an attempt to reposition the MGD brand as a premium brand in line with its competitors' set. Therefore, it not surprising that this pricing behaviour has not disrupted the behaviour of Diageo and Heineken in off-trade market.

5.70. While it is true that B&C did not increase the price of MGD on two out of five occasions, the evidence shows that this period (2004 to 2006) coincides with the flow of parallel imported MGD from the UK. However, in 2007, after stemming the import problem, the evidence shows MGD's price increased by twice the amount of its competitors.

5.71. If B&C is a maverick with Foster's, one would expect that its pricing behaviour in respect of this brand would result in an increase in market share and a disruptive effect on the behaviour of other competitors in the market. While is true that Foster's, on four out of five occasions, did not follow the price announcement of Diageo, the evidence shows that Foster's competes in the value brand segment of lager and as such can only achieve a price point in line with those of its competitors in this segment. The evidence shows that Foster's pricing behaviour has not resulted in an increase in its market share. In fact, its market shares rose slightly to 3.6% in 2005 from 3.4% in 2004 and then continued to decline to 2.8% in 2007.

5.72. The evidence does not support the view that B&C is a maverick with its MGD and Foster's brand in the off-trade lager market. B&C's pricing strategy for MGD is consistent with those of its competitors within the premium lager set. Foster's, on the other hand, is a value lager brand that is priced accordingly.

Substantial Lessening of Competition in Off-trade Lager

5.73. The Authority's assessment of impact of the proposed transaction on the off-trade market is done within the framework of two theories of harm: unilateral and co-ordinated effects. The Authority's Merger Guidelines discusses these theories of harm in much greater detail at paragraphs 4.4 to 4.16 and paragraphs 4.17 to 4.25, respectively.

Unilateral Effects

5.74. Unilateral effects refer to a situation where the anti-competitive effect of a merger results from non-coordinated action by market players and arises where the merged entity has the incentive and ability post-acquisition to unilaterally exercise market power by, for example, raising price or reducing output. The exercise of unilateral effects usually involves a merger of sellers of differentiated products competing on the basis of price and depends largely on the closeness of the merging firms' products. In other words, if the two products are each other's closest substitute, a pre-merger price increase of Product A would result in customers switching their purchases to Product B (and other rivals). Post-merger, the merged entity would internalise consumer substitution away from Product A, thereby avoiding at least some of the penalty otherwise associated with raising price.

Submissions of the Undertakings involved

5.75. None of the parties argued that the proposed transaction will result in unilateral effects in the off-trade lager market.

Authority's Analysis of Unilateral Effects

5.76. For the sake of completeness, the Authority assessed whether the proposed transaction is likely to lead to unilateral exercise of market power by the merged entity in the off-trade lager market.

Incentive

5.77. The merged entity will only have the incentive to exercise market power by raising prices if it would be profitable to do so. In order for this to occur, the lager brands currently supplied by B&C should be the closest substitutes to those supplied by Heineken and vice versa. If this is the case, a post-merger price increase in any of the brands supplied by B&C will result in a switch by consumers to the Heineken brand making it profitable for Heineken to raise the price. Similarly, a rise in the price of Heineken's lager brands will be profitable if consumers switch to B&C brands such as MGD.

5.78. The evidence in Table 5.3 above shows that Heineken lagers and Coors Light's closest competitors are the Diageo lager brands, that is, Budweiser and Carlsberg. This implies that any post-merger rise in the price of Heineken lager and/or Coors Light will lead to a switch by consumers to the Diageo brands rather than B&C's, so that the externalities from a rise in the price of the Heineken lager and Coors Light brands are unlikely to be internalised by the merged entity.

5.79. If Heineken was to increase the price of MGD post-merger, the evidence in Table 5.4, suggests that customers will switch in a much higher proportion to Budweiser than to either of the Heineken lager brands, Coors Light and Heineken. However, the switch to Budweiser would be slightly below the combined proportion of consumers switching to the Heineken brands, that is, 29% versus 31%, respectively.

5.80. Notwithstanding this, B&C's internal documents – discussed above – state that Budweiser is MGD's closest competitor due to the fact that it is an American brand and that both products target the same customers. This suggests that a post-merger increase in the price of MGD is likely be unprofitable to the merged entity due to the fact that the customers likely to be gained by the other Heineken brands may not offset the loss to Budweiser which is owned by Diageo.

Ability

5.81. The larger the market share acquired by the merged entity as a result of the proposed transaction, the more likely it is that the merged entity will possess market power. The proposed acquisition will result in Heineken becoming the market leader in the supply of lager to the off-trade market. However, the resulting increment in market share (8-9%) is unlikely to enable Heineken to exercise market power due to existing market conditions: (i) Heineken will continue to face competition from its closest competitor, Diageo, in the off-trade market; (ii) barriers to entry into the off-trade market will not increase as a result of the proposed transaction; and, (iii) the credible threat of customers to obtain packaged lager brands from alternative sources, including parallel imports.

View of the Authority on Unilateral Effects

5.82. On the basis of the above, it is the Authority's view that the proposed transaction will not lead to a unilateral price increase in the off-trade lager market as the merged entity will have neither the incentive nor the ability to raise prices.

Coordinated Effects

5.83. Coordinated effects occur where the proposed transaction changes the nature of competition in the relevant market by making it more likely that the merged entity and some or all of its competitors will engage in co-ordinated interaction to raise prices or decrease output. Such interaction refers to actions that are profitable only as a result of each firm accommodating the reactions of others. Here the main question is whether the merger materially increases the likelihood that firms in the market will successfully coordinate their behaviour or strengthen existing coordination.

Views of the Undertakings Involved

Heineken

5.84. Heineken's QIN[58] (p. 50) states that the proposed transaction will not result in coordinated effects in the off-trade market due to the following market conditions:

[58] Heineken, "Submission to the Competition Authority concerning the proposed acquisition of parts of the business of Scottish and Newcastle in the Republic of Ireland (namely, Beamish & Crawford plc)", 28 April 2008, p 22. This was referred to as the QIN or Quasi Irish Notification in paragraph 1.21

- Heineken/S&N/B&C and Diageo may have a similar size on the off-trade market, but they have incomparable market positions on the total Irish beer market. As Diageo sells its full range of brands to the off-trade customers, it is unlikely to engage in tacit coordination on the lager segment if it has no incentive to do so on the two other segments (stout and ale);

- The low barriers for imports of beer, resulting in a high proportion of imports and a strong growth of imports in recent years, make it unlikely that the merger of Heineken and B&C would lead to coordinated effects on the off-trade market.

- The buyer power and strong price competition on the off-trade market also make it unlikely that the merger of Heineken and B&C would lead to coordinated effects.

5.85. This view was emphasised by RBB's Report #2 (p. 30) which states that coordinated effects are unlikely in the off-trade market due to the market characteristics in the market.

<u>B&C</u>

5.86. Compecon Report #1 submits that many of the factors that would give rise to a risk following the proposed acquisition of B&C by Heineken "would also appear to arise in the off-trade lager market" (p. 65). In particular:

- Number of firms in the market: Collusion is easier with a small number of firms and a merger that eliminates a significant competitor makes collusion more sustainable.

- Symmetry: it is easier to collude among equals, that is, among firms that have similar market shares, similar cost structures, similar production capacities, or offer similar ranges of products.

- The existence of structural links: a merger that would create such links or remove a maverick would be more likely to facilitate collusion.

Authority's Analysis of Coordinated Effects

5.87. A summary of the conditions needed for successful coordination are presented in Table 5.5 below. The first set of conditions relate to finding common terms of coordination. In other words, what set of conditions are conducive to coordination? The terms of the coordination, as stated in the Authority's *Merger Guidelines*, "need not be complex, but may follow simple precepts such as a common price, stable market shares, or some form of territorial restriction." (paragraph 4.20).

5.88. In the pre-merger situation it is not at all clear that the conditions for reaching a common understanding are present. The retail price of lager in the off-trade is transparent but the price that the retailer pays to a wholesaler or brewer, either in the State or located elsewhere is not transparent as these arrangements are often negotiated bilaterally. Retail prices are set exclusively by retailers, which, pursuant to the removal of the Groceries Order, have an incentive to offer substantial discount on lager brands in order to attract customers.

5.89. Lager, as the discussion on closeness of competition made clear, is a differentiated not a homogeneous product.

5.90. The undertakings competing in supply of lager to the off- trade include: brewers such as the merging parties and wholesalers who purchase from brewers both in the State and elsewhere. These two groups of competitors are unlikely to have common costs, production techniques etc. Indeed, the wholesalers/retailers do not brew beer products at all.

5.91. As discussed above there is no evidence to support the theory that B&C is a maverick. There do not appear to be any structural links between the merging parties.

5.92. While pre-merger there do not appear to be the conditions conducive to identifying common terms of coordination, the merger will increase the symmetry of market share among the leading brewers in the off-trade in lager. As shown in Table 5.1 above, pre-merger Diageo is the clear market leader with a market share of 32.5%, while Heineken is ranked number two with a share of 22.3%, while B&C accounts for 15.0% of the market. Post-merger Heineken's market share will increase to 37.3%, much closer in size to Diageo than is the case at the moment.

Table 5.5
Necessary conditions and evidence required for coordinated behaviour

Condition	**Evidence required**
1. Identify common terms of coordination	Market transparency
	Product homogeneity
	Symmetry of costs, production techniques and capacity
	Non-existence of 'maverick' firms
	Structural links – joint ventures, cross shareholdings etc
2. Costly to deviate	Market transparency
	Market stability
	Structural links
3. Weak competitive constraints	Same as unilateral effects

Source: The Competition Authority

5.93. Table 5.6 below presents the relative strength of each type of beer within the portfolio of beers supplied by the leading brewers in the state.

Table 5.6
Leading Brewers, Volume, by Beer Type, the State, 2007

Beer type	**Diageo (%)**	**Heineken (%)**	**B&C (%)**	**InBev (%)**
Lager	39	93	74	94
Stout	51	7	23	0
Ale	10	0	0	6
Cider	0	0	<1	0
Total	**100**	**100**	**100**	**100**

Source: Section two above

5.94. The following conclusions can be drawn from Table 5.6:

- Lager accounts for the vast majority of sales by Heineken and Inbev, and to a lesser extent, B&C, while stout is the main revenue earner for Diageo.
- The asymmetry in the share of contribution to revenue by different types of beer as between Diageo and other players suggests that it will be difficult to engage in tacit coordination on the off-trade lager market, since other players will have no incentive to do so on the other markets (stout and ale).

5.95. The second set of conditions for successful coordination relates to the fact that it is costly for firms to deviate from the coordinating price or whatever is agreed. This requires that deviation can be detected and punished. In the absence of transparency in prices it is hard to see how this condition applies to the off-trade market. Furthermore, it is not clear what the punishment mechanism would be.

5.96. The third set of conditions relates to the presence of weak competitive constraints. Barriers to entry by established foreign brands are low, while parallel imports arise if prices in the State are too high compared with other countries. Post-merger, any attempt by the remaining suppliers to engage in tacit collusion in the off-trade lager market are likely to be: (i) disrupted by the entry of new brands; and, (ii) countered by customers who have the ability to obtain supply from alternative sources or sponsor entry.

Views of the Authority on Coordinated Effects

5.97. On the basis of the above, the Authority considers that the proposed acquisition of B&C by Heineken will not result in coordinated effects in the off-trade lager market.

Authority's Conclusion: Off-trade Lager Market

5.98. In consequence of the foregoing, the Authority is of the opinion that the proposed acquisition will not result in a substantial lessening of competition in the off-trade lager market in the State.

National On-trade Lager Market- Market Conditions

5.98 The current market conditions that exist in the on-trade lager market are presented below and an assessment of the potential impact on these market conditions by the proposed acquisition is made.

5.99 The parties supply the same brands of lager in the on-trade market as in the off-trade market albeit in two delivery formats: draught (keg) and packaged (mainly bottled). The overall split in market share between the two delivery formats in the on-trade is 75% draught and 25% packaged. However, there is some variation by brand. For the leading brands of the undertakings involved the split is as follows:[59]:

Heineken:

- Heineken - 91% draught and 9% packaged;
- Coors – 31% draught and 69% packaged;
- Amstel – 98% draught and 2% packaged.

B&C:

- Fosters - 100% draught;
- Carling – 54% draught and 46% packaged;
- Miller – 28% draught and 72% packaged.

Trend in Market Shares: by Undertakings

5.100 Table 5.7 below presents the market shares of the leading suppliers (Diageo, Heineken, B&C, Comans, Inbev, Gleeson and BFM) of lager to the on-trade lager market. Diageo, Heineken, B&C and Inbev supply their lager brands to the on-trade in both keg and packaged formats. Comans, Gleeson and BFM supply only in packaged format. Unlike the off-trade market, the market shares reported here are more precise due to the significantly lower prevalence of parallel trade in the on-trade market. The issue concerning parallel trade in the on-trade market is discussed further below.

Table 5.7
Market Shares, Lager, On-Trade, Sales, Leading Suppliers, the State, 2002-2007

Year	Diageo (%)	Heineken (%)	B&C (%)	BFM (%)	Inbev (%)	Others (%)	Total (%)
2002	55.9	35.9	6.5	0.0	0.9	0.7	100
2003	53.9	37.3	6.9	0.0	1.1	0.7	100
2004	50.6	39.4	7.6	0.1	1.4	1.0	100
2005	46.0	41.4	8.8	0.5	1.8	1.5	100
2006	42.6	43.2	9.2	1.4	1.9	1.7	100
2007	41.4	43.8	9.1	2.1	2.0	1.6	100
Change	**-14.5**	**7.9**	**2.6**	**2.1**	**1.1**	**0.9**	**0**

Source: Based on RBB's Analysis of AC Nielsen data

5.101 The following conclusions can be drawn from Table 5.6:

[59] Based on ACNeilsen data for August 2008.

- Diageo experienced a sharp fall in market share from 55.9% in 2002 to 41.4% in 2007. Other brewers and wholesale suppliers have gained substantial market share at the expense of Diageo, the market leader between 2002 and 2005. The market share lost by Diageo has been gained by Heineken, B&C, BFM, Inbev and "Others" which increased their market shares by 7.9%, 2.6%, 2.1%, 1.1% and 0.9%, respectively, between 2002 and 2007.

- In 2006, Heineken (43.2%) became the market leader while Diageo (42.6%) ranked second, followed by B&C with a market share of 9.1%. No other competitor has a share of at least 5%.

- The proposed acquisition involves a takeover by the market leader of the third ranked firm in the on-trade market.

- The proposed acquisition will result in a virtual duopoly with the merged entity and Diageo accounting for over 94% of the sale of lager to the on-trade market.

- The proposed transaction will increase the asymmetry in market share between the merged entity (52.9%) and Diageo (41.4%).

Trends in Market Shares: by Lager Brand

5.102 The leading lager brands supplied to the on-trade market and the nature of their ownership are presented in section two above. The market shares of the main lager brands supplied by the leading suppliers are presented in Table 5.8 below.

Table 5.8
Market Shares, Lager, On-Trade, Sales, Leading Lager Brands, the State, 2002-2007

Supplier	Brand	2002 (%)	2003 (%)	2004 (%)	2005 (%)	2006 (%)	2007 (%)	Change
Diageo	Budweiser	33.6	32.5	31.7	28.7	26.4	24.2	**-9.4**
	Carlsberg	18.1	17.8	16.1	15.0	14.0	14.4	**-3.7**
	Harp	2.8	2.2	1.7	1.4	1.2	1.2	**-1.6**
	Satzenbrau	1.4	1.3	1.0	0.8	0.7	0.7	**-0.7**
Heineken	Heineken	33.2	33.8	34.8	35.8	37.0	37.1	**3.9**
	Coors Light	2.7	3.5	4.5	5.5	6.1	6.3	**3.6**
B&C	MGD	4.5	4.9	5.6	6.1	6.3	6.3	**1.8**
	Fosters	0.6	0.8	1.0	1.9	2.2	2.3	**1.7**
	Carling	1.4	1.2	1.0	0.7	0.6	0.5	**-0.9**
BFM	Corona	0.0	0.0	0.1	0.5	1.4	2.1	**2.1**
Inbev	Tennents	0.6	0.6	0.5	0.5	0.7	0.7	**0.1**
	Stella Artois	0.1	0.3	0.5	0.8	0.6	0.4	**0.3**
Others	Various brands	1.0	1.1	1.6	2.3	2.8	3.7	**2.7**
Total	-	100	100	100	100	100	100	**0**

Source: Based on RBB's analysis of AC Nielsen data

5.103 For the period 2002 to 2007, Table 5.8 shows that lager brands shares trends reflect the trend in market shares of the key suppliers in the on-trade market:

- As in the off-trade market, all the lager brands supplied by Diageo have witnessed declines in market share: Budweiser's market share fell from 33.6% in 2002 to 24.2% in 2007; while Carlsberg market share declined from 18.1% in 2002 to 14.4% in 2007. In contrast, Heineken's main brand, Heineken lager, gained 3.9% in market share to overtake Diageo's Budweiser as the number one lager brand in the on-trade market.

- B&C's MGD and Fosters also gained market share while its Carling brand experienced a substantial decline in its market share from 1.4% in 2002 to 0.5% in 2007. MGD and Heineken's Coors Light had identical market shares in 2007, with the latter having experienced a greater increase in market share between 2002 and 2007.

- BFM's Corona gained 2.1% market share to rank fourth ahead of Inbev's Tennents (0.7%) in the on-trade market.

- Heineken will, post-merger, control four out of the top six lager brands supplied to the on-trade market. Heineken will, post-merger, become the market leader in the on-trade market.

Competition Assessment

5.104 In order to assess whether the proposed acquisition will result in SLC in the national on-trade lager market, the following characteristics of this market, identified by the undertakings involved, by third parties, and by the Authority during the course of the investigation, are discussed:

- closeness of competition;
- entry and parallel imports;
- countervailing buyer power; and,
- the removal of a "maverick firm".

Closeness of Competition

5.105 It is clear from a comparison of Tables 5.2 and 5.8 above that the parties supply the same lager brands to the on-trade as to the off-trade, albeit with an additional form of delivery, that is, in keg. The same competitor sets identified in the off-trade market are present in the on-trade market. As a result some of the evidence examined and analysis carried out above in respect of off-trade lager is also applicable to on-trade lager. Where this is the case, reference will be made to the earlier discussion and only a brief summary provided.

Submissions of the Undertakings Involved

5.106 The submissions of the undertakings involved concerning the closeness of competition are presented in paragraphs 5.21 to 5.22 above. In particular:

- Heineken and Amstel: competing brands include Carlsberg and Stella Artois.

- Coors Light and Sol: competing brands include Budweiser, Bulmers, Miller and Corona.

- MGD: competing brands include Budweiser, Heineken, Coors Light and Carlsberg.

Review of the Parties' Internal Documents

5.107 The review of the parties internal documents with respect to closeness of competition are set out in paragraphs 5.23 to 5.26 above. These documents show that the closest competitor to the main lager brands of both Heineken and B&C is Budweiser which is owned by Diageo.

Authority's Survey Evidence

5.108 In order to enable the Authority to establish which lager brands are closest competitors for each other in the on-trade market, the Authority asked the following questions to on-trade customers (that is, publicans, restaurants, hotels and recreational centres) in its survey: "For each brand listed in the following tables which other brand(s) do you view as the closest competitor and why?"

5.109 Table 5.9 below presents a summary of the response of on-trade customers to this question in respect of the key lager brands supplied by Heineken.

Table: 5.9
Closest Competitor, Heineken's Main Lager Brands, On-Trade, 2008

Brand	Closest Competitor	Percentage of Respondents
Heineken	Carlsberg	46.6
	Budweiser	27.6
	Budweiser and Carlsberg	5.7
	MGD	5.7
Coors Light	Budweiser	36.8
	Budweiser Light	8.8
	MGD	14.0
Amstel	Harp	7.0
		5.3

Source: The Competition Authority Survey of On-Trade Customers

5.110 The following conclusions can be drawn from Table 5.9:

- As in the off-trade market, the lager brands of Diageo (Budweiser, Carlsberg and Harp) are closer competitors to the lager brands of Heineken than those of B&C.

- Almost half of on-trade customers (46.6%) state that Carlsberg is Heineken's closest competitor followed by Budweiser (27.6%). Only 5.7% of on-trade customers state that MGD is the closest competitor of Heineken larger.

- As in the off-trade market, a significant percentage of on-trade customers (45.6%) stated that Budweiser and Budweiser Light are Coors Light's closest competitors. 14% of on-trade customers stated MGD is Coors Light's closest competitor.

- As in the off-trade, Amstel does not appear to have a clear closest competitor. Any lager brand would appear to be substitutable for Amstel.

5.111 Table 5.10 below presents a summary of the response of on-trade customers to the question in paragraph 5.109 in respect of the main lager brands supplied by B&C.

Table: 5.10
Closest Competitor, B&C's Main Lager Brands, On-Trade, 2008

Brand	Closest Competitor	Percentage of Respondents
MGD	Heineken	31.6
	Coors Light	15.8
	Budweiser	14.0
Foster's	Carlsberg	7.0
	Bavaria	7.0

Source: The Competition Authority Survey of On-Trade Customers

5.112 The following conclusions can be drawn from Table 5.10:

- In contrast to the off-trade, there is substantial support for the view that Heineken lager (31.6%) is MGD's closest competitor followed by Coors Light (15.8%) and Budweiser (14%).

- As in the off-trade market, Fosters, like Amstel, does not appear to have a clear closest competitor. Any lager brand would appear to be substitutable for Fosters.

5.113 The Authority's survey finds that similar to the off-trade market, the closest competitor brands to Heineken lager are the Diageo lager brands, Carlsberg and Budweiser. However, in respect of MGD, its closest competitor brands are the Heineken lager brands, Heineken lager and Coors Light, rather than Diageo's Budweiser.

5.114 The Authority considered a possible explanation for this asymmetry: that even for the on-trade MGD is seen primarily as a bottled beer (i.e. 72% of on-trade Miller sales revenues in August 2008 were generated by bottle sales) and therefore its closest competitors could be lagers which are distributed in bottle format .In contrast Heineken is predominantly a draught beer in the on-trade (i.e. 91% of its on-trade sales revenues in August 2008 came from sales of the draught format. Thus Heineken drinkers may be more likely to regard other draught lagers as close substitutes However closer examination of the relative split between draught and bottle sales for the lagers mentioned in Tables 5.9 and 5.10 does not provide any clear evidence that this is the case.

Entry and Parallel Imports

5.115 As stated in the Authority's *Merger Guidelines* and outlined in paragraph 5.33 above for entry to discipline a price increase by the merger entity such entry must be timely, likely and sufficient. Entry refers to a new brand entering the on-trade lager market; while parallel imports refer to the unauthorised importing of an existing on-trade lager, which is subsequently sold by the publican to a customer.

Submissions of the Undertakings Involved

Heineken

5.116 Heineken's QIN (pp. 44-47), submits that it is easy to enter the on-trade market due to the following:

- Unlike the situation that prevails in some other Member States, brewers do not own pubs and there are no exclusivity arrangements between brewers and publicans in the State;

- There are no technical restrictions on publicans on switching to another brand or taking an extra brand. Pubs own the equipment that circulates draught beer. Approximately, 75% of pubs own "multi circ systems", a tap installation with a large number of connection points to which a publican can connect different brands of beer. A "multi circ system" can connect up to 20 different lines. This makes switching of brands and the introduction of new brands easy;

- The only investment by a new brewer or wholesaler in respect of introducing their brands in the pub is the handle with the brand logo, which needs be installed on the counter (which cost €100) and promotional materials such as beer mats, posters, and glasses;

- The fact that the barriers for brewers/wholesalers getting their brands in the pub are low is demonstrated by the number of different brands offered in Irish pubs[60] and the speed at which new brands can penetrate the market. Irish customers ask for a specific brand. Pubs need to have the range of brands in stock to meet consumer demand; and

  - Barriers to entry in the on-trade of packaged segment (bottled/canned) beers are low:

  - There is little restriction on the number of bottled/canned products that a publican can stock;
  - Consumption of bottled beer is increasing. This gives brewers and importers an easy way to get entry to the on-trade consumers; and,
  - Low barriers for international imports of packaged lager are reflected in the strong increase of lager imports in recent years for sale in on-trade.

5.117 In a subsequent submission on 17 September 2008, Heineken argued:

- Parallel trade is already an important competitive constraint on prices for packaged beer products in the on-trade in the State. Heineken estimates that between 10% and 30% of packaged lager in Ireland is supplied from parallel trade to the off-trade. MGD in particular, has one of the highest proportions of parallel traded product on sale in the State.

[60] On average 5.8 draught beer and 8.6 bottled beer.

- It is usual for publicans to source products from several wholesalers at any one time. There are usually no exclusive arrangements and publicans seek the benefits of having several suppliers. As the wholesale market in Ireland is virtually independent of the brewers, wholesalers are free to source their products from whatever source they wish. Virtually all of these wholesalers either already parallel import product or can do so (for example, wholesalers could be offered product by third parties). Therefore parallel trade is an existing and significant competitive constraint at both the retail and the wholesale level in the on-trade.

- On-trade outlets can also purchase packaged products which are offered for sale in the off-trade (which may itself be parallel traded). Heineken believes that this occurs particularly when multiples have special offers. Heineken is even aware of at least one example where a multiple has offered to supply an on-trade outlet with packaged product.

- There is a real incentive for publicans to seek out the best value source of packaged products, whether it is through a wholesaler, off-trade retailer or internationally. Since wholesalers compete for publicans' business, there is also an incentive at that level in the supply chain to minimize the cost of packaged products. Publicans do not have to import the product themselves because they will shop around between wholesalers to obtain the cheapest product and this will put pressure on wholesalers to get the cheapest product possible which, in its turn, puts pressure on brewers such as Heineken to sell as cheaply as possible.

<u>B&C</u>

5.118 The B&C submission in the Compecon Report #1 (pp. 56-58), focuses on barriers to entry in respect of brewing facilities and submits that barriers to entry in the Irish beer industry are relatively high due to the following:

- The construction of a new efficient-scale brewery would involve large sunk costs which constitute an entry barrier. Purchasing a disused brewery would not appear to be an option in the Irish context;

- The costs of advertising constitute a significant barrier to entry. Advertising represents an endogenous sunk cost in the beer industry[61];

- Technical services installation of branded taps and counter mountings, installation and cleaning of beer lines, quality control, handling customer complaints, facilitating special events and concerts may constitute a further barrier to entry;

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[61] J. Sutton, 1991, Sunk Costs and Market Structure, Cambridge, Mass: MIT Press and UK Competition Commission, 2001, Interbrew SA and Bass plc: A report on the Acquisition by Interbrew SA of the brewing interests of Bass plc. London; the Commission. The latter report may be accessed at:

http://www.competition-commission.org.uk/rep_pub/reports/2001/452interb.htm#full

- Access to distribution: Brewers in Ireland distribute their products to pubs. Thus a new entrant might have to establish a distribution network. Given economies of scale of distribution, a new entrant would face significantly higher distribution costs due to its smaller sales volumes irrespective of whether it undertook distribution itself or was able to use an independent distributor;

- The existing beer suppliers of draught beer have entered into a joint agreement with BOC Gasses for supply and distribution of gas to pubs. Any potential new entrant would either have to be granted access to this agreement or arrange for an alternative means of distributing gas for its draught products. Pubs might be unwilling to give over cellar space for a separate gas system for a product with relatively low sales; and,

- New entrants by way of imports are at a cost disadvantage due to higher transport costs.

