

Response to CAMRA's super-complaint

October 2009

OFT1137

© **Crown copyright 2009**

This publication (excluding the OFT logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as crown copyright and the title of the publication specified.

CONTENTS

Section	Page
Executive Summary	4
1. Introduction	14
2. Previous assessments of the UK pub sector	18
3. Overview of supply chain	27
4. Barriers to entry at the brewing level	39
5. Impact of tied lease agreements at retail level	47
6. Restrictive covenants	70
7. Technical services	75
8. Possible outcomes	79

EXECUTIVE SUMMARY

Background

On 24 July 2009, the Campaign for Real Ale ('CAMRA') submitted a super-complaint to the Office of Fair Trading ('OFT') regarding the UK pub industry (the 'super-complaint').

A number of the issues raised in the super-complaint relate to the operation of exclusive purchasing obligations by pub-owning companies ('pub companies')¹ which require their tenant or lessee (both are referred to in this response as the 'lessee') to purchase beer and other drinks solely through the pub company (the 'beer tie'). CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK in relation to beer, and other drinks.²

The super-complaint refers in particular to the existence of 'serious market failures which create the wrong incentives for market participants' within the beer and pub market.³ The key issues that CAMRA recommended that the OFT investigates further are:

- the foreclosure of tied outlