

Completed joint venture between Constellation Brands Incorporated and Punch Taverns plc relating to Matthew Clark Wholesale Limited, Forth Wines Limited and Wine Studio Limited

The OFT's decision on reference under section 22(1) given on 5 July 2007. Full text of decision published 13 July 2007.

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

## **PARTIES**

1. **Punch Taverns plc** (Punch) is a UK based pub operator with a portfolio of over 9,000 pubs (the Punch estate),<sup>1</sup> 90 per cent of which are leased to tenants.
  
2. **Constellation Brands Incorporated** (CBI), is a US based producer and seller of alcoholic beverages, and owns the three companies that are the subject of this investigation (referred to in this decision as the 'Joint Venture Companies'):
  - **Matthew Clark Wholesale Limited** (MCW) is a UK based wholesaler and distributor of alcoholic and non-alcoholic beverages to on-trade businesses (hotels, pubs and restaurants). MCW achieved [more than £70 million] of (unaudited) sales in the financial year ending 28 February 2007.
  
  - **Forth Wines Limited** (FWL) is a small specialist wine merchant operating in Scotland and other parts of the UK. FWL achieved

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<sup>1</sup> The OFT understands that Punch was to reduce the number of pubs it owns to around 8330 during the course of the investigation.

approximately [less than £70 million] of (unaudited) sales in the financial year ending 28 February 2007.

- **Wine Studio Limited** (WSL) is a new business which came into operation in January 2007. Its turnover for the first two months of operation was approximately [less than £70 million].

## **TRANSACTION**

3. As a result of the joint venture Punch acquired a 50 per cent interest in the Joint Venture Companies from CBI. The joint venture was completed on 17 April 2007 and the parties notified the transaction to the OFT on 30 April 2007. The (extended) administrative deadline is 5 July 2007 and the statutory deadline is 16 August 2007.

## **JURISDICTION**

4. As a result of this transaction Punch and the Joint Venture Companies will cease to be distinct. The UK turnover of the Joint Venture Companies exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## **FRAME OF REFERENCE**

5. The parties argue that there is no horizontal overlap between the parties' activities. Punch has no wholesale interests and CBI has no retail activities. However, Punch does purchase beverages to supply to its own (managed and tenanted) pubs. It is therefore active in wholesale markets although the parties do not consider each other to be competitors.

### **Product market**

6. CBI and its subsidiaries supply alcoholic and non-alcoholic beverages to customers in the hospitality sector (the 'on-trade') and large retail customers (the 'off-trade'). These products are purchased from a number of suppliers, many of whom are the leading suppliers of products in each category. CBI products sold through MCW account for only [5-15] per cent of MCW's sales by volume and CBI sells its products through a number of

other wholesalers. For sales to off-trade, CBI generally sells direct. The parties suggested that it was not appropriate to distinguish between the on-trade and off-trade because the skill set and infrastructure required to supply both groups is the same. However, the OFT has taken a cautious approach in this case and considered on-trade supply separately from off-trade.

7. The parties also submit that there is no basis to divide the product market by either beverage category or by Small Pack (packaged drinks, including bottled beer and cider) and Large Pack products (draught products). The parties claim that these products are essentially the same in respect of the skills required to supply them.
8. The OFT found that, from the demand side, on-trade operators will buy a range of beverages to meet demand. These are generally purchased through wholesalers, although a large on-trade operator might negotiate directly with manufacturers. On the supply-side, a wholesaler to the on-trade may choose to specialise in a particular beverage or may offer a whole range of beverages. No third parties suggested that the market should be narrower than the supply of beverages to on-trade.
9. On the basis of the evidence provided to the OFT for the purposes of this investigation, the OFT has considered the wholesale supply of non-alcoholic and alcoholic beverages to the on-trade as the relevant frame of reference. However, the OFT's conclusions on the competitive effects of the merger do not change whichever frame of reference is considered.