5.119 Compecon submits that the difficulties in gaining entry to the on-trade market are underlined by two things: (i) in the last ten years there has not been any change to the market shares of the top three brands. Together, these three brands account for 86% today compared to 88% in 1999; over 96% of the volume of draught lager sold in the on-trade is accounted for by the top three brewers (Diageo, Heineken and B&C); and, (ii) there has been a number of brand failures despite substantial marketing investments, for example, Breo, Stella and, to a lesser extent, Amstel.

5.120 B&C submits that parallel trade in MGD is not an issue in the on-trade which is also recognised by publicans. Sales of MGD draught are considerably stronger than sales of MGD bottle in the on-trade in Dublin and Cork city. In respect of bottled MDG, publicans prefer supply format in returnable bottles, rather than the normal bottles used for off-trade delivery. This is due to the cost of disposal of one trip packaging. MGD bottle is no longer produced in the UK so the incidence of parallel trade has diminished since the main source was the UK. SABMiller have strongly positioned MGD as "an international worth more" brand (or premium brand) which has led to higher and consistent pricing policies across their major markets. This makes parallel trade in MGD less attractive.

Views of Customers

5.121 As noted in section two above, the LVA is the trade association and representative body for the publicans of Dublin. The LVA has over 700 members and collectively represents over 90% of all publicans in Dublin.

5.122 The LVA stated to the Authority on 31 July 2008 that parallel imports are prevalent in the State, particularly for bottled beer. There is no parallel trade in kegs. Alternative suppliers exist for bottled products. Wholesalers are very price aggressive and they target publicans. Imported packaged products could be an issue depending on the brand in question. Consumers might find that the imported products taste different to the ones supplied by the brewer in the State. For example, imported Heineken is bottled differently and it tastes stronger. Imported beer bottles are not reusable, publicans dispose of the bottles.

5.123 Parallel imports are more frequent in the off-trade. Publicans obtain imported beer from wholesalers. Parallel trade acts to restrain what domestic suppliers can charge.

Authority's Survey Evidence

5.124 In its survey of on-trade customers, the Authority asked a number of questions to shed light on whether entry is likely, timely and sufficient to constrain the merged entity in the on-trade larger market. First, the Authority asked on-trade customers: "Do you know of any companies that have entered the Irish beer markets in the past 3 years?"

5.125 In response to this question, 79% of on-trade customers said "no", while 19% said "yes". Those who answered in the affirmative mainly referred to the introduction of new foreign brands rather than to entry by the construction of a new brewery facility. This suggests two things: (i) that the awareness level of the introduction of new brands to the on-trade market appears to be very low and (ii) the level of penetration new brands does not appear to be high. This is consistent with Table 5.8 above.

5.126 The Authority also asked the following question which was used by the Commission in its investigation of Case No COMP/M.4999, Heineken/Scottish & Newcastle:

> The European Commission understands that there are generally no capacity constraints in pubs. In other terms, when a publican wishes to add a new brand of draught, it is easy to connect a new keg to the multi-circ installation and place a new handle on the counter (and there is no need to replace an existing brand by this new brand due to lack of space/capacity). Do you agree with this perception?

5.127 In response to this question, 64% of on-trade customers said they agree that there are no capacity constraints while 37% said they disagree, mainly citing logistics problems. This suggests a majority support for the view that there is spare capacity in pubs which will facilitate entry of new beer brands.

5.128 Finally, the Authority asked on-trade customers: "Do you consider there are any 'must have' or 'must stock' beer brands in Ireland?"

5.129 In response to this question, the vast majority, that is, 96% said yes, citing mainly Heineken and Guinness. Budweiser and Miller were also cited as "must have" brands. Only two respondents said there are no "must have" or "must stock" brands.

Discussion

5.130 Entry in the on-trade market occurs mainly by the supply, in either packaged lager or keg lager or both, of established foreign brands by licensed brewers or through importation of established foreign brands by licensed wholesale distributors. As stated in paragraph 5.100 above, 75% of lager sold in the on-trade market is in draught form. Over 95% of draught lager sold in the on-trade market is brewed and supplied by the top three brewers: Diageo; Heineken; and, B&C. Inbev (2%) is the only significant importer of draught lager into the State which it imports from its UK based brewery facilities. BFM and "others" are only active in the bottled segment of the on-trade market.

5.131 Although packaged beer is subject to parallel trade, there is no evidence to suggest that there is a significant prevalence of parallel traded packaged beer in the on-trade market. This does not mean, however, that parallel imports do not affect price in the on-trade market as discussed below. That there is no parallel trade in draught beer is due to the fact that technical support and services are required in order to supply draught beer to pubs.

5.132 The point of entry into the on-trade for a new brand or a new entrant is the pub or other on-trade outlet. There are no exclusivity or other arrangements such as exist in other jurisdictions that tie on-trade outlets to particular suppliers of lager. The majority of pubs have the capacity to facilitate the introduction of new lager brands.

5.133 In terms of the supply of lager to the on-trade, the entrant could import packaged and draught lager from outside the State. Wholesalers/retailers supply the on-trade with imported package beer, while some of the leading brewers in the State send their product outside the State to be packaged, before reimporting it in a packaged form.[62] In terms of draught beer, it is not necessary to have a production facility in the State as demonstrated by InBev's experience. Hence, if the merged entity were to raise price then entry from a brand would be timely and perhaps likely.

5.134 However, there are grounds for taking the view that entry is unlikely to be sufficient to prevent any post-merger price increase profitable. The evidence in Tables 5.7 and 5.8 above shows that entry by new brands has not had a significant impact on the market shares of the top three brewers in the on-trade market. Together, the market shares of the top three brewers – Diageo, Heineken and B&C - was 98.3% in 2002 and this has only declined modestly to 94.3% in 2007. In respect of the impact on the shares of the top three brands, Table 5.8 above illustrates that the top three brands (two owned by Diageo and the other owned by Heineken) collectively increased their market shares from 71.3% in 2002 to 79.5% in 2007. However, it should be noted that the market shares of the two leading lager brands owned by Diageo declined significantly while the Heineken lager brand gained substantial market share at the expense of Diageo.

5.135 The overwhelming support for the view that there are "must have" or "must stock" brands which are mainly the brands controlled by the top three brewers and the low level of awareness of entry of new lager brands suggest that entry will not be sufficient to constrain the merged entity post-merger. This is also supported by the evidence which shows that the most successful entrant, BFM, which entered via bottled lager, took five years to capture just over

[62] See section two above.

2% of the market. Inbev, a supplier in both bottle and keg, has been in the market for over 10 years and accounts for only 2%.

5.136 There is of course the question of whether parallel trade could constrain a post-merger price increase. Any such impact is likely to be confined only to packaged on-trade lager. At the present time parallel imports play a limited role in the on-trade lager market, because on-trade outlets prefer the returnable bottle that is not provided by parallel imports. The returnable bottle saves the on-trade outlet the time and trouble of disposing of bottles. This suggests that existing suppliers that use returnable bottles are able to charge a premium reflecting the value of the service. If, however, the supplier of the returnable bottled lager were to charge a price above this premium then parallel imports would be expected to enter the on-trade. Thus the presence of parallel imports, particularly of MGD, places an upper bound on what the current supplier can charge without attracting entry.

Countervailing Buyer Power

5.137 The Authority's approach to assessing countervailing buyer power is presented in paragraphs 5.54-5.56, above. The parties are in disagreement in respect of whether publicans have countervailing buyer power. The views of the parties and those of the Authority are presented below.

Submission of the Undertakings Involved

Heineken

5.138 RBB Report #1 (p. 17) states that publicans are represented by two large trade associations. These two associations are the Licensed Vintners Association ("LVA"), which represents publicans in the Dublin area, and the Vintners' Federation of Ireland ("VFI"), representing publicans outside of Dublin. Although these associations do not directly engage in price negotiations, they have nonetheless the ability to harm the brewers if they attempted to raise price above a competitive level.

5.139 Heineken submits[63] that publicans have the ability to constrain it from raising prices excessively. Moreover, the publicans have the power to do so lawfully and without resorting to illegal means such as collective boycotts. Publicans control an essential route to market for brewers such as Heineken. As Heineken owns no pubs, it is entirely dependent on publicans for its sales in the on-trade. Publicans are aware of this powerful and pivotal position.

5.140 Heineken also submits that individual publicans have in the past disciplined various brewers by reducing purchases or stopping purchases altogether. Publicans have the ability to punish a brewer such as Heineken by choosing to discipline it by reference to a product different to the one at issue. This is what Heineken believes occurred when certain publicans in Dublin decided to no longer stock Diageo's Carlsberg for a period of time in 2004. According to

[63] Heineken, "On the constraints imposed by publicans", response of 17 September 2008 to the Authority's query concerning countervailing power by individual pubs.

Heineken, this action by the publicans had a lasting impact on Diageo's position in the on-trade lager market.[64]

5.141 Heineken further submits that publicans can discipline brewers (for example, by insisting that brewers remove taps) at relatively low or no cost to the publicans (because the brewer bears the cost of supplying, installing, and maintaining the taps, etc.) and they can do so on short notice. Equally, publicans can, by their own admission "make" brewers such as Heineken. It follows, as a matter not only of logic but also commercial reality, they could probably "break" them as well given, for example, the gatekeeper role which they have in the chain of supply.

5.142 Finally, larger pub chains, that is, Fitzgerald group, Capital Bars and Thomas Read Group, can exercise certain buyer power vis-à-vis brewers.

B&C

5.143 The Compecon Report #1 (p. 63), submits that "publicans, would not appear to have any significant degree of countervailing buyer power." Compecon argues that there are very few pub chains in the state and the largest of these would have at most 20 pubs. Thus the majority of customers are individual public houses and would not be able to exercise any degree of buyer power. It would be difficult for any publican to replace Diageo's and Heineken's draught lager brands with products from other suppliers. Publicans could decline to purchase some of their lesser brands in an attempt to resist price increases by the brewers but they would probably have to replace such products by purchasing more of the brewers' other brands.

5.144 Compecon submits that countervailing buyer power requires that buyers have the capacity to obtain sufficient supplies from alternative sources so as to be able to reduce or delay purchases in the event of a price increase. Given that post-merger there would only be two brewers, by definition there would not be alternative sources of supply in the event of coordinated price increases.

5.145 Compecon Report #1 (p. 63) agrees with Heineken that some Dublin publicans have delisted certain Diageo brands in the past in an attempt to persuade it to reverse price increases. However, Compecon submits that such actions proved unsuccessful. The Compecon Report #1 (p. 63) cited the Minutes of a meeting of the Directors of BDVI dated 23rd March 2005, which record a Mr. Eamonn McCormack as stating that "while there was reluctance from the Trade to price increase, there was also little enthusiasm from the Trade to take any action against Diageo if they go for a price rise."

Discussion

5.146 It is common ground that publicans are the main route to market in the on-trade. Publicans are pivotal in facilitating entry and expansion in the on-trade market. In order to enter and penetrate this market, a brewer or supplier will require the goodwill of

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[64] The impact of this action is analysed in RBB Report #1 (pp. 17-19) and RBB Report #2 (pp. 12-13).

publicans who, based on consumer demand, decide on which brands are sold in their premises. The question the Authority has to answer is whether publicans acting individually will have the ability to constrain post-merger price increases by the merged entity?

5.147 Both Inbev and Diageo[65] agree with Heineken's view that the trade associations of the publicans are aggressive as demonstrated by the refusal of publicans to stock certain Diageo brands as reaction against Diageo's price increase. However, there is no evidence to suggest that this refusal by publicans, in 2004, to stock certain Diageo lager brands was organised by these associations. The action was only undertaken by some members of the LVA.

5.148 This event has been presented by Heineken as evidence that publicans can discipline brewers who attempt to raise price above competitive levels. In assessing this event, the Authority considers the following:

- *The context and nature of the price increase*: In March 2004, Diageo announced a price increase across all its brands of beer and cider. This period coincided with a time when publicans were facing a drop in sales due to the introduction of a "smoking ban" in public houses, and government efforts to limit alcohol consumption, with special attention to binge drinking and underage drinking. The publicans did not want to take a wholesale price increase which would result in an increase in the price of a pint. The publicans reckoned that this price increase would have had a negative impact on their sales.

- *The brands that were affected*: The publicans, through their associations, requested the brewers not to carry out the price increases due to the then market realities facing publicans. B&C acceded to the request of the publicans by freezing price increases at 2003 prices until 2005. Diageo on the other delayed the price increases by three months until June 2006. Diageo's action was followed by Heineken. As a result of Diageo's refusal to freeze its price increases, 200 out of the 800 publicans (that is, 25%) in Dublin delisted Carlsberg and to some extent Budweiser. These are brands that Diageo produced under license. There is no evidence of negative reaction to Heineken. In fact, Heineken grew at the expense of Carlsberg and Budweiser.

- *The impact on Diageo's lager brands and its response*: Diageo lost substantial market shares as a result of this action. Diageo submits to the Authority that it reacted by: (i) announcing that prices would be frozen for at least one year (they would not increase the price before June of the following year (instead of March) and (ii) [..]. Diageo while incurring significant expense on both consumer marketing programmes and advertising, managed to recover some ground taking into account that the Irish market for beer is contracting, especially the on-trade segment. Diageo The impact of the refusal to stock Carlsberg and Budweiser could have been detrimental to Diageo since its licence agreements for Carlsberg and Budweiser are based on performance targets.

[65] Based on interviews with the Authority.

5.149 Past experience suggests that publicans are likely to be able to credibly counter the ability of a supplier of on-trade lager, including the leading supplier of lager in 2004, Diageo, to raise prices in situation where the publicans feel that such rises are unwarranted. Publicans have shown themselves capable of individually disciplining a brewer were it to attempt to raise prices.

5.150 The evidence suggests that such countervailing buyer power takes the form of the publicans refusing to stock certain brands of the supplier which are likely to have close substitutes. It is, however, unclear whether publicans have the power to successfully delist strong brands such as Heineken and Guinness. By Heineken's own submission, "Irish consumers often have a strong preference from one or more brands and therefore may be less sensitive to price than consumers in other markets where brand and quality attributes (for example, taste) are less important. Indeed, the importance of non-price competition confirms that consumers are particularly sensitive to non-price aspects of the product, such as branding and quality." Countervailing buyer power could take the form of delisting weaker brands of a brewer's portfolio of brands.

