

Anticipated acquisition by Diageo plc of The 'Old Bushmills' Distillery Company Limited

The OFT's decision on reference under section 33 given on 11 August 2005. Full text of decision published 18 August 2005.

PARTIES

1. **Diageo plc (Diageo)** has a global presence in the production, distribution, marketing, exporting and importing of spirits and wine. Diageo is the owner of a number of leading spirits brands such as 'Smirnoff' vodka, 'Johnnie Walker' Scotch whisky, 'Baileys' liqueur and 'Captain Morgan' rum. Diageo does not produce or supply Irish whiskey. Diageo also brews, markets and distributes beer on a worldwide basis, including 'Guinness' stout, 'Kilkenny Irish Beer' and 'Harp' larger.
2. **The 'Old Bushmills' Distillery Company Limited (Old Bushmills)** is owned by Pernod Ricard SA and is the second largest Irish whiskey brand. Old Bushmills produces Irish whiskey at its distillery in County Antrim, Northern Ireland, under the brands 'Old Bushmills Malt', 'Old Bushmills Original' and 'Black Bush', and has recently launched a new product, 'Bushmills Irish Cream'. Old Bushmills' UK turnover in 2004 was £2.7 million.

TRANSACTION

3. The agreement between Pernod Ricard and Diageo for the acquisition of Old Bushmills (the Acquisition) was exchanged in 6 June 2005. Diageo agreed to pay a consideration of €295.5 million. The Acquisition is conditional on the completion of Pernod Ricard's proposed acquisition of Allied Domecq plc (Allied).
4. A pre-notification submission was received on 6 July 2005. The statutory deadline was extended by ten working days and expires on 17 August.

JURISDICTION

5. The acquisition has resulted in two enterprises ceasing to be distinct within the meaning of section 26(1) of the Enterprise Act 2002 (the Act). The turnover test is not met.

6. Diageo argues that the share of supply test is not met due to the fact that it has no interest in the Irish whiskey market – in which Old Bushmills is active - in the UK or elsewhere. However, Old Bushmills has recently launched a liqueur product (Bushmills Irish Cream), and, if the OFT considers this new brand as part of a separate market, the merger qualifies under the Act since Diageo has a share of supply in excess of 25 per cent in any of the candidate markets (flavoured spirits, liqueurs or cream/coffee liqueurs).
7. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

Product scope

8. The parties overlap in the manufacture and supply of whisky and cream liqueurs. Each product will be analysed in turn.

Whisky

9. The European Commission (the Commission) has held in *Guinness/Grand Metropolitan*¹ and in *Pernod Ricard/Diageo/Seagram*² that in the spirits sector the relevant product market is no wider than for each main type of spirit and accepted that it could be the case that whisky should be further segmented by origin, particularly in relation with Scotch whisky.³
10. Diageo claimed that Irish whiskey and whisky from other origins are not substitutable but did not provide any further evidence to support this contention. Third party responses on this issue were mixed: some maintain that Irish whiskey is distinct due to its unique taste and consumer preference, whilst others submit whiskies from other origins, such as Scotch, constrain the Irish whiskey segment. On supply-side substitution, to be labelled as 'Irish', whiskey must be distilled and matured in Ireland, therefore limiting substitutability.
11. Other possible ways of segmenting the whisky sector are by quality (malt or blended), by brand (branded or private label) and by customer type (on-trade and off-trade).
12. For the purposes of this case, it is not necessary to conclude on the issue of whether the whisky sector should be further segmented, either by origin or according to other

¹ Case No IV/M.938 – *Guinness/Grand Metropolitan*, 15 October 1997.

² Case No COMP/M.2268 – *Pernod Ricard/Diaego/Seagram Spirits*, 8 May 2001.

³ In *Guinness/Grand Metropolitan*, the Commission segmented whisky by origin only 'where different possible definitions would lead to significantly different shares and overlaps (notably, Spain and Ireland)' (para 16). In *Pernod Ricard/Diageo/Seagram*, the Commission held that a further segmentation within the whisky market should be made for Scotch whisky.

characteristics, given that the transaction does not give rise to a significant lessening of competition on any reasonable market definition.

Cream liqueurs

13. Diageo submits that cream liqueurs products should be considered part of the flavoured spirits segment, as did the Commission in the *Seagram* decision. Other possible classifications are liqueurs and cream or coffee liqueurs.
14. For the purposes of this case it is not necessary to conclude on this point, given that the transaction does not give rise to a significant lessening of competition on any reasonable market definition.

Geographic market

15. Diageo submits that the relevant geographic market is broadly the United Kingdom. This is consistent with the approach taken by the Commission, which considered a national scope due to differences in consumption patterns, logistic and distribution networks, marketing strategies, taxation, duties and legislation, among other factors. Diageo also maintains that various influences mean that there is a trend towards a wider European Economic Area market. Third parties agree that the geographic scope is national. The UK was taken as the relevant frame of reference for the purposes of this case, although the possibility of a wider frame being more appropriate is not excluded.