### **Geographic market**

10. The parties' activities are focused in the UK. Some third parties commented that MCW is the only viable national wholesaler and that other wholesalers were generally regional. However, the parties identified a number of other wholesalers supply throughout the UK, offering a broad range of beverages. The parties submitted that while some wine wholesalers are more focused on London and the South East of England, a national market was the appropriate frame of reference.
11. The evidence available supports a definition of a national market for the supply of non-alcoholic and alcoholic beverages to the on-trade.

## HORIZONTAL ISSUES

12. The primary concerns raised in relation to the joint venture were vertical in nature. However, the OFT has considered the overlap between the parties in relation to wholesale supply, as the extent of this overlap (and the increment resulting from the joint venture) is relevant to the vertical analysis.
13. Notwithstanding their submissions on the appropriate market definition, the parties provided a number of different share of supply measures.<sup>2</sup> Assuming the widest possible market definition (both on-trade and off-trade) the parties' combined market share is [1-10] per cent. On-trade share of supply is [15-25] per cent, with an increment of [1-10] per cent as a result of the merger. On a narrower definition, considering on-trade shares of different drink categories, the parties' largest combined market share is [25-35] per cent for 'flavoured alcoholic beverages'. The parties also supplied market share figures indicating that the wholesale market was relatively fragmented, with a number of different suppliers. These shares of supply, and the number of competitors to the parties (and in particular the Joint Venture Companies), are not indicative of market power in the market for the wholesale supply of non-alcoholic and alcoholic beverages to the on-trade.

## VERTICAL ISSUES

14. The OFT generally considers that vertical concerns are unlikely to arise except in the presence of existing market power at one level in the supply chain at least, or in markets where there are already significant vertical integration restraints.<sup>3</sup> As set out above, the joint venture will not create market power at the wholesale level. In addition, Punch does not enjoy market power at the retail level, where it owns only [10-20] per cent of pub outlets. This is illustrated in a recent OFT decision regarding Punch's acquisition of another pub group,<sup>4</sup> the OFT found that Punch's share of

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<sup>2</sup> The parties provided market share information using both their own figures and AC Nielsen, the latter of which the parties submit understates the true position with respect to on-trade and overestimates the parties' market shares. We have taken a cautious approach in the decision and quoted the AC Nielsen figures.

<sup>3</sup> See the OFT's *Mergers-substantive assessment guidance* (May 2005) section 5.

<sup>4</sup> Completed acquisition by Punch Taverns plc of Spirit Group Holdings Limited (OFT decision of 5 May 2006).

pubs (between 15 and 17 per cent) did not raise substantial competition concerns at a national level.

15. Notwithstanding the apparent lack of market power held by the merging parties, a number of vertical concerns in relation to the joint venture were raised by third parties. The primary vertical concerns included:
  - that the new venture would expect to capture preferential terms from suppliers, making it difficult for wholesalers to compete on an equal basis
  - that the Punch estate (both managed or leased) would be supplied on preferential terms or service levels to other on-trade customers, and
  - that confidential information obtained by MCW of Punch's on-trade competitors in its role as a wholesaler would be supplied to Punch.
16. Each of these concerns is discussed briefly below.

### **Purchasing power**

17. The OFT does not consider that there is consumer detriment (or competition concerns) where a joint venture, with increased purchases, requests better terms from its suppliers. This is particularly the case where lower costs are passed on in the form of lower prices to end customers. Concern arises where suppliers will have no alternative options for the sale of its products, so that the buyer is a single buyer or in a small group of buyers.
18. The evidence does not suggest that the joint venture will put the parties in a position where they can exercise undue purchaser power. Suppliers will offer the joint venture low prices only if there are few other routes to market for their products, or if they are concerned that the joint venture will take its business elsewhere. As set out above, the joint venture will have only a modest share of the on-trade supply, and Punch accounts for a relatively low share of market demand in all beverage categories.
19. The parties also pointed to a number of other factors limiting the joint venture's purchasing power, including the inability to switch to alternative

suppliers for 'must stock' brands, the size and sophistication of drinks suppliers, and competition in downstream markets.