5.151 Moreover any suggestion that publicans may delist a brand to counter any exercise of market power must be considered in the context of the limits imposed by the Act. In order for the action of delisting to be effective, such action may have to be taken by a large number of publicans. Where ever a large number of publicans take similar action, there would always be a question whether such action was taken individually or jointly. Any coordinated or joint action by publicans may constitute an agreement or concerted action by undertakings (or a decision of an association of undertakings) contrary to section 4 of the Act.

Removal of a Maverick?

5.152 The question of whether B&C is a maverick is discussed in relation to off trade lager in paragraphs 5.60 to 5.71. With the exception of the constraining ability of parallel trade on the price of Miller much of the discussion in paragraphs 5.60 to 5.71 above applies, mutatis mutandis, to the on-trade market.[66]

5.153 The pre-merger situation is characterised by price leadership in the wholesale pricing of draught lager sold in kegs[67]. The evidence suggests that, when Diageo implements price increases, publicans will generally increase prices for all brands of lager, regardless of whether the brewer implemented a price increase. For example, in 2006, Inbev did not follow Diageo and held the price increase for six months. According to Inbev in an interview with the Authority this was a "silly" move since publicans increased the price of their beer products anyway. This was also confirmed by B&C on 25 July 2008

[66] In an interview with the Authority Galvins, a major importer of parallel traded when asked "Does Galvins sell packaged parallel traded Miller to publicans?" replied: "No. Galvins' main customers for parallel traded Miller are off-licences, small grocery stores and wholesalers. Very few/none publicans stock parallel traded Miller in Ireland. According to Mr. Galvin, brewers would not supply kegs to publicans that obtain the packaged product from the parallel trade or would make their life difficult by not providing them with certain services or products (e.g. technical services for kegs, glasses etc.)"

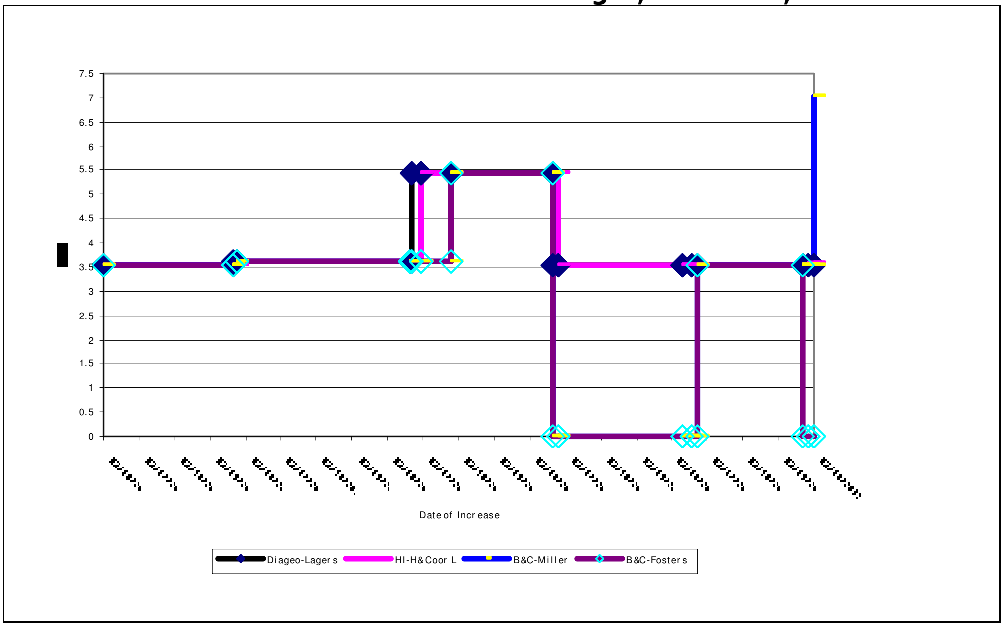
[67] There is no suggestion nor is there any evidence to suggest that such pricing behaviour is as a result of tacit collusion.

at a meeting with the Authority. In instances where B&C did not increase the price of its lager brands it got some kind of commitments from the individual publicans and the LVA and VFI that publicans would not increase the price of its products in line with other products.[68]

5.154 In order to assess the extent of parallel pricing with respect to wholesale increases in the on-trade lager market, the Authority analyses the wholesale price by the three main players in respect of the supply of 50 litre keg draught lager to the on-trade channels in the State for the period 2002 to 2007 (See Figure 5.1).

[68] For example, Waterford Licensed Properties Ltd T/A Garvey's wrote to B&C on 28 June 2004 complementing them on deferral of the price increase and giving a commitment not to increase price: "I sincerely hope Publicans will not increase the price of your products as obviously this defeats the purpose of your decision. While I only stock two of your products namely Beamish and Miller I can confirm that their prices shall remain unchanged until your company decides to alter their prices."

Figure 5.1
Increase in Price of Selected Brands of Lager, the State, 2002 – 2007



Source: The Competition Authority, based on S&N's Response to the Commission's Article 11 Request.

5.155 The following conclusions can be drawn from Figure 5.1:

- Diageo leads the wholesale price increase both in terms of timing and euro amount across lager brands.
- A few weeks later, Heineken always applied to its lager brands the exact Euro amount of wholesale price increase applied by Diageo.
- B&C did not follow the Diageo wholesale price increases for any of its lager brands in the period 2003 to 2005. However pre and post this period it has followed the price increases and in 2007, while not increasing the price of its Foster's brand B&C applied a higher increase to the price of MMGD.

5.156 B&C's documentary evidence is also consistent with the view that it is not a pricing maverick. The business plans for MGD for 2005-2009, for 2006-2010 and for 2007-2011 all contain the following reference under 'Pricing':

> 'Maintain price parity on MGD Draught with competitor set in the on-trade."

5.157 The evidence does not support the view that B&C is a maverick with its MDG and Foster's brands in the on-trade market.

Substantial Lessening of Competition in On-trade Lager

5.158 As in the off-trade market, the Authority's assessment of the impact of the proposed transaction on the on-trade market is done within the framework of two theories of harm: unilateral and co-ordinated effects.

Unilateral Effects

5.159 The Authority's approach to assessing the likelihood of unilateral effects is presented in paragraphs 5.73 above. Unilateral effects will occur in the on-trade lager market if, post-merger, the merged entity will have both the incentive and ability to raise the price of its lager brands.

Views of the Undertakings Involved

Heineken

5.160 Heineken's QIN (p.47) submits that the proposed acquisition will result in no risk of unilateral effect on the on-trade market. Heineken submits that its increment in the on-trade market will be modest, that is, its on-trade market share will increase by 8.4% to 50.6%. The market position of Heineken does not change fundamentally especially in light of the considerable market power of Diageo.

5.161 Heineken submits that there is no evidence that competitive dynamics between Heineken and B&C are important to the continued presence of effective competition in the beer market (or any part thereof). Heineken submits that the most significant competitive dynamic in the market is the quest of Heineken, B&C and the other challengers to compete with and win share from, the dominant competitive force of Diageo. The market share data show that Heineken has been the most successful in that quest, and its incentive to continue to compete in this way will be in no way diminished by the proposed acquisition. If anything, the transaction will allow the post-merger firm to increase the efforts to profitably gain business from the market leader.

5.162 Heineken submits that the crucial competitive dynamic is and will remain the competition that Heineken is able to offer against Diageo's historically strong position as a supplier to the on-trade. Heineken's incentive to continue to compete by supporting its brands in marketing terms, and in developing relationships with the on-trade customers, will continue unaffected post-merger.

5.163 Other important competitive forces in the on-trade market such as the growth of cider, increased drinking at home and the easy entry of new brands, in particular in bottle, will constrain Heineken from raising price.

5.164 Heineken also submits that there is strong parallel trade in MDG attracted by B&C premium pricing in the State. Heineken estimates that as much as 30% of packaged MGD in the State is parallel traded and that pattern would only increase thereby limiting Heineken's ability to charge a higher price for MDG by Heineken.

5.165 In addition Heineken refers to the constraints imposed by the licensing agreements between brewers and brand owners. Taking the example of Miller it would be in the interests of the MBC to have its product (i.e., Miller) compete fully in the Irish market so if Heineken failed to enable the brand to compete in the market, the licensor would simply switch the licence to another licensee. Heineken would also suffer in that other putative suppliers or licensors would note Heineken's failure to promote a brand such as

Miller and may be less inclined towards appointing Heineken in Ireland in relation to other brands.

B&C

5.166 Compecon in a presentation to the Authority on 12 September 2008 states that there is a potential for non-negligible price increases in the various lager markets as a result of the combination of competing brands under the same ownership, and the internalisation of competition between them, that is, unilateral price effects.

5.167 Compecon also submits that preliminary results from a simple merger simulation provided by CRA, a competition economics practice, indicates that in the on-trade segment, the parties' lager brands prices could increase by up to 3-5%.

5.168 B&C submits that Heineken has reportedly indicated that it does not expect to continue the marketing of the Miller brand post-merger and the risk exists that this brand might therefore disappear from the Irish market. This elimination would reduce consumer welfare by reducing choice.

Authority's Analysis of Unilateral Effects

Incentive

5.169 The merged entity will only have the incentive to exercise market power by raising prices in the on-trade market if it would be profitable to do so. In order for this to occur, one of the pre-conditions is that the lager brands currently supplied by B&C should be the closest substitutes to those supplied by Heineken and vice versa. If this is the case, a post-merger price increase in any of the brands supplied by B&C will result in a switch by on-trade consumers to the Heineken brand making it profitable for Heineken to raise the price. Similarly, a rise in the price of Heineken's lager brands will be profitable if consumers switch to B&C's brands such as MGD.

5.170 The evidence in Table 5.9 above shows that Heineken lager and Coors Light's closest competitor are the Diageo lager brands, that is, Budweiser and Carlsberg. Eighty per cent of customers stated that these two brands were Heineken's closest substitute and 45% stated that these two brands were Coors Light's closest substitute.

5.171 This implies that any post merger rise in the price of Heineken lager and, to a lesser extent, Coors Light, will lead to a switch by consumers to the Diageo brands rather than B&C's, so that the externality from a rise in the price of the Heineken lager and Coors Light brands is unlikely to be internalised by the merged entity.

5.172 However, if post-merger Heineken were to increase the price of MGD, the evidence in Table 5.10 above shows that MGD's closest competitors are Heineken Lager and Coors Light, the lager brands supplied by Heineken, followed by Diageo's Budweiser. The results show that 47% of on trade customers see Heineken and Coors Light as the closest substitute to MGD, while 14% see Budweiser as the closest substitute to MGD.

5.173 This implies that just under half of all on-trade customers believe any post merger rise in the price of MGD will lead to a switch to the Heineken owned lager brands. However the implication that an increase in the price of MGD is likely to be partially internalised by the merged entity needs to be qualified: As noted in paragraph 3.55 these estimates are based on expert opinions rather than evidence of actual switching behaviour in response to actual price changes. As such they should be seen as orders of magnitude with respect to switching and need to be interpreted in the context of other evidence.

5.174 B&C's internal documents provide additional evidence on this point – see paragraph 5.25 above. B&C consider Budweiser is MGD's closest competitor due to the fact that it is an American brand and both products target the same customers in contrast to Heineken:

- "we wish to be considered a credible alternative to Budweiser. Budweiser stands for brash America and MGD to stand for urban cool America."
- "the core image of Budweiser and Miller has many similarities which make Miller an ideal alternative for Bud drinkers. Carlsberg also offers potential to encourage switching to Miller as the brand performs well in a forced choice situation and Carlsberg drinkers are less loyal than Heineken drinkers, who are potentially the most difficult to appeal to as they are the most satisfied with their brand."

5.175 Thus the evidence suggests that post merger the merged entity will have a weak incentive to raise the price of MGD. This incentive is further weakened by Heineken's own requirement to market itself as a brewer of choice for other brands. Thus if Heineken were to acquire the Miller brand and then fail to adequately promote and sell it this would damage Heineken's ability to be the licensee in Ireland of other brands (e.g., it is currently the licensee of Coors and Sol) because putative licensors would be unwilling in the future to entrust their brands to Heineken in Ireland.

Ability

5.176 The proposed acquisition will result in Heineken consolidating its position as the market leader in the supply of lager to the on-trade market. Its market share will increase from 44% to 53%. However, the resulting increment in market share is unlikely to enable Heineken to exercise market power due to existing market conditions.

5.177 First as the Authority's *Merger Guidelines* suggest in paragraph 4.7, attention needs to be paid to the reaction of other competitors. Heineken will continue to face competition from its closest competitor, Diageo. Moreover the evidence suggests that Diageo has the capacity to expand output particularly given its recently announced plans to increase capacity substantially.[69] It could also

[69] "When the new Leixlip brewery is commissioned in 2013, all production from Kilkenny and Dundalk breweries will be transferred. The new brewery will produce Guinness to meet growing export demands and will also brew ales and lagers with a capacity of 5m hectolitres… The remodelled St. James's Gate will continue to brew Guinness beer primarily for the Irish and

be argued that the recent loss of market share of Diageo coupled with its expanded brewing capacity would provide it with an incentive not to follow any price increase by the merged entity. In a differentiated market such lager there might be expected to be both a price rise – but by less than the merged entity – and some output expansion. However, the discussion in this paragraph suggests that Diageo will lean more to the output expansion than price rise.

5.178 Second, as discussed in paragraphs 5.146 to 5.151 above publicans can exercise (and have in the past exercised) countervailing buyer power. This might be particularly effective if publicans used this countervailing buyer power to delist certain brands of the merged entity.