HORIZONTAL ISSUES

Shares of supply

Whisky

16. There is no overlap in the supply of Irish whiskey as Diageo is currently not active in this segment. Considering all types of whisky, the parties' combined UK share of supply is [15-20 per cent], with an increment of merely [<1 per cent]. Post merger, the HHI is 680 (excluding competitors that were aggregated by the parties under the 'others' line, representing almost 32.5 per cent of the segment) with an increment of 10, indicating no prima facie competition concerns.
17. The picture is not very different if whisky was to be segmented into blended and malt. In that case, the combined share of supply would be [15-20 per cent] and [5-10 per cent] for blended and malt, respectively, and the increment would be [<1 per cent] and [<5 per cent], respectively.
18. Given the absence of substantiated third party concerns; the modest resulting shares of supply; and the fact that the increments to share of supply are very small; it is not

expected that this transaction will result in a substantial lessening of competition in the whisky sector.

Cream liqueurs

19. The parties' combined UK share of supply for cream liqueurs is [60-70 per cent], with an increment of only [<1 per cent]. Competitors number two and three in the market have a share of supply of just over [<5 per cent]. If the frame of reference is taken to be flavoured spirits, the combined share of supply is [40-50 per cent], with an increment of only [<1 per cent].
20. Post merger, the HHI in the cream liqueurs segment (excluding competitors that were aggregated by the parties under the 'others' line, representing almost 22 per cent of the segment) is 3906. Whilst an HHI in excess of 1800 suggests the sector is highly concentrated, the increment is only 20, which indicates no prima facie competition concerns.
21. A few third parties noted that the transaction removes an independent supplier within a concentrated sector and the fact that Bushmill is a new and growing brand might mean that share of supply figures understate its future competitive force. On the other hand, Diageo argues that competitors within the flavoured spirits market such as Tia Maria, Kahula, Malibu and Southern Comfort place a constraint on the parties.
22. Given the presence of alternative suppliers within the cream liqueur segment and the very low increment to the share of supply, it is not expected that this transaction will result in a substantial lessening of competition and therefore it is not necessary to reach a conclusion on the extent that other competitors in the flavoured spirits market constrain the parties.

Portfolio effects

23. Some third parties raised concerns that the transaction adds a leading Irish whiskey brand to Diageo's strong portfolio of other whisky brands. This could enable Diageo to exercise market power in individual markets more effectively.
24. Nonetheless, it is not expected that this merger would substantially enhance Diageo's market power – due to the very small share of supply increment - and therefore the chance that it could tie services together anti-competitively as a result of this transaction are too remote to be credible. Furthermore, alternative suppliers are active in the whisky segment, and the evidence indicates that customers are able to multi-source.

Barriers to entry and expansion

25. According to third party information, barriers to entry in the Irish whiskey segment are high due to the level of concentration of existing production capacity in Ireland, among

other factors. On other whisky segments, barriers to entry may exist, but the issue of how significant they are can be left open due to the lack of competition concerns arising from this merger. We did not receive any information on barriers to entry in the cream liqueurs sector.

26. Nonetheless, it is not necessary to reach a firm conclusion regarding barriers to entry and expansion due to the fact that the merger does not cause any competition concerns.

Buyer power

27. Given the lack of competition concerns arising from this merger, it is not necessary to reach a conclusion on the issue of countervailing buyer power.

VERTICAL ISSUES

28. Diageo and Bushmill are vertically integrated companies from the production of spirits through the marketing and wholesale distribution of their products. However, Diageo maintains the parties have less than [10-15 per cent] of the share of supply of inputs and outputs in a vertical supply chain and third parties have not raised any vertical competition issues. Therefore, there is no evidence to suggest that significant vertical issues arise in this case.

THIRD PARTY VIEWS

29. The majority of third parties did not express any concerns about the transaction. A few raised concerns that the merger would increase the size of Diageo's portfolio and remove a competitor from the cream liqueur segment – these concerns are addressed above.

ASSESSMENT

30. The transaction qualifies on the share of supply test under the Act. For the purposes of this analysis the appropriate frames of reference are taken to be the UK production and supply of Irish whiskey, of all whiskies, as well as of cream liqueurs.
31. The parties do not overlap in the production and supply of Irish whiskey. Taking the whisky segment as a whole, the merger creates a combined share of [15-20 per cent] (increment [<1 per cent]). A number of competitors remain in the sector, and the shares of supply, as well as the accretions to those shares, are not significant. In the cream liqueurs segment, although the merger creates a combined share of [60-70 per cent] and Diageo holds a strong position with its Baileys brand, the accretion to share of supply is very small (<1 per cent).
32. There appears to be some barriers to entry in the Irish whiskey segment but the parties do not overlap in that segment. Barriers in other segments may exist, but the

issue of how significant they are can be left open due to the lack of competition concerns arising from this merger.

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

DECISION

34. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.