20. Two upstream suppliers were concerned that the joint venture would prevent them from price discriminating between managed pubs and independent pubs (or wholesalers and pub estates). However, neither Punch nor the Joint Venture Companies account for a high percentage of purchases from either of these suppliers and the OFT does not believe that the joint venture could exercise its buyer power in requiring the supplier to offer it preferential terms, particularly since the supplier is offering cost-reflective prices to different groups of consumers.

### **Preferential trading terms**

21. One of the stated reasons for the merger is that Constellation will gain access to Punch's terms for beer - which are better than those that Constellation would obtain absent the merger. Some third parties expressed concern that the joint venture would pass on its purchasing economies by charging lower prices to the Punch estate, at the expense of other pub groups. If however, this reflects efficiencies gained through lower distribution costs, it does not appear to raise competition concerns.
22. Internal documents obtained from the parties do not indicate that the joint venture intends to price discriminate in favour of the Punch estate (or its tenants). Consistent with the parties' public statements, the internal documents suggest that the Joint Venture Companies will attempt to obtain more retail market share through lower distribution costs to all customers. The ability for on-trade customers to switch to alternative suppliers if they perceive that they are obtaining less favourable trading terms means that, even if the joint venture had the ability to offer preferential trading terms to the Punch estate, there would be no incentive to do so.

### **Access to confidential information**

23. As Constellation provides Punch's competitors with alcoholic and non-alcoholic beverages it is argued that Punch will therefore be aware of prices paid by competitors and volumes purchased. While this information may have some commercial value, it is unclear that access to this commercially

sensitive information would give Punch a significant competitive advantage over its retail competitors.

24. As with the concern regarding preferential trading terms, even if the joint venture possesses the ability to access confidential information it is not clear that there is any incentive to pass this information onto Punch. Punch's competitors would move their business away from the Joint Venture Companies to other wholesalers if they believe that this is occurring.

### **THIRD PARTY VIEWS**

25. There were a number of vertical concerns expressed regarding the merger, the primary concerns having been dealt with above. Another concern raised was that Punch would use the joint venture to increase the ties it currently has on its leased pubs, or otherwise foreclose access to the Punch estate. At present, the vast majority of tenants (more than [85-95] percent) are not obliged to source wine and spirits from Punch, although Punch tenants are obliged to buy beer from Punch. However, the OFT found no evidence to suggest that Punch would seek to increase ties following the joint venture.
26. Another third party was concerned that the joint venture will restrict the choice of wine available to Punch tenants, and hence the availability of wine to consumers. However, Punch accounts for a very small proportion of the market for the on-trade supply of wine, and Punch tenants are not generally required to purchase wine directly from Punch. Hence, the joint venture is not likely to raise any issue as to the choice of wine available at on-trade premises.
27. A number of third parties were unconcerned about the merger, and in particular there were very few concerns from third parties at the retail level.

### **ASSESSMENT**

28. The transaction concerns a joint venture between Punch and Constellation, involving the wholesale supply of alcoholic and non-alcoholic beverages to the on-trade. While the parties do overlap in the wholesale supply of

alcoholic and non-alcoholic beverages, Punch's activities are restricted to the supply of its own (managed and tenanted) pubs. As a consequence, the increment for the wholesale supply to the on-trade is relatively small, and the merger does not raise competition concerns on a horizontal level.

29. A number of third parties had concerns regarding the vertical effects of the merger. These concerns included an increase in the parties' purchasing power, the possibility of the joint venture offering preferential trading terms to the Punch estate and access by Punch to its competitors' confidential information. However, the OFT generally considers that vertical concerns are unlikely except in the presence of existing market power at some level of the supply chain, or where there are already significant vertical integration restraints. In the current case, the joint venture will not result in market power at either the wholesale or retail level. As such, the OFT does not consider that the joint venture will raise competition concerns on a vertical level.
30. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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