5.179 Third, it is inconceivable that in the event of MBC negotiating a contract with Heineken to brew and distribute its Miller brand in Ireland that it would do so under terms and conditions that are inferior to its existing contract with B&C. Thus Miller would set targets for Heineken with the latter obliged to commit significant amounts of money for marketing purposes (as B&C is currently obliged to do under its license agreement with MBC). If Heineken failed to meet these targets then it would be risk losing the brand and the investment it had previously made in marketing that brand. Furthermore it is difficult to see why Miller would agree to the price of MGD increasing when the main beneficial would be Heineken. Working out a side agreement to share the increased profits is likely to be a difficult exercise given the inherent uncertainty in deciding how much of any profit change is due to this strategy.

Views of the Authority on Unilateral Effects

5.180 On the basis of the above, it is the Authority's view that the proposed transaction will not lead to a unilateral price increase in the off-trade lager market as the merged entity will have neither the incentive nor the ability to raise prices.

Co-ordinated Effects

5.181 Coordinated effects occur where the proposed transaction changes the nature of competition in the on-trade market by making it more likely that the merged entity and some or all of its competitors will engage in co-ordinated interaction to raise prices or decrease output. Such interaction refers to actions that are profitable only as a result of each firm accommodating the reactions of others. Here the main question is whether the merger materially increases the likelihood that firms in the market will successfully coordinate their behaviour or strengthen existing coordination.

Views of the Undertakings Involved

<u>Heineken</u>

5.182 RBB Report #1 (pp. 2-3) submits that the market conditions in the on-trade lager market do not support the view that the proposed

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British markets and will be the second largest brewery in Ireland with a brewing capacity of 3mHL." Diageo press release 11 September 2008.

transaction will result in coordinated effects. In particular, the RBB Report argued that:

- Heineken has exerted substantial competitive pressure on the Irish on trade beer market. The empirical evidence shows that Heineken has been exerting substantial competitive pressure in the Irish market, and has proved itself to be the main challenger to the strong position of market leadership enjoyed by Diageo. First, between 2002 and 2007 Heineken has significantly increased its market shares in the lager market. Second, Heineken offers significant discounts which foster competition with other brewers and exert a downward pressure on prices. Third, Heineken is a particularly strong competitor on non-price aspects of competition such as product quality, service quality and free services to pubs. Fourth, public data indicate that Heineken was among the most aggressive competitors in terms of advertising.
- B&C is not a "pricing maverick". The prices of B&C brands have not been systematically lower than those of its rivals. On the contrary, for example, the average retail price of MGD has been substantially higher than the price of the main lager brands, and has increased at a faster rate. Also, although B&C's market shares have increased between 2002 and 2007, they have increased less than those of other brewers such as Heineken and Corona. This confirms that B&C is not the main or critical source of competitive pressure in the Irish market for beer and cider. Instead, the main challenge to Diageo's market leadership has come from Heineken, and there is no indication that the merger with B&C would change that position.
- Publicans have substantial countervailing buying power. The vast majority of Heineken's sales in the on-trade sector are made to outlets that are part of one of two large trade associations. Although such trade associations do not negotiate prices and discounts with brewers on behalf of their members, they have the ability to retaliate against the brewers if these were to raise prices above the competitive level. This is demonstrated for instance by the refusal to stock Carlsberg that took place in summer 2004 as a retaliation for Diageo's price increase. This means that a hypothetical attempt by Heineken and Diageo to impose a coordinated (or indeed unilateral) price increase post merger would likely be disrupted by the countervailing purchasing power of the trade associations.
- Price increases reflect increases in underlying costs rather then the exercise of collective (or individual) market power. The net price paid by on-trade customers for Heineken draught lager has increased significantly less than consumer price inflation between 2002 and 2007. This has also increased by less than the retail price charged by publicans to end consumers (that is, publicans' margins have increased). The gross percentage margin of Heineken on on-trade beer sales has remained constant in this period, indicating that Heineken's net prices have not increased at a faster rate than variable costs.

5.183 RBB Report #2 (pp. 22-24) assessed the above evidence against the criteria set out in the Commission's *Horizontal Merger Guidelines* as they relate to the analysis of coordinated effects.[70]

Reaching the terms of coordination.

5.184 The importance of non-price competition in product quality, service quality and advertising make it particularly difficult if not impossible to agree tacitly (or indeed explicitly) on a common strategy. This is for two reasons. First, the intensity of competition on non-price dimensions is very difficult to measure and therefore non-transparent. This would hinder the brewers' ability to reach the terms of coordination. Second, it is more difficult for firms to coordinate when they compete, and therefore need to agree, on several variables (price, product quality, frequency of line cleaning, etc) than when they compete only on dimension, i.e., price. The more dimensions of competition the more complex the market and the more difficult it is for firms to reach an agreement. Absence of transparency on prices makes difficult to agree on terms of coordination.

5.185 Heineken's aggressive discount and rebate schemes increase the market complexity and make it more difficult for firms to reach terms of coordination. In particular, such schemes give customers a strong incentive to expand purchases of Heineken's brands at the expenses of other brewers, since it amounts to a discount on marginal sales.

5.186 Heineken negotiates […] on a bilateral basis with a number of its on-trade customers (in particular a number of large customers). The terms of agreements made with these customers are private and therefore not transparent for other brewers.

5.187 The important variations of market shares that have taken place between 2002 and 2007 indicate that the market environment is unstable and therefore unsuitable for coordination. In particular, instability in market shares and variations in consumer habits would make it more difficult for firms to reach an understanding on a common strategy.

Monitoring deviations

5.188 Discounts and rebates substantially reduce transparency on prices. Although retail prices are observable, they do not provide reliable information on the level of wholesale net prices.

5.189 The importance of non-price competition implies that monitoring deviations would be particularly difficult. Even in the hypothetical case where firms could monitor the net price charged by their rivals (after discounts and rebates), the firms could still seek to increase their market share by intensifying non-price competition. Since non-price competition is difficult for rivals to measure, this form of deviation could be particularly difficult to monitor.

[70] Commission (2004) *Guidelines on the assessment of horizontal mergers* under the Council Regulation on the control of concentrations between undertakings Official Journal C 31, 05.02.2004, p. 5-18.. These will be referred to as the Horizontal Merger Guidelines. They may be accessed at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004XC0205(02):EN:NOT

5.190 The instability of market shares and the important trends of consumer tastes (for example, the increase of consumption of lager and cider and the decrease of stout) are also likely to hinder monitoring of a hypothetical (tacit) agreement. This is because firms experiencing a reduction of their market shares would find it difficult to establish whether the share loss is the result of exogenous trends in consumer demand or the consequence of one of the firms deviating from the common strategy.

Deterrent mechanisms

5.191 The most obvious mechanism for punishing firms that deviated from a hypothetical agreement is for other firms to lower prices. This mechanism however is not necessarily effective in the Irish on-trade market. Irish consumers often have a strong preference for one or more brands and therefore may be less sensitive to price than consumers in other markets where brand and quality attributes (e.g. taste) are less important. Indeed, the importance of non-price competition confirms that consumers are particularly sensitive to non-price aspects of the product, such as branding and quality. However, it is generally not possible for firms to "retaliate" against deviation for the hypothetical agreement by, say, "suddenly improving" product quality. This means that deterrence based on price reduction alone may not be sufficient to prevent deviations.

5.192 Moreover, given the strong role of publicans in the Irish market (e.g., see the refusal to stock Carlsberg as a reaction to the Diageo price increase in 2004) it is unclear that, following a significant price reduction, suppliers would be able to increase prices to the level prevailing before the "punishment". This means that suppliers would have a relatively smaller incentive to engage in retaliatory strategy. If the threat of retaliation is not credible, then the deterrence mechanism cannot be expected to be effective.

Reactions of Outsiders

5.193 The evidence clearly shows that publicans could disrupt hypothetical coordination using their substantial countervailing buying power. RBB note that publicans' ability to retaliate against brands that are distributed in Ireland under license may well put additional pressure on the members of the hypothetical tacit agreement. Whilst a supplier would be harmed by a loss of market share of one of its own brands it could potentially be harmed much more if, as a result of this disruption, the licensor was to decide to assign the license to another brewer or possibly to enter the market directly (in which case entry could be particularly easy given that the brand is already established).

5.194 Moreover, in view of the strong sales growth achieved by smaller suppliers such as Inbev and BFM in recent years, the absence of barriers to entry and expansion suggests that hypothetical coordination could also be disrupted by entry or expansion of such smaller players. RBB note in particular that although Inbev has a small market share in the State, it is the world's largest brewer and has a strong position in Northern Ireland. In view of its large resources, experience and recognised international brands, Inbev's current relatively small market share in the State is likely to underestimate the competitive constraints that Inbev exerts in the Irish market

B&C

5.195 Compecon Report #2 submits that there is already evidence of parallel pricing behaviour by Diageo and Heineken in the draught lager market. The draught lager market displays many of the characteristics recognised in the economics literature as likely to give rise to coordinated behaviour:

(i) Barriers to entry are relatively high. See paragraphs 5.118 to 5.119 above for Compecon's view on this point.
(ii) There is repeated interaction between suppliers.
(iii) The market is mature and is not characterised by a high degree of innovation.
(iv) Post merger market shares of the two remaining firms would be approximately symmetrical.
(v) The acquisition would result in the elimination of a maverick firm.
(vi) There are cooperative agreements between Diageo and Heineken.
(vii) There is a strong degree of transparency as regards pricing with standard supply terms. Information on market shares is provided on a regular basis throughout the year.
(viii) Demand would appear to be relatively price inelastic.
(ix) Demand would appear to be relatively stable, i.e. it would not appear to be subject to any significant cyclical fluctuations.
(x) Multi-market contacts via the on-trade markets for stout and lager and tenders for various concerts and other one-off events.
(xi) The majority of customers would not appear to have any significant degree of countervailing buyer power.
(xii) The products are largely homogenous.

5.196 The first three facilitating factors may or may not be directly affected by the merger but are seen as having a decisive impact on firms' ability to sustain tacit collusion. Factors (iv)-(vi) are highly relevant to whether or not collusion is sustainable and are directly affected by a merger. Factors (vii)-(xi) are seen as potentially influencing the sustainability of collusion, albeit possibly to a lesser extent, and may or may not be affected by a merger.[71]

5.197 Compecon submits that there are grounds for believing that punishment strategies may be credible. In the case of Diageo, sales of draught lager account for approximately 28% of its total draught beer sales. Thus in response to deviations by Heineken in the lager market, Diageo could institute a price war in the draught lager market, which would not affect the bulk of its beer sales but which would have a rather severe effect on Heineken. Similarly although Heineken and B&C combined have a small share of the stout and ale markets, the merged entity could punish any deviation by Diageo in the on-trade lager market by engaging in significant price cutting in stout and/or ale, thereby potentially imposing a significant cost on

[71] See paragraph 5.85 for Compecon's view on these market characteristics.

Diageo at little cost to itself. There would appear to be reasonable grounds for believing that such strategies are possible and credible.

Discussion

Reaching the terms of coordination.

5.198 A summary of the conditions need for successful coordination are presented in Table 5.5 above. The first set of conditions relate to finding common terms of coordination. The terms of the coordination, as stated in the Authority's *Merger Guidelines*, "need not be complex, but may follow simple precepts such as a common price, stable market shares, or some form of territorial restriction." (paragraph 4.20).

5.199 Transparency of retail and wholesale prices is a factor which facilitates coordination. The more transparent the pricing the easier, other things being equal, it is to coordinate. The retail price of lager in the on-trade is transparent. Indeed, it has to be posted in the pub by law.[72] However, although the wholesale price list and wholesale price increases of draught lager are also transparent, the final price paid by publicans is not. This is due to the complex nature of the negotiated discounts (including volume discounts, settlement discounts, etc.) that apply to the final price paid by publicans which in turn make it very difficult to compare the final price paid to suppliers and thus frustrates coordination between them.

5.200 Furthermore specifically in relation to the packaged segment of the on-trade, pubs purchase from wholesalers/retailers through arrangements that are often negotiated bilaterally. Also, prices per pint of lager are set exclusively by publicans whose incentives may not align with those of the brewers and/ wholesalers/importers. Thus it is not at all clear that the transparency required for reaching a common understanding are currently present.

5.201 Lager, as the discussion on closeness of competition made clear, is a differentiated, not a homogeneous product. Therefore Heineken and Diageo must and do invest heavily in advertising to attract consumers to their brands. As a consequence this makes it difficult for common terms on coordination to be reached.

5.202 In addition, apart from common membership to the Irish brewers Association there do not appear to be any structural links between the merging parties in the State.

5.203 The proposed acquisition is likely to increase the asymmetry of market share between Diageo and the merged entity. As shown in Table 5.7 above, pre-merger Diageo was ranked second with a market share of 41.4%, while Heineken is ranked number one with a share of 43.8%. Post-merger Heineken's market share will increase to 52.9%, farther from to Diageo than is the case at the moment. If anything this small increase in the asymmetry may

[72] According to The Retail Price (Beverages in Licensed Premises) Display Order, 1999 licensed premises must display 2 lists of drinks prices. A comprehensive list of all items sold and a summary (i.e., abbreviated) list of the 16 most popular drinks for sale.

reduce the incentive for coordination in the on-trade lager market, post-merger.

5.204 Table 5.6 above clearly shows the asymmetry in the share of contribution to revenue by the different types of beer to Diageo and other players. It is accepted that multi-market contacts can facilitate collusion and this can be further strengthened by complementary asymmetry between stout (Diageo) and lager (Heineken). However the proposed merger will not significantly change the asymmetry that currently exists between the relative importance of stout and lager to each of Diageo and Heineken and as such will not facilitate coordination any more than absent the merger

Deviation and punishment

5.205 The second set of conditions for successful coordination relates to the fact that it is costly for firms to deviate from the coordinating price or whatever is agreed. This requires that deviation can be detected and punished. Given the difficulty that suppliers face in comparing the prices that are paid by publicans (see paragraph 5.199 above) it is hard to see how this condition applies to the on-trade market. Furthermore, it is not clear what the punishment mechanism would be given the evidence in Table 5.6.

