

Anticipated acquisition by Brulines (Holdings) plc of Nucleus Data Holdings Limited

No. ME/3365/07

The OFT's decision on reference under section 33(1) given on 20 November 2007. Full text of decision published 30 November 2007.

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**Please note that square brackets indicate figures or text which have been deleted or replaced with a range for reasons of commercial confidentiality.**

## **PARTIES**

1. **Brulines (Holdings) plc** (Brulines) supplies data capture services, data management, market intelligence and beer quality monitoring services to the UK licensed on-trade, including the supply and service and maintenance of volume and revenue protection equipment for draught alcoholic drinks (or 'dispense monitoring equipment'). Brulines' group turnover for the year ended 31 March 2007 was £16.8 million, all of which was earned in the UK.
2. **Nucleus Data Holdings Ltd** (Nucleus) also supplies data capture services, communication platforms, data management, market intelligence, and dispense monitoring equipment to the UK licensed on-trade. The UK turnover of Nucleus in the financial year ending 31 December 2006 was £3.1 million.

## **TRANSACTION**

3. On 4 September 2007 a share purchase agreement was entered into under which Brulines will pay a fixed consideration of £3.8 million for the entire issued share capital of Nucleus. A further consideration of up to £700,000

is payable, depending on sales of certain products in the period up to 31 March 2009.

4. The parties notified the transaction on 3 September 2007. The administrative timetable on this case expired on 30 October 2007.

## **JURISDICTION**

5. As a result of this transaction Brulines and Nucleus will cease to be distinct. The parties overlap in the supply of dispensing monitoring services to the tenanted licensed on-trade and the merger will give rise to a combined share of supply (assuming a base of all tenanted pubs) of approximately 64 per cent in the UK (increment seven per cent).<sup>1</sup> As a result, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. 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.

## **FRAME OF REFERENCE**

6. The parties have identified six areas of overlap between their respective businesses:
  - a) Communication platforms for remote data capture – Brulines and Nucleus both sell third party communication platforms to pub companies and bar owners to allow remote harvesting of data; although primarily for beer volumes, platforms are capable of harvesting information for other applications, such as footfall, utilities monitoring and gaming machines.
  - b) Data management and analysis – both parties provide outsourced data management and analysis services for major pub companies.
  - c) Dispense monitoring equipment provision – dispense monitoring equipment provision has been a core product during the early uptake and growth of dispense monitoring services and involves the

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<sup>1</sup> It should be noted that the group of goods or services used to determine jurisdiction may be different to the relevant economic market used for the purposes of the OFT's competition assessment. Generally, the OFT will have regard to the narrowest reasonable description of good and services to determine whether the share of supply test is met. See paragraph 2.24 of *Mergers – substantive assessment guidance*.

sale and installation of dispense monitoring equipment which generate data for harvesting and remote capture.

- d) Service and maintenance of dispense monitoring equipment – Brulines provides an in-house service and maintenance offering for their customers; Nucleus also provide this through an in-house department, which utilises Coors UK and two regional providers as third party contractors.
  - e) Beer quality measurement – Brulines supplies a beer quality measurement product, under the trade name Brand Quality Monitoring (BQM); Nucleus has developed a product under the trade name Starway, which allows remote capture of information from other third party off-the-shelf measurement applications.
  - f) Market intelligence services – on a limited basis, both parties provide ad hoc market intelligence reports to pub companies, on-trade licensed press and brewers.
7. Sales of market intelligence services does not form a core part of the services provided in respect of dispense monitoring and/or beer quality measurement. In addition, many third parties indicated that they either purchased such services from other, more specialist providers (such as AC Neilson or BBPA) or undertook such services in-house. On this basis, it would appear that a number of competitors for the provision of market intelligence services will remain present post-merger to constrain the parties' behaviour, which is supported by the fact that third parties have not raised this as a potential issue. Therefore, competition concerns are not considered to arise in relation to the supply of market intelligence services and, as a result, will not be considered further.

## **Product market**

### Dispense monitoring services

8. Evidence from third party responses shows that the vast majority of customers typically tend to purchase dispense monitoring equipment along with support services, such as maintenance, communication platforms and data management and analysis, from one supplier.<sup>2</sup> A number of customers expressed a preference for purchasing bundled services, as this

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<sup>2</sup> That is, all the services outlined in points a-d in paragraph 6 above.

meant dealing with fewer suppliers and hence lower administrative costs, as well as avoiding any potential interoperability issues. The parties confirmed that while customers have a choice of whether or not to purchase a bundled service, a number of them have a preference for buying all four services from one supplier. However, they did note that as the pub industry evolved and became more focussed on organic growth and cost management (as opposed to consolidation) this may lead to a drive towards unbundled services in the future.

9. The parties indicated that both dispense monitoring equipment and communications platforms for remote data capture could be purchased from third party suppliers. Similarly, there are a number of third parties capable of installing and servicing dispense monitoring equipment (for example, Nucleus currently contracts out some of its servicing requirements to Coors and two regional companies, while Brulines also out sources some installation work at times of high demand). Some customers may also be able to undertake data management and analysis in-house, or out-source this function to a data processing company outside the industry. However, it may not be economical for each customer, particularly smaller customers, to bring all of these individual services together to complete the 'package' as it is likely to not only involve additional cost and time, but difficulties could also be faced in ensuring compatibility between the different elements.
10. The parties submitted that suppliers of technical services equipment may have the incentive to enter the supply of dispense monitoring equipment and related services. However, third party responses appear to indicate that the likelihood of supply side substitution by technical services firms was limited. It was considered more likely that they would support an existing supplier, for example by supporting expansion and providing the installation and servicing of the dispense monitoring equipment, rather than undertake supply of the whole package themselves.
11. As a result, a cautious approach has been taken and the relevant product frame, for the purposes of this case, is considered to be the supply of a bundled package of all four services: communication platforms for remote data capture; data management and analysis; dispense monitoring equipment provision; and service and maintenance of dispense monitoring equipment (referred to hereafter for ease of reference as 'dispense monitoring services'). The extent to which customers have the ability to

take these services in-house and/or contract for services separately, and the constraint this imposes on the merged entity, is discussed further in the section on buyer power.

#### Beer quality measurement

12. The parties submitted that beer quality measurement was a growing sector and that the systems being designed and marketed by several recent entrants were capable of undertaking dispense monitoring. Historically, beer quality management appears to have been provided by in-house quality assurance teams and quality accreditation schemes.<sup>3</sup> However, several more recent entrants to the sector have developed a 'technology based' solution to beer quality management. For example, Brulines' beer quality measurement product (as distinct from its dispense monitoring product) seeks to measure beer quality in real time by installing equipment to assess key aspects such as flow rate, dispense temperature, line cleaning and volume throughput. According to the parties, these technology based beer quality measurement product contain all of the necessary hardware and technology to measure beer flows, the primary function of dispense monitoring. Customers also indicated that while the products supplied by these 'technology based' beer quality measurement suppliers were different to the dispense monitoring services of the parties, they did view them as credible substitutes. Beer quality measurement suppliers also confirmed that they were willing and able to provide dispense monitoring services. Therefore, these technology based suppliers would appear able to engage in supply side substitution into the provision of dispense monitoring services.
13. However, as noted above, not all suppliers of beer quality measurement use these technology based methods, and these historic suppliers would not appear capable of easily undertaking supply side substitution into dispense monitoring services. Furthermore, the technology based solutions to beer quality measurement are currently in their infancy and the market for these services is to some extent unproven. A cautious approach is therefore warranted and it is not considered appropriate to widen the product frame to include beer quality measurement. However, the

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<sup>3</sup> For example, Cask Masque is an accreditation scheme which involves unannounced visits by an independent assessor twice a year, where the assessor will check all cask ales on sale for temperature, appearance, aroma and taste. This differs from the parties products which seek to measure beer quality in real time by installing equipment to assess key aspects such as flow rate, dispense temperature, line cleaning and volume throughput.

competitive constraint posed by those beer quality measurement suppliers capable of also supplying dispense monitoring services is taken into account and considered further as part of an analysis of the horizontal effects of the merger.

14. Examining beer quality measurement as a separate product frame of reference, the parties' presence in the sector is currently limited and there are a number of established (non-technology based) in-house and third party providers. Similarly, there are several recent entrants marketing similar technology driven beer quality measurement solutions. On this basis, there would appear to be a number of competitors capable of constraining the parties' behaviour post-merger. Therefore, competition concerns are not considered to arise in relation to the supply of beer quality measurement and, as a result, will not be considered further.

### **Geographic market**

15. Previous cases in the beer industry<sup>4</sup> have adopted a national frame of reference. In this case, customer contracts are predominantly set on a national basis. In addition, both parties provide their services on a national basis and policies on pricing, marketing and advertising do not vary by geographic location. As such, the parties have suggested that the appropriate geographic frame of reference in this case encompasses the whole of the UK. This view was generally supported by third parties.
16. There may be regional or local aspects to competition, as providers of support services associated with dispense monitoring equipment will need to be able to respond quickly and customers' outlet networks can vary widely in terms of their coverage. Nevertheless, most customers have stated that they require national coverage for their service suppliers.
17. Therefore, based on the evidence available and consistent with the approach taken in similar cases, the OFT considers the appropriate geographic frame of reference to be UK-wide.

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<sup>4</sup> For example, see Competition Commission, March 2005: *A report on the proposed acquisition by Serviced Dispense Equipment Limited of the Technical Services Function of Coors Brewers Limited.*

## HORIZONTAL ISSUES

### Market shares and existing competitive constraints

18. The dispense monitoring services sector is relatively new. Brulines began trading in 1994, and Nucleus entered in 2001, and further, the parties submitted that wider market acceptance of the concept of the service has only been achieved in recent years. Dispense monitoring has proved particularly attractive to pub companies seeking to monitor compliance with and enforcement of tenants' tied purchase obligations.<sup>5</sup>
19. The parties submitted that dispense monitoring is relevant to all bar operators across the licensed on-trade draught beer market as it provides physical verification of actual sales. According to the parties' estimates, there are approximately 149,000 licensed on-trade outlets (pubs and bars) in the UK. Of these outlets, Brulines supplies services to [ ] ([10 - 15] per cent) and Nucleus supplies services to [ ] ([less than five] per cent).
20. However, a significant proportion of licensed on-trade outlets do not currently use dispense monitoring services, nor does this currently appear to be an essential part of their business. The parties estimate that less than 15 per cent of the 149,000 licensed on-trade outlets (approximately 22,350) currently purchase dispense monitoring services, with tenanted pub companies accounting for almost all of the installations.
21. These figures imply that the parties account for approximately [90-95] per cent (increment [5-15] per cent) of the supply of dispense monitoring services to those customers which have the necessary equipment currently installed.<sup>6</sup> Furthermore, third party responses consistently indicated that the parties are the two main suppliers of dispense monitoring services, and that they considered the parties to be each other's closest competitors.

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<sup>5</sup> A tenanted pub is one owned by a brewer or pub company and then leased to the tenant. Typically, tenanted pubs are also 'tied' to purchasing all or a set proportion of their beer and other alcoholic requirements direct from the brewer or pub company in return for a rent set below market rates. Where a tenant breaches this agreement and buys its requirements from another supplier, this is commonly referred to as 'buying out of tie'.

<sup>6</sup> This share of supply is calculated using the estimated number of current customers purchasing dispense monitoring services ([19,500 – 24,500]) as the denominator. This differs from the basis upon which jurisdiction was established, where the number of tenanted pubs (estimated by the parties as 32,000 pubs) was used as the basis for the share of supply calculation. The ability to expand supply into those pubs and bar currently not purchasing dispense monitoring equipment is considered in barriers to entry.

22. The parties submitted that direct competition between them was limited. There are only a small number of examples where a tendering process (or similar) has been run by customers to select a supplier. In all but one of these instances, however, the only two bidders were the parties, and in all cases, the contract was won by either Brulines or Nucleus. This evidence of head-to-head competition between the parties pre-merger is consistent with third party views that they are each other's closest competitors. The limited evidence of competitive interaction between the parties may be due to the fact that, in the past, each of the parties appeared to have focussed on achieving new installations and greater market penetration through slightly different strategies (Brulines concentrating on large national pub companies and Nucleus on smaller, regional chains). However, it might be expected that such tendering processes may become more frequent in the future as these contracts come up for renewal, particularly where there is a diminishing number of customers to target for new installations.
23. There are a number of small suppliers of dispense monitoring services, several of whom also provide beer quality measurement, present in the sector, though a few of these have only been active in the UK for a relatively short time. Some of these smaller suppliers have entered into trials of their products with customers. However, as noted above, there is limited evidence of examples of where these suppliers have successfully competed against the parties and won contracts. Competitors also raised concerns that they have been unable to win any significant business in the dispense monitoring services sector, despite continued efforts.
24. Almost all third party customers considered that the merger would, to some degree, reduce their negotiating strength through the removal of the constraint imposed by each of the party's closest competitor and the ability to play the two off against one another. However, the extent to which this was perceived to be a problem depended on customer beliefs about future entry or agreements over future prices set out in recent contracts, with less than one third of customer responses expressing concerns that the merger would lead to a substantial lessening of competition.
25. During the course of its investigation the OFT found a valuation document prepared by consultants, on behalf of the parties, which suggested that price rises might be possible post-merger. However, neither the valuation nor the eventual purchase price to be paid by Brulines appears to incorporate any premium for the potential to gain market power. Instead,

the price to be paid by Brulines (approximately £3.8 million) appears to be consistent with the annual revenue and estimated efficiency gains associated with the transaction ([ ]<sup>7</sup> respectively).

26. Overall, the parties would appear to be the main two suppliers of dispense monitoring services in the UK and account for over 90 per cent of the installed customer base. Furthermore, customers consider the parties to be each other's closest competitors and there are (albeit limited) examples of customers playing the parties off against one another in order to achieve improved contract terms. Post-merger this constraint will be lost, and therefore prima face competition concerns arise. The extent to which this loss of competition is offset by new entry, expansion and buyer power is discussed further below.

### **Barriers to entry and expansion**

#### Cost of entry and expansion

27. The parties argued that barriers to entry are low, and pointed to the existence of a number of small players, several of whom were very recent entrants, as evidence that new entry was feasible. Nucleus itself only entered the sector in 2001 and was the first firm to challenge Brulines who was the sole supplier of dispense monitoring services at that time.
28. In its prospectus for the placement of shares and admission to the AIM (Alternative Investment Market), Brulines' Directors indicated that they considered barriers to entry in the sector to be high, but there was a risk of new competitors emerging that could have a significant effect on Brulines position in the sector.<sup>8</sup> This statement is at odds with Brulines' submission that barriers to entry are low. However, the document also identifies new entry as a potential risk factor, suggesting that entry and expansion by competitors is viewed by Brulines as a credible threat.
29. According to the evidence of Nucleus and third party comments, new contracts are usually won following free or discounted trial periods. The parties state that in general pub companies have a trial/evaluation phase lasting around three months, then a slow start of installations (often initially targeting suspected 'problem' outlets first) with a total lead time of 2-3 years to achieve complete coverage of their estates. We have

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<sup>7</sup> [ ]

confirmed that at least two recent entrants have undertaken successful trials with some pub companies, however, this has yet to develop into any significant contracts. Several customers have also confirmed that they view these new trialed products as credible technical alternatives to those supplied by the parties.

30. The parties submitted that there are no intellectual property issues and no planning restraints, that inputs are widely available and only limited R and D spending is required to enter. In addition, the parties suggested that there is negligible capital expenditure associated with entering the supply of dispense monitoring equipment, as manufacturers will supply equipment with 60 days' terms, whilst customers pay on installation. The parties estimated that the costs of software development would be between [£30,000 to £65,000] and completion would be within three months. Installation, servicing and maintenance could be contracted out to third parties, as demonstrated by Nucleus' current contract with Coors (and others) to supply these services. The OFT also found evidence that there were other third party suppliers interested in providing maintenance support services to both the parties and new entrants.
31. A number of competitors submitted that barriers to entry were significant, with one competitor trying unsuccessfully for as long as seven years to gain a share in the supply of dispense monitoring services. Some third parties provided estimates of the cost of entry to be in excess of £500,000 and up to £1.5 million. These higher costs may be a reflection of the fact that several of these new entrants have developed products targeted at the beer quality measurement sector, rather than the more basic flow meter arrangements necessary for dispense monitoring. However, even in this respect, the parties were able to provide strong supporting evidence that their own costs of development for a complete new suite of products suitable for use in the beer quality measurement sector were relatively low.
32. Indeed, responses from competitors indicated that they did not believe it was difficult to replicate the technology or services offered by the parties and considered that it was relatively easy to expand supply of products and/or services due to the presence of sub-contractors. Instead, competitors considered that the greater barrier to entry was the existing relationships between the parties – as the two main suppliers – and their customers which made it difficult to win business.

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<sup>8</sup> Brulines (Holdings) plc, Admission to Trading on AIM, page 23.

33. Furthermore third parties have not supported the parties' assertion that expenditure on advertising and marketing is not important, as there is good general awareness amongst pub companies and bar operators. Based on the evidence available, the OFT considers that there may be aspects of brand awareness which are important to achieving successful expansion, however, this may in part be achieved through developing reputation and the good relationships with customers (discussed above).

#### Examples of entry and expansion

34. As noted above, Nucleus represents the most recent, and only, example of new entry into the sector which resulted in winning any significant (10 per cent) share of supply. The OFT therefore examined what factors led to Nucleus' entry and whether new entry and/or expansion could be successfully replicated by another firm, and thus replace the constraint lost as a result of the merger.
35. According to the parties, Nucleus' decision to enter the sector in 2001 was driven by their view that there was a gap in the dispense monitoring services market for providing an enhanced service proposition to customers. Until that time it appears that Brulines had predominantly focussed on the sale of dispense monitoring equipment. Nucleus saw an opportunity to provide an improved data management and analysis service which would be of greater use to the pub companies.
36. The parties submitted that Nucleus was initially set up with minimal funds as a joint venture with Kunick Leisure (now called Gamestech) an amusement with payment (AWP) machine supplier. Nucleus established its presence in the sector relatively quickly by sourcing many of the necessary inputs– dispense monitoring equipment, field service engineers, and telecoms provision – from third parties. In addition to this, Nucleus achieved the development of its own software and the initial database hardware, with a relatively small investment (£[ ]). Nucleus also retained responsibility for the collection and audit of the data, preparing and sending the reports to all the clients, and all customer contact and development.
37. Within 18 months of entry Nucleus had obtained approximately 200 installations and by 2006 this grew to over 2000. It would appear that following entry Nucleus did not focus a significant amount of its time on winning customers from Brulines. Instead, it sought to roll out its equipment and services to new customers (primarily the smaller regional

pub groups) and, as a result, the growth in its share of supply is predominantly down to increased market penetration as more pub companies have taken up the service.

38. In 2007, market penetration in the tenanted sector is significantly higher. However, the parties estimate that there are still at least 6,000 tenanted pubs<sup>9</sup> not currently purchasing dispense monitoring service which provide the potential for expansion through new installations. They submitted that this represented an opportunity more than twice the size of Nucleus's current business. However, the parties did acknowledge that full market penetration was unlikely, for example, some very small pub companies may have strong relationships with tenants, and/or may have other means to monitor when buying out of tie occurs. But, even when this is taken into account there still remains a reasonable number of potential customers for new installations available in the sector. In addition, the parties also estimated that there would be approximately [2,000 – 7,000] replacement installations per year, as the equipment operated on a five year replacement cycle. Therefore, there still remains the ability for new entrants to achieve growth through new installations and replacement installations as they become due for renewal in the future.
39. New entrants are, to some extent, likely to benefit from the general acceptance across the tenanted sector regarding the need for dispense monitoring services. According to the parties, wider market acceptance of the dispense monitoring services has been a drawn out process, which only really took hold in 2005 following Enterprise Inns' decision to implement full coverage in its estate.
40. The parties also argued that there is significant potential for growth in installations and product penetration through the expansion of services into the rest of the pub and bar industry. The parties estimate that there are approximately a further 117,000 pubs and bars outside the tenanted sector, a substantial portion of which could be targeted for the roll out of new beer quality measurement services designed for the 'managed' sector. The parties submitted that several of these new entrants were well placed to grow through new installations in the managed sector, and once established, would be able to use their technology and reputation to target

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<sup>9</sup> The parties estimated that there were approximately 10,000 tenanted pubs in the sector which did not currently have dispense monitoring equipment installed. Of these they estimated that approximately 4,000 were (i) pub companies that Nucleus or Brulines currently serve that do not have full coverage; and (ii) pub companies who have free of tie leases.

the tenanted sector in competition with the parties. However, the OFT is of the view that dispense monitoring and beer quality measurement services to the managed sector is still in its infancy, with relatively few customers, and therefore remains unproven. In light of this, we do not consider that entry and expansion through the managed sector is sufficiently certain, such that it could be relied upon for the purposes of our analysis.