5.206 One of the indicia in the second set of conditions is the stability of market shares. Table 5.7 shows that the shares of the leading three suppliers to the on-trade lager market have experienced little stability. Diageo's market share has decreased while that of Heineken and B&C have increased. A similar pattern is observed with respect to the lager brands marketed by these firms as shown in Table 5.8 above.

Removal of a maverick

5.207 As discussed in paragraphs 5.152 to 5.157 there is no evidence to support the claim that B&C is a maverick.

5.208 In sum it would appear that there are only weak conditions to support the view that there will be co-ordinated effects in the on-trade lager market. Furthermore the merger is not likely to strengthen or increase the probability of coordinated effects. Compecon identified three conditions that the merger might influence: in all three cases the merger has not strengthened the case for increased co-ordinated effects: the symmetry between Diageo and Heineken has decreased not increased; B&C is not a maverick; and there do not appear to be any agreements between Diageo and Heineken.

Views of the Competition Authority on Coordinated Effects

5.209 On the basis of the above, the Authority considers that the proposed acquisition of B&C by Heineken will not result in coordinated effects in the off-trade lager market.

The Competition Authority's Conclusion: Off-trade Lager Market

5.210 In consequence of the foregoing, the Authority is of the opinion that the proposed acquisition will not result in a substantial lessening of competition in the on-trade lager market in the State.

SECTION SIX: COMPETITIVE ANALYSIS - STOUT

Introduction

6.1. In section four above, the Authority established that the proposed acquisition falls in Zone B of the *Mergers Guidelines* in respect of the on-trade stout market. Zone B mergers "may raise significant competitive concerns," according to the Authority's *Merger Guidelines* (paragraph 3.10), in the instant case competitive concerns have been voiced by both B&C as well as third parties.

6.2. It is a three to two merger. There are only three brands of stout (Guinness, Beamish and Murphy's) in the on-trade market in the State. These are supplied by three brewers: Diageo, B&C and Heineken, respectively. Together, they account for 100% of the stout sold in the on-trade market. Further, it is argued that the target is a maverick, disrupting the status quo. Thus the loss of B&C is, in some sense, out of proportion to its market share.

6.3. In this section, the Authority analyses the competitive characteristics of this market to establish whether the proposed transaction will or will not result in a substantial lessening of competition.

Trend in Market Shares: by Undertakings

6.4. Table 6.1 below presents the market shares of the three brewers of stout in the State for the period 2003 to 2007.

Table 6.1
Market Shares, Stout, On-Trade, Sales, the State, 2003-2007

Year	Diageo (Guinness) (%)	Heineken (Murphy's) (%)	B&C (Beamish) (%)
2003	90.5	5.2	4.3
2004	91.3	4.7	4.0
2005	90.8	4.8	4.5
2006	89.6	5.0	5.4
2007	89.9	4.7	5.4
Change	**-0.6**	**-0.5**	**1.1**

Source: Based on RBB's Analysis of AC Nielsen data

6.5. The following conclusions can be drawn from Table 6.1:

- The market leader, Diageo, has consistently accounted for approximately 90% of the on-trade stout market over the period 2003 to 2007.

- B&C's Beamish brand increased its market share from 4.5% to 5.4%, becoming the second ranked stout brand from 2006 onwards, displacing Heineken's Murphy's brand, whose market share declined from 5.2% to 4.7% over the period 2003 to 2007.

- Thus the proposed transaction involves the merger between the number two and three ranked brewers in the on-trade stout market.

- The total market share lost by both Guinness (-0.6%) and Murphy's (-0.5%) appears to have been gained by Beamish (1.1%).

Trends in Market Shares: Regional Presence of Stout Brands

6.6. As noted in section three above, Murphy's and Beamish are particularly strong in the Cork area, reflecting the fact that both brands are brewed in Cork. In contrast, Guinness, although brewed in Dublin, has a strong presence throughout the State.

6.7. Table 6.2 below presents the market shares of each stout brand in various regions in the State.

Table 6.2
Regional Market Shares, Stout, On-Trade, Sales, 2007

Year	Diageo (Guinness) (%)	Heineken (Murphy's) (%)	B&C (Beamish) (%)
Cork	51.8	28.0	20.2
Rest of Munster	94.1	1.4	4.5
Dublin	95.0	0.4	4.6
North Leinster	97.5	0.0	2.4
South East	96.6	1.2	2.2
West	99.8	0.0	0.2

Source: Based on RBB's Analysis of AC Nielsen data

6.8. The following conclusions can be drawn from Table 6.2:

- Cork is the only area where all three competitors have significant market shares. Unlike the national market Murphy's is the second ranked brand, not Beamish.

- Murphy's has a limited or no presence outside of Cork.

- Beamish accounts for 4.6% of the Dublin market, reflecting its marketing initiative, the Brewing and Vintner Investment Company ("BDVI") details of which were presented in section two above.

- In five out of the six regions considered, Guinness has at least 94% of the market. This suggests that Guinness is the most preferred brand by consumers. For example, in the West, consumers almost exclusively consume Guinness.

Competitive Assessment

6.9. In order to assess whether the proposed acquisition will result in SLC in the national on-trade stout market, the following characteristics of this market, identified by the undertakings involved, by third parties, and by the Authority during the course of the investigation, are discussed:

- closeness of competition;

- entry and parallel imports;

- countervailing buyer power;
- competition for second place; and
- the removal of a "maverick firm".

Closeness of Competition

Submission of the Undertakings Involved

Heineken

6.10. In a submission to the Authority dated 1 September 2008, Heineken state that Beamish is the No.2 stout brand while Murphy's is the No.3 stout brand. Beamish and Murphy's are not each other's closest competitor, Heineken argues. Guinness is the closest competitor of each of them because of, among other reasons, the taste profile and market share of Guinness. Moreover, Guinness, with around 90% of the stout segment, is overwhelmingly dominant, having the ability to operate independently of, and without paying any meaningful regard to, either Beamish or Murphy's (Diageo does not offer discounts on Guinness). Equally, neither of these two brands constrains the other because, competition in the stout segment is determined by Guinness. Guinness will continue to face competitive challenges from the fall in stout sales and the fall in on-trade sales, and those challenges are far more significant than whether the two very minor stout brands are under common or separate ownership.

6.11. In a presentation to the Authority on 11 September 2008 Heineken present evidence to support the view that Beamish is a value brand targeted at older male consumers.

6.12. In market research conducted by Pathfinder Research, dated June 2008, the following conclusion was reached:

> "Beamish makes more effective and targeted communications for older value conscious drinkers …Its value platform is key initial driver of consideration here."
>
> "Beamish is clearly about Value and has an implied Inner Cork/Working Class Cork provenance"

6.13. The view that Beamish is a value brand Heineken argues is supported by its advertising strategy. Heineken presented to the Authority advertising posters for Beamish which feature the following phrases prominently:

> "Heaven Sent, and up to 50c less too"
>
> "Tastes better. Costs up to 50c less. Case closed."

6.14. The 50c price cut or discount reflects a strategy introduced by Beamish in 2004 and discussed below on the question of whether or not B&C is a maverick in the on-trade stout market.

6.15. Heineken also submits that Beamish's media strategy has an older focus with some national reach. While Guinness and Murphy's try to recruit new drinkers, Beamish are clearly going after the older stout drinkers with their communications strategy: (i) Beamish generally use outdoor as the lead medium but also use press as support; (ii) as of Feb 07, Beamish have been the title sponsors of the Cork City football team; and, (iii) Beamish focuses primarily on Cork but does have a presence in Dublin when they advertise.

6.16. In contrast, Heineken's Murphy's brand is positioned differently from the value proposition of Beamish, Heineken argue. Heineken argues that Murphy's conveys 'quality' and that its sponsorship has elevated its brand status amongst a younger target audience. Heineken promoted Murphy's as a premium stout for the discerning drinker. There were extensive advertising campaigns. Murphy's stout was distributed extensively in the State and elsewhere. However, export volumes peaked in the mid-1990s and domestic volume peaked around 2000. Marketing expenditure in the State for Murphy's dropped by 60% in nominal terms between 2000 and 2003. However, Heineken still continues to actively market Murphy's in the State, particularly in Munster.

6.17. In terms of taste profile, Heineken submits that Murphy's is much closer to Guinness than it is to Beamish. In terms of both drinkability rating and aroma rating, the ranking is Beamish (3), Guinness (2) and Murphy's (1).

6.18. One measure of closeness of competition is the degree to which Beamish exerts a competitive constraint on Murphy's and vice versa. If, for example, Beamish were to be priced below Murphy's and not many consumers switched then it would be clear that the brands are not close substitutes.

6.19. RBB Report #3 (pp. 8-10), submits that the evidence of switching does not support the view that Beamish has exerted significant constraint on Murphy's. In this regard, RBB analysed the impact of Beamish's pricing strategy, in the Cork area, on first, the number of outlets that stock Murphy's. This evidence shows that Beamish's pricing did not cause Murphy's to lose on-trade accounts. RBB then analysed the impact of the pricing strategy in the Cork area on sales of Murphy's volume. The evidence shows that sales in Murphy's declined at a slightly faster rate in outlets where Beamish was not sold.

<u>B&C</u>

6.20. In a submission to the Authority dated 19 September 2008, B&C argue that the following evidence supports their view that Murphy's is a close competitor of Beamish.

- B&C's production team regularly analyse competitor brands and B&C's own brands. Over the years, this team has carried out taste testing of Beamish, Guinness and Murphy's and it has shown that the perceived bitterness and astringency levels of

Guinness and Murphy's have changed over the past twenty year period. On the basis of this, Guinness bitterness levels have reduced significantly, Beamish' have reduced slightly and Murphy's have increased, resulting in an overall narrowing of the differential between the stout liquids. B&C submits that it is generally accepted that Beamish has a taste profile somewhere between the other two stouts. In summary Guinness has "mellowed" towards Beamish while at the same time Murphy's has "strengthened" its flavour profile towards that of Beamish. However, Beamish is closer to Guinness than to Murphy's.

- Independent consumer research conducted in 2002 by independent research company Lansdowne Market Research with stout drinkers in Cork and Dublin, supports the view Beamish and Murphy are close competitors in taste terms. This research was an unbranded product taste test carried out in 2002. In overall preference terms for Murphy's drinkers in Cork in 'blind taste' they much preferred Beamish Stout (29%) to Guinness (4%).

Discussion

6.21. The evidence suggests that in terms of product positioning, Heineken has positioned Murphy's as a premium brand while B&C have positioned Beamish as a value brand. This is reflected in the pricing and advertising. Guinness would appear to be positioned closer to Murphy's than Beamish from this perspective. In terms of 'closeness in taste' the evidence is ambiguous and no firm conclusions can be drawn.

Review of Parties' Internal Documents

Heineken

6.22. A review of Heineken's internal documents shows that Guinness is Murphy's closest competitor. Almost all of Heineken's internal documents show that Guinness is the only stout brand monitored by Heineken. There is hardly any reference in the Heineken internal documents to Beamish. The following extracts from some of the Heineken internal documents support this:

> "Whilst we have seen some large and impressive lifts for the Murphy's brand amongst stout drinkers in Munster, these movements have been difficult to sustain and more recent movements show the brand dropping (likely as a result of Guinness activity). This reflects the size of the challenge for Murphy's and whilst we made good gains, the brand is susceptible to attack and needs strong support to keep growing". Page 060396, Murphy's Monthly Report by Hall and Partners 2005
>
> "Within Cork, Murphy's is seen as a source of local pride and people feel proud to support the brand. People often consider it to be a family business. As it is brewed I the area and there is felt to be a strong local presence in the area in terms of advertising and sponsorship." " People outside Cork see Murphy's as a sort of poor relation to Guinness. Although they do not see it as necessarily being of poorer quality, they do

> consider that it will never really be a contender with Guinness (but this may of course be due to the fact that Murphy's is seen as not being available on trade outside of Cork)." Page 070195, Channel and brand research on-trade 2004.

B&C

6.23. B&C's internal documents show that it competes with other stout brands in the on-trade market. Beamish tracks the advertising activities as well as the pricing and market shares of the other stout brands. In respect of its closest competitor, however, its internal documents do not show a clear close competitor to Beamish:

> "Nationally 47% prefer Beamish V's 43% Guinness,..." Beamish Stout –The Brand Day, 17 October 2002
>
> "The one thing that all stout drinkers know about Beamish is that it is less expensive than Guinness (& Murphy's)" Beamish –Its all about the Stout, 21 April 2005.
>
> "Competitive Reference Point- "the valid alternative, offering real value and exceptional quality, standing apart from main stout competitors: Guinness" Beamish Stout, Brand Plans, 2006, p. 14.
>
> "Competitor Reference Point- Guinness and Murphy's" Beamish Stout 2007- Commercial Planning Day, 24 January 2007, p. 6.
>
> "Should we actively target a younger age profile with our marketing resources? (1) Murphy's are trying this and not succeeding… (4) Current distribution of Beamish is out of kilter with a focus on targeting a younger age profile, whose lifestyles generally will not revolve around the 'local' pub. (5) There is a danger of diluting limited resources by casting age profile tow wide. Dilution of resources and our communication focus will result in us reaching everybody, but ultimately appealing to nobody." Beamish Stout 2007- Commercial Planning Day, 24 January 2007.

Discussion

6.24. Heineken's internal documents suggest that Guinness is Murphy's closest competitor. B&C's internal documents referred to above do not show a clear close competitor. The documents suggest that Beamish competes with both Murphy's and Guinness. However, when B&C was considering its pricing strategy in 2004[73] - when Diageo raised its prices - there is only reference in B&C's internal documents to Diageo and no attention paid to Murphy's reaction. Indeed, reference is made to Diageo as being B&C's main competitor.

Authority's Survey Evidence

6.25. In order to assist the Authority in establishing which stout brand is each other's closest competitor, the Authority asked the following

[73] This documentation is discussed below as to whether or not B&C is a maverick in on-trade stout.

questions to on-trade customers (that is, publicans, restaurants, hotels and recreational centres) in its questionnaire survey: "For each brand listed in the following tables which other brand(s) do you view as the closest competitor and why?"

6.26. Table 6.3 below presents a summary of the response of on-trade customers to this question in respect of each of Beamish and Murphy's.

Table 6.3
Closest Competitor, Beamish and Murphy's, On-Trade, 2008

Brand	Closest Competitor	Percentage of Respondents
Beamish	Guinness	37.9
	Murphy's	29.3
	Guinness and Murphy's	5.2
Murphy's	Guinness	48.3
	Beamish	25.9
	Guinness and Murphy's	-

Source: The Competition Authority Survey of On-Trade Customers

6.27. The following conclusions can be drawn from Table 6.3:

- Guinness appears to be the closest competitor of Beamish. 37.9% of customers compared to 29.3% stated that Guinness is Beamish's closest competitor.

- Guinness is the closest competitor of Murphy's. 48.3% of customers compared to 25.9% stated that Guinness is Murphy's closest competitor.

- Between 25 and 29% of respondents consider Murphy's and Beamish to be each other closest competitors

6.28. The survey evidence suggests, on balance, that the closest competitor of each of Murphy's and Beamish is Guinness.

Entry and Parallel Imports

6.29. Entry in the on-trade stout market is unlikely to be timely, likely or sufficient. The evidence in Tables 6.1 and 6.2 above clearly shows that no entry has occurred in the on-trade stout market in the last five years. There is no evidence to suggest that entry in the on-trade stout market is likely in the next two years. There is no dispute between the parties that entry in the on-trade stout market is unlikely. In contrast to lager discussed in section five above, there is not a ready supply of stouts in other markets that could be readily imported.

6.30. While it is common ground that there are barriers to entry so that entry is unlikely to be timely, likely or sufficient, it could also be argued that even if entry were timely and likely it would be insufficient because there are barriers to expansion in the stout market. Both Beamish and Murphy's have employed different strategies to expand market share – Beamish as a value brand and Murphy's as a premium brand – but neither has been successful in challenging the 90% market share of Diageo.

Parallel Trade

6.31. Parallel trade is a phenomenon associated mainly with the lager market, especially, the off-trade lager market. There is no evidence to suggest that there is parallel trade of stout in the on-trade market in the State.

Countervailing Buyer Power

6.32. The Authority discussed the issue of countervailing power in the on-trade lager market in section five above. The arguments advanced there as to the presence of countervailing market power also apply, mutatis mutandis, to the in-trade stout market.

Competition for Second Tap Stout

6.33. A possible theory of harm that the Authority proposed to the parties regarding the on-trade stout market is that a pub will only stock two stouts. Guinness is always stocked by the pub. There is, however, competition for the second brand to be carried in the pub. Beamish and Murphy's compete to be the second tap. If the merger takes place then this source of competition would be removed.[74]

Submission of the Undertakings Involved

Heineken

6.34. In a presentation to the Authority on 11 September 2008, Heineken submits that competition in the on-trade stout market in the State is not analogous to competition in the baby foods case (see footnote 2) (that is, there is no competition for the second stout tap). They say that in order for competition for second place to hold, all of the following should apply:

- Significant numbers of pubs stock two (and only two) brands;
- That second brand is *either* Murphy's *or* Beamish;
- Strong rivalry for that second spot; and,
- Elimination of that rivalry makes a significant difference to the on-trade stout market as a whole.

6.35. Based on Heineken's 2007 Census Number of Accounts,[75] Heineken submits the following:

- In 72% of on-trade accounts Murphy's or Beamish do not play any role, only Guinness is stocked;
- Murphy's is largely confined Cork (<1.5% elsewhere) so it is not a rival for the second tap;

[74] This theory of harm was based on the baby foods case in the US. For a discussion see J. Baker, 2004, "Efficiencies and High Concentration: Heinz Proposes to Acquire Beech-Nut (2001)", in J. E. Kwoka and L. J. White (eds), 2004, *The Antitrust Revolution, Economics, Competition and Policy*. New York: Oxford University Press. 4th Edition, pp. 150-169.
[75] Every two years Heineken sales representatives collect data, by pub, on issues such as what brands of stout are sold by a pub.

- There is no evidence of crucial 2nd tap rivalry between Beamish and Murphy's in Cork outlets: (a) 59.2% of outlets stock all three brands, (b) 30.8% of outlets stock just Guinness and Murphy's, and (c) only 0.2% of outlets stock just Guinness and Beamish.

B&C

6.36. Compecon Report #1 (p. 80), argues that the US *Heinz/Beech Nut* case is relevant in the context of the stout market. Compecon states that this case involved a proposed merger between two baby food manufacturers, Heinz and Beech Nut. These two firms had market shares of 17% and 15% respectively in the relevant market. The only other producer, Gerber, accounted for the remainder of the market.

6.37. Barriers to entry in the relevant market were quite high. The evidence indicated that very few supermarkets sold all three brands of baby food while the vast majority sold Gerber. In effect this meant that the only competition that existed in the market was between Heinz and Beech Nut to be the number two brand in a particular supermarket. The merger would therefore eliminate such competition and provide the merged firm with a unilateral incentive to raise prices. The Federal Trade Commission also argued that Beech Nut was a particularly innovative firm.

6.38. B&C submit that similar considerations would appear to apply in the present case in respect of the stout market. Essentially B&C further submit that B&C represents the only competition to Guinness in this market while Heineken and B&C compete to be the number two stout brand in pubs. The merger would probably result in increases in the price of Beamish as competition between the two brands for the number two slot was eliminated.

Discussion

6.39. The Authority' is of the view that competition for the second place or tap in the pub is not relevant in the on-trade stout market for the following reasons:

- Guinness is a "must have" or "must stock" brand by pubs and each of Murphy's and Beamish compete against Guinness albeit in mainly in one region - Cork. In this area the evidence presented by Heineken does not support the view that there is competition for a second tap.

- The majority of pubs do not appear to have capacity constraints in respect of taps. .Hence they could easily stock two or three brands of stout should they so wish.[76]

Removal of a Maverick?

6.40. Section five above contains a discussion of what a maverick is and how the removal of a maverick would typically reduce competition. The maverick, as its name suggests, does not follow the pattern of

[76] A representative of Heineken stated to the Authority that Heineken could easily put Murphy's in 50 pubs in Dublin, but that because of lack of demand, Murphy's would be withdrawn.

price changes of its rivals. Instead, the maverick undertakes pricing and other strategies that disrupts any possible tacit collusion and co-ordination amongst its rivals. One argument put forward in the instant case is that B&C is a maverick in the on-stout market. Hence if B&C were acquired by Heineken any disruption provided by B&C would be removed.

Submission of the Undertakings Involved

<u>Heineken</u>

6.41. RBB Report # 3 (p. 4) submits that B&C has not behaved as a maverick. RBB argues that B&C has exactly followed Diageo's list price increases on most occasions at least since 2003. Only in 2004 and 2005 has B&C not increased all its list prices in line with Diageo's prices; however, B&C merely held some of its list prices constant in nominal terms. The price differential between Beamish and Guinness (currently approximately 50c per pint) appears to be a price reposition strategy rather than a "maverick behaviour". Indeed, B&C has increased the price of Beamish by exactly the same amount as Guinness since the end of 2005.

<u>B&C</u>

6.42. In a submission dated 19 September 2008, B&C's argues that it is evident from its internal documents that it is a maverick. B&C argues that its commercial policy was not developed in response to market conditions at the time or as part of a positioning of its brands but rather as part of a clear strategy to compete aggressively with Heineken and Diageo in various product markets.

6.43. B&C argues that its history of deviating from the market norm has been pro-competitive:

- B&C is the only company offering, to its customers and in turn to consumers, value propositions in both the draught stout and draught lager market. Beamish Stout sells at an average of 51c less per pint to the consumer than a pint of Guinness in the Greater Dublin sales region and at an average of 48c less per pint in the Rest of Ireland sales region. No such offerings would be available to consumers without B&C's initiatives.

- Unique initiatives such as BDVI[77] have led to increased competition on the supply end of the market. In response to B&C's initiatives, both Diageo and Heineken have introduced discount schemes to publicans, for example: (i) Guinness Trading Terms Incentive' introduced in Dublin on Guinness Stout in July 2001; and (ii) Heineken Growth Incentive introduced in July 2004.

- By way of example, Dublin publicans have commented on Guinness stout being promoted in pubs in Dublin for the first time subsequent to the introduction of BDVI and Beamish stout into the market, i.e. statements such as – "Guinness now doing

[77] The BDVI is described in section two above.

promotions which it never did before"[78] This was in direct response to competition from Beamish.

- Finally, the following passage in the Commission's Referral Decision is quoted::

  "It seems clear that S&N plays the role of the most price aggressive player on the market and its efforts are in strong contrast with the existing commercial policy of Heineken." (paragraph 47)

In light of the above, B&C argues that behaviour in the marketplace is very much consistent with that of a "maverick" as defined by the Authority.

Pricing Behaviour in Stout: Comparison of 50 Litre Keg Price

6.44. In order to assess the pricing behaviour of B&C vis a vis its competitors with respect to wholesale increases in the on-trade stout market, the Authority analyses the wholesale price charged by the three brewers in respect of the supply of 50 litre keg draught stout to the on-trade channels in the State for the period 2002 to 2007.[79] Figure 6.1 below presents euro amount of wholesale price increases applied by each of Diageo, Heineken and B&C.

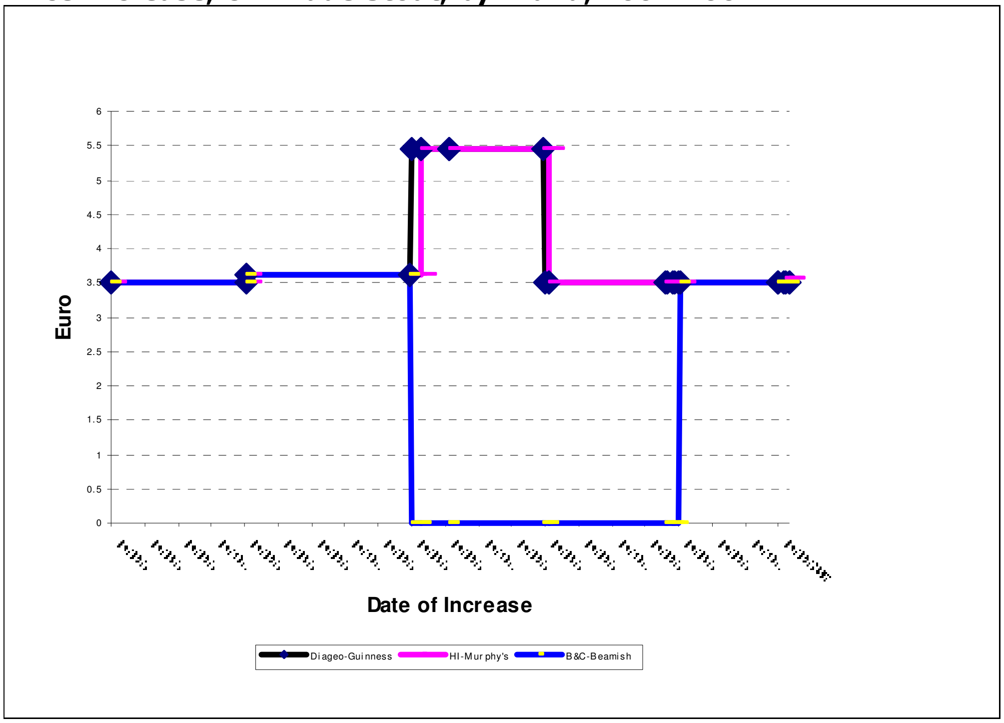
6.45. The following conclusions can be drawn from Figure 6.1 below:

- Diageo lead the wholesale price increase for stout both in terms of timing and euro through its Guinness brand;
- A few weeks latter, Heineken always follows the lead of Diageo with respect to its Murphy's brand in terms of the exact euro amount of wholesale price increase applied by Diageo; and,
- In 2004 and 2005, B&C did not increase the wholesale price of its Beamish brand. In the other years, B&C followed the wholesale price increases applied by Diageo.

[78] Ref : Publicans comments in BDVI Video – Meeting the Challenge – 1996

[79] In September 2008 B&C announced a price freeze on its beers, arguing that a second price increase in one year cannot be justified. The Authority in M/08/009, *Kerry/Breeo*, set out in paragraph 2.63 how it treats such evidence: "Any evidence about marketplace behaviour occurring after the merger is negotiated or announced must be subject to careful scrutiny as to whether the behaviour may be influenced or impacted by the positions taken by the players in the market about the proposed merger. Such evidence is cleafrly unreliable especially considering key issues in merger review such as market definition or competitive effects of the merger. In general, little weight can be given to such evidence."

Figure 6.1
Price Increase, On-Trade Stout, by Brand, 2002-2007



Source: The Competition Authority, based on S&N's Response to the Commission's Article 11 Request.

<u>Review of Parties' Internal Documents</u>

6.46. The internal documents of B&C do not support the view that B&C is a maverick with respect to its pricing of Beamish.

6.47. In 2004 B&C internal documents show that it intended to follow Diageo's price increase. An e-mail from the Commercial Director dated 13 February 2004 to the Commercial Management Team states:

> "Just putting everybody on notice that it is likely – <u>I will confirm early next week</u> – that we will be going with a Draught Price increase with effect from Monday, 8th March next." (emphasis in original)

6.48. The modalities of implementing the price increase are then outlined.

6.49. A little later that day another e-mail is sent by the Commercial Director which states:

> "**At this stage, I do not want any indication going to the trade of what we are planning to do or when we are planning to do it with regard to a price increase.**
>
> Our main competitor [Diageo] who went to press to-day on the issue is getting quite an amount of flak from trade …." (emphasis in original)

6.50. After much consideration B&C, in an e-mail from the Commercial Director to sales managers and representatives states that;

> …. We have decided to defer our price increase on all Beamish and Crawford Draught Products until September 1st next.