41. Nucleus' entry through innovation and differentiation appears to have also been a factor in its success as a new entrant. Similarly, several of the more recent entrants have also sought to use innovation as a means of entry, with customers indicating that they offered similar but not identical services to the parties. As noted above, a number of these new products are designed not to just monitor the amount of beer passing through the lines, but also to provide 'real time' beer quality measurement. Recent development by the parties of similar beer quality measurement products is likely to have diminished the comparative advantage the new entrants hold as a result of their innovation; however, this evidence does lend support for the proposition that this is a sector which offers opportunities for entry through innovation.

#### Barriers to switching

42. Some third parties have suggested that switching suppliers in situations where customers have already purchased dispense monitoring equipment would be prohibitively expensive. However, other third parties indicated that they had switched suppliers in the past (albeit between the parties) without significant difficulty.
43. There was limited evidence of actual customer switching, and most examples provided by the parties were following acquisitions or mergers where pubs were transferred from one pub company (and so one dispense monitoring services supplier) to another. In those instances, the acquiring pub group had sought to have dispense monitoring services transferred to their incumbent provider. In order to facilitate such transfers, the parties reach an agreement whereby the raw data is collected from the system by one party and then sent to the other party. This means that the pub company continues to receive a single consolidated report for all its pubs.
44. Furthermore, the parties informed the OFT that the data collected from dispense monitoring equipment was owned by the pub companies and they could ultimately decide what it was used for and to whom it could be

shared. The parties argued that this, combined with the damage to their reputation, would be sufficient to prevent them from refusing to come to an agreement with the customer's new supplier for the transfer of raw data.

45. The OFT also found that, in almost all cases, the dispense monitoring equipment is owned by the pub companies and would not necessarily need to be replaced following a change of service or data management provider. Rather, the parties indicated that equipment is replaced at the end of its useful life (generally five years) which usually coincides with the end of the supply contract. As a result, the replacement of the equipment would be inevitable regardless of whether the incumbent or another supplier won the new contract. The ability to transfer data between providers would also enable the smooth transition from old provider to new during the transitional period whilst the replacement equipment was rolled out. Therefore, any incumbency advantage would appear to be limited to that of good customer relationships and familiarity with the provider's service.

## Conclusions

46. On the basis of the information gathered during the OFT's investigation, the OFT considers that, possibly with the exception of reputation and customer relationships, barriers to entry and expansion are relatively low. There is strong evidence to show that the costs of entry are low and equipment, software and servicing support are easily available. Furthermore, there do not appear to be any substantial barriers to customer switching, with any incumbency advantage being limited to existing customer relationships and familiarity with systems and services. There also appears to be sufficient opportunities for new entrants to compete for new contracts, either through new installations or following customer contract renewals.
47. Therefore, the primary barriers to new entry and expansion are those of competitor reputation and customer relationships. The parties submitted that some of the more recent entrants had the potential to overcome this problem as they were well funded and included within their Board or management teams were a number of individuals with significant experience in the pub sector and who would have the necessary industry contacts to help develop their business. In addition, the OFT considers that customers themselves may have the incentive to overcome any reputational and/or relationship barriers, in the event of an increase in

prices or a reduction in service quality post merger. The ability for customers to achieve this through sponsoring entry or supporting expansion is discussed further below.

### **Buyer power**

48. The parties submitted that many of the larger pub companies have significant buyer power and that such customers make up a significant proportion of sales for both merging parties, with the top five customers account for [ ] per cent and [ ] per cent of Nucleus' and Brulines' annual sales, respectively. [ ].
49. The parties also argued that dispense monitoring services are a discretionary purchase and it not vital to the pub companies business. A number of customers confirmed this view, indicating that in the event of a price increase they may decide to no longer use the service. There is also evidence that full roll out of dispense monitoring services to an entire estate provides diminishing returns to investment. That is, when rolling out the service, pub companies may tend to initially target those tenants they consider are most likely to be buying outside the tie. Therefore, it may be reasonable to expect that following a price increase a customer may decide to restrict its use of the services back to these more 'suspect' tenants, as the return on investment in dispense monitoring for the less problematic tenants reduces. Such a roll back of services may render a price increase by the merged entity unprofitable.
50. Most importantly, a number of customers also indicated that they would be willing to sponsor new entry or expansion by an existing competitor, or take the service in-house. The parties provided customer correspondence confirming that at least one of the major pub companies was considering the possibility of taking the service in-house in the future. Also, with several small competitors present in the sector, there would appear to be significant opportunities for customers to sponsor expansion. As discussed above, the main potential barrier to entry is reputation and good customer-supplier relationships. Given customers willingness to sponsor entry and expansion it would appear that, to the extent that reputation does pose a barrier, this could be overcome relatively easily.
51. Overall, the combined constraint imposed by the threat of new entry and/or expansion and the potential for customers to sponsor or support such entry or expansion would be expected to provide a significant constraint on the