6.51. Under 'The Opportunity', the Commercial Director states:

> "I am sure you agree as a result of us progressing with this initiative, we have a great opportunity over the coming months with our brands:
>
> * Price differential between our brands and Diageo brands
>
> - Should be a 40c differential between beamish and Guinness"

6.52. When considering whether to increase prices in 2005, B&C again deferred any price increase. However, in an e-mail dated 20 June 2005 from B&C's Commercial Director to sales managers the decision not to increase price was seen as temporary – "we are looking at a six month timeframe only (we will be putting up our prices in January 2006)." One of the rationales was that, "Opportunity for B&C to distinguish ourselves from the competition – very difficult for us to outspend them, so let's create our own point of difference."

Discussion

6.53. The evidence suggests that B&C decided to reposition their Beamish brand in response to an unpopular price increase by the price leader Diageo. The evidence cited above concerning its marketing of Beamish as a value brand is consistent with this view. B&C had fully intended to raise its price and absent the resistance from the publicans the evidence suggests that it would have increased its price.

6.54. Furthermore there is no evidence that the pricing behaviour of B&C caused Heineken not to follow the price increases of Diageo. In other words, the price leadership by Diageo and followership of Heineken was not disrupted by the pricing policy of B&C.

Substantial Lessening of Competition in On-trade Stout

6.55. As in the lager market, the Authority's assessment of the impact of the proposed transaction on the on-trade stout market is done within the framework of unilateral and coordinated effects.

Unilateral Effects

6.56. The Authority's approach to assessing the likelihood of unilateral effects is presented in paragraphs 5.72 above. Unilateral effects will occur in the on-trade stout market if, post-merger, the merged entity can profitably raise its price, irrespective of its competitors and/or where some or all of the firms unilaterally change their behaviour. The merged entity will raise price as a result of the merger if it has both the incentive and ability to do so. Other competitors will unilaterally raise price if it is profitable for them to do so.

Submissions of the Undertakings Involved

Heineken

6.57. In RBB Report #3 (pp. 6-8) the following claims are proposed by RBB:

- The proposed merger could only change the parties' pricing incentives to the extent that there is a substantial competitive interaction between Beamish and Murphy's, yet RBB's empirical analysis shows that this interaction is negligible. Standard economic theory shows that, in general, a merger can affect the parties' pricing incentives if and only if, following a price increase by one of the parties, a substantial proportion of its customers would switch to the other merging party. This excludes the case where the merger results in higher prices through coordinated effects. Pre merger, this competitive constraint arising from the risk of customers switching prevents the firm in question from raising prices. However, customers switching between the parties do not represent lost sales for the merged entity. As a consequence, the merged firm may well have the incentive (and ability) unilaterally to raise prices with respect to the pre merger level. Yet, the RBB empirical analysis has shown that the reduction of Beamish's price (relative to Guinness and Murphy's) did not have any significant impact on the sales of Murphy's (see in particular the empirical analysis presented in the Annex). This being so, there is no reason to expect that Murphy's sales would expand following a hypothetical increase of Beamish price. Rather, the sales lost by Beamish would probably accrue to Guinness and possibly also to other types of drink (such as lager or ale). Hence, post merger Heineken is unlikely to have the economic incentive to increase the price of Beamish relative to the price that would have been charged by B&C.

- Beamish is priced at a discount to Guinness because this is now a key part of the brand positioning and identity, not because of some generic "Maverick character" of B&C. The Beamish brand has been positioned as a "value brand" which is attractive to its historical customer base composed primarily of older and working class people. By not following Diageo's price increases in 2004 and 2005 B&C has increased the price "gap" between Guinness and Beamish – currently approximately 50c per pint for consumers. However, in the subsequent period B&C has applied to Beamish exactly the same price increases as Guinness. This is consistent with the conclusion that B&C's pricing behaviour of 2004 and 2005 was a simple "price repositioning", consistent with the image and customer base of the Beamish brand, and does not demonstrate B&C's alleged "Maverick character".

- Beamish has been positioned as a value brand and it would be against Heineken's interest to increase its price. For a brand to be successful, the price, taste, image and customer base have to be coherent. The Beamish brand has been positioned as a value brand and has developed a customer base that is consistent with this price position, as well as with its taste and image. This being so, it would be costly and counterproductive for Heineken to change Beamish's current pricing strategy. First, it would alienate Beamish's customer base but would likely fail to attract other customers (since the brand's image, taste, and other characteristics are not attractive to these customers). Second, increasing the price of Beamish might erode the coherence of the brand's positioning.

- Furthermore, RBB also note that the extent to which Guinness is constrained by the price of Beamish is not relevant to assess the impact of the merger on Heineken's pricing incentives. The only relevant question in this respect is whether Beamish exerts a significant competitive constraint on Murphy's. RBB argue that they have shown, the price of Beamish does not appear to have a significant impact on the sales of Murphy's and therefore the merger is unlikely to provide the merged entity with the incentive to raise stout prices. Crucially, this conclusion holds regardless of the impact of Beamish's (or Murphy's) price on Guinness.
- In any event, the price of Guinness does not appear to have been constrained by the price of Beamish. This is shown for example by the fact that Guinness' list price has increased at approximately the same annual rate both before and after the 2004-2005 period, and that Guinness does not offer specific discounts in regions where it faces competition from Beamish (or Murphy's).
- In summary, RBB argue that they have shown that the pricing strategy followed by B&C in recent years is not due to some intrinsic "Maverick character" of the firm or of its management. Rather, it is the result of the firms' economic incentive to maximise profits. Crucially, these incentives are unlikely to be affected by the proposed transaction. As a consequence, Heineken can be expected to charge prices not higher than those that would have been charged by B&C absent the merger.

<u>B&C</u>

6.58. B&C argues

- that contrary to views expressed to the Authority its policies have had a 'disruptive effect' or have impacted on the pricing policies of Diageo or Heineken;

- that the need to have a "disruptive effect" does not appear to be consistent with the definition of a "maverick firm" in the Authority's own *Merger Guidelines*; and,

- In any event, B&C does not believe that it has not had such an effect on the pricing policies of Heineken and Diageo, the price leader in the relevant markets.

6.59. In this instance, one must consider what would have happened to prices if B&C as a 'maverick' firm has not been present – it is strongly arguable that in pursuing the policies it has on price that B&C has, in fact, constrained both Diageo and Heineken from taking more substantial increases in a co-ordinated manner.

6.60. Compecon, Report #1 (p. 68-69), argues that the proposed acquisition would reduce the number of competitors in the on-trade stout market from three to two. The merged entity would account for just over 10% of the market with Guinness accounting for the remainder. There are grounds for believing that the transaction would result in a reduction of competition in the stout market.

6.61. Compecon further submits that B&C has pursued a very aggressive strategy in the draught stout market built around a strategy of having its stout sold at a significant discount relative to competing brands. As a result it has surpassed the Murphy's brand to become the number two brand in the stout market. Beamish has increased its sales at a time when both Guinness and Murphy's sales volumes have declined. Despite declines in Murphy's sales volumes Heineken has not sought to counter B&C's strategy. Rather it has been content to increase the price of Murphy's in line with Guinness and the net keg prices of both have been the same for some years. B&C has pursued an independent strategy and has deviated from the price increases of the other two brewers in three of the past four years. Thus in a very real sense Beamish represents the only competition in the market to Guinness. The likelihood is that such competition as is currently provided by B&C would disappear following the merger.

6.62. B&C's market research data indicates that in certain urban areas, mostly working class parts of Dublin and in Cork, there is evidence that Guinness' monolithic image has been dented. Stout is no longer seen as synonymous with Guinness.

6.63. An important aspect of B&C's competitive strategy, particularly regarding its attempts to increase its share in the stout market in the Greater Dublin area is the BDVI strategy. This is a firm whose shareholders are Dublin publicans that are members of the Licensed Vintners Association (LVA). Through this mechanism B&C seeks to provide incentives for publicans to purchase B&C products, notably Beamish Stout by offering significant volume related rebates. It also seeks to encourage publicans to pass on the benefits of cost reductions to their customers in the form of lower prices. This is a clear example of the way in which B&C seeks to compete aggressively in the market to the benefit of publicans and the final consumer. As noted such competition is likely to be eliminated if the proposed transaction goes ahead.

6.64. Compecon Report #1 (p. 67) submits that there are grounds for believing that the transaction would result in a reduction of competition in the stout market thus enabling the merged entity to unilaterally raise price. Particularly, in the Cork and Munster regions where the proposed transaction has the potential of leading to a unilateral effect.

Authority's Analysis of Unilateral Effects

6.65. In considering the incentive and ability of the merger entity going forward a crucial issue concerns the continued existence of the Beamish brand. Since Beamish is positioned differently from Murphy's (and Guinness) it is expected that the Beamish brand will continue post-merger. [Heineken's internal documentation demonstrates that the Beamish brand will continue post-merger].[80]

Incentive

6.66. The merged entity will only have an incentive to exercise market power by raising prices in the on-trade stout market if it would be profitable to do so. In order for this to occur, Beamish must be Murphy's closest substitute and vice versa. If this is the case, a post-merger price increase in either brand will result in a switch by on-trade consumers to the other making it profitable for the merged entity to raise the price.

6.67. The evidence cited above shows that Guinness is the closest competitor of each of Beamish and Murphy's. This implies that any post merger rise in the price of either Beamish or Murphy's is likely to lead to a switch by consumers to Guinness, so that the externality from a rise in the price of either Murphy's or Beamish are unlikely to be internalised by the merged entity.

Ability

6.68. The proposed transaction is likely to result in the merged entity acquiring only 10% of the market with its remaining competitor accounting for 90% of the market. Also, Guinness is the "must have" brand in the on-trade stout market and it has the capacity to satisfy the demand resulting from a switch from either Murphy's and/or Beamish.

Views of the Authority on Unilateral Effects

6.69. On the basis of the above the Authority is of the view that the merged entity will have neither the incentive nor the ability to raise price post-merger.

Coordinated Effects

Submissions of the Undertakings Involved

Heineken

6.70. RBB Report #3 argues that the theory of coordinated effects assumes that pre merger the market is characterised by tacit coordination or by "cosy competition" between all, or at least the main market players except the Maverick. Yet, RBB's previous submissions have shown that this is not the case. (RBB Report #1) To the contrary, Heineken has competed intensely and has substantially increased its share of lager at the expenses of Diageo. It is unlikely that two firms which compete intensely in one market (lager) would tacitly collude in another, closely related market (stout). Indeed, RBB have also shown evidence that Heineken has engaged in strong competition in stout. It spends more on advertising than B&C.

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[80] `"Inca Phase 1 "80/20" Review of Value Gap – Supporting Materials ", 11 June 2006, updated 24 January 2008, page 020377. As Table 5.7 above shows, in terms of volume of output, stout is by far the most important beer that it sells.

6.71. Tacit collusion between Diageo and Heineken in the on-trade stout market is unlikely to materialise irrespective of the proposed transaction. First, Guinness, with 90% share of stout, is unlikely to be constrained to any significant extent by Murphy's and Beamish, which have approximately 5% each. Diageo is unlikely to collude with its smaller rivals because its ability to raise the price of Guinness is unlikely to change irrespective of whether the price of Murphy's and/or Beamish follows the price of Guinness or not. Moreover, coordinated behaviour can only materialise if suppliers have the ability to punish the firms which deviate from the (tacit) understanding. Yet, it is hard to see how Murphy's or Beamish could 'retaliate' against Guinness; and it would be extremely costly for Guinness to 'punish' Murphy's or Beamish since this would involve lowering prices to all its customers which represent 90% of the market. Diageo has a national pricing policy and is dominant in stout. As a consequence, it does not and could not target discounts specifically to Beamish's and Murphy's customers.

6.72. In sum, Diageo and Heineken are unlikely to have the ability or indeed the incentive to engage in tacit (or indeed explicit) coordination on the price of stout.

<u>B&C</u>

6.73. B&C made no argument that the proposed transaction is likely to result in coordinated effects.

Authority's Analysis of Coordinated Effects

6.74. The asymmetry in market share between Guinness and the merged entity in the on-trade stout market suggests that the merger is unlikely to result in coordinated effects. Although the degree of asymmetry has been reduced because of the merger, it is still substantial (i.e. market shares in % terms change as follows: from 90:5:5 to 90:10).

6.75. Although it could be argued that complementary asymmetry between stout (Diageo) and lager (Heineken) could facilitate collusion the proposed merger will not significantly change the asymmetry that currently exists between the relative importance of stout and lager to each of Diageo and Heineken.

6.76. Finally it is accepted that the removal of a maverick firm could facilitate collusion post merger. However, as discussed in paragraphs 5.152 to 5.157 and 6.50 to 6.52 above B&C is not considered a maverick and thus its removal will not remove a source of disruption to Heineken and Diageo.

Views of the Authority on Coordinated Effects

6.77. On the basis of the above, the Authority considers that the proposed acquisition of B&C by Heineken will not result in coordinated effects in the on-trade stout market.

The Competition Authority's Conclusion: On-trade Stout Market

6.78. In consequence of the foregoing, the Authority is of the opinion that the proposed acquisition will not result in a substantial lessening of competition in the on-trade stout market in the State.

SECTION SEVEN: DETERMINATION

Determination

The Competition Authority, in accordance with Section 22(3) (a) of the Competition Act, 2002 has formed the view that the result of the proposed acquisition of Beamish & Crawford plc by Heineken N.V. will not be to substantially lessen competition in markets for goods and services in the State and, consequently the Authority hereby determines that the acquisition may be put into effect. Before making a determination in this matter, the Authority, in accordance with Section 22(8) of the Act, considered whether any relevant international obligations of the State existed, concluding that there were none.

For the Competition Authority

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William Prasifka
Chairman of the Competition Authority
Member of the Competition Authority

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Declan Purcell
Member of the Competition Authority

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Dr Paul K. Gorecki,
Member of the Competition Authority

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Carolyn Galbreath
Member of the Competition Authority

____
Dr. Stanley Wong
Member of the Competition Authority

3 October 2008