parties post-merger. The relative buying strength of the large customers and the discretionary nature of the service would also be expected to constrain the merged entity.

## **VERTICAL ISSUES**

52. Neither of the parties have facilities for the manufacture of dispense monitoring equipment, nor do they have any links to pub companies or breweries. In light of this, the merger is not considered to give any vertical issues.

## **THIRD PARTY VIEWS**

53. All of the competitors who responded expressed concerns regarding the merger, which they considered would increase their current difficulties in winning new business. One competitor did acknowledge that there could be some benefits to the merger as some customers prefer to split their buying between two suppliers and, given that Nucleus has historically been the second supplier, post-merger this 'space' might be available for a different supplier.
54. Of the 19 customers who responded, the majority (14) were unconcerned, with several noting that they would be either willing to sponsor entry or take services in-house. Where these customers had experience of other suppliers in the sector through trials, they generally considered that these new entrants products were credible alternatives to the parties' products. Of the five customers who expressed concerns, most were primarily worried about a lack of alternative suppliers if problems were to arise during their current contract. Others considered that the merger would only present a short-term problem (as they felt future entry was likely) and/or they felt other strategies were available to mitigate any reduction in negotiating power.
55. The concerns raised have been discussed and addressed in detail above.

## **ASSESSMENT**

56. The parties overlap in the supply of a number of services: communication platforms for remote data capture; data management and analysis; dispense monitoring equipment provision; service and maintenance of dispense monitoring equipment; beer quality measurement; and market

intelligence services. No competition concerns were considered to arise in relation to the supply of beer quality measurement and/or market intelligence services given that there are a number of other competitors present in these sectors who will continue to constrain the parties' behaviour post-merger.

57. For the remaining four areas of overlap – communication platforms for remote data capture; data management and analysis; dispense monitoring equipment provision; and service and maintenance of dispense monitoring equipment – the OFT found that the vast majority of customers had a preference for purchasing these services as a bundle. It would appear possible for customers to achieve supply of each of these services separately; however, this may involve additional costs and/or compatibility issues. A cautious approach is therefore warranted and the appropriate product frame of reference is the supply of all four 'dispense monitoring services'. It was recognised that some suppliers of beer quality measurement, that is, those with suitable 'technology based' offers, were capable of supply side substitution into the provision of dispense monitoring services. However, it was considered more appropriate to examine the constraints imposed by these technology based suppliers individually, rather than including all beer quality measurement providers within the relevant frame of reference. The appropriate geographic frame of reference was considered to be UK-wide.
58. Together the parties account for over 90 per cent of customers currently purchasing dispense monitoring services in the UK. In addition, third parties confirmed that the parties were the two main suppliers of dispense monitoring services and customers considered them to be each other's closest competitors. Concerns therefore arose that post-merger the constraint imposed by competition between the parties would be lost.
59. Based on the evidence available, the OFT considers that the costs of entry and expansion are relatively low, and there are sufficient opportunities for new and existing competitors to achieve expansion either through new installations, or following customer contract renewals. The only potential barrier to entry identified related to issues surrounding reputation and customer relationships. Countervailing buyer power is also expected to provide a significant constraint on the parties post-merger. In particular, several customers indicated that they would be willing to sponsor entry or expansion by an existing competitor, or take services in-house. This

willingness to sponsor entry/expansion would also be expected to assist in overcoming any reputational / customer relationship barriers to entry. On this basis, the combined constraint imposed by the threat of new entry, expansion by existing competitors and countervailing buyer power is considered to be significant.

60. 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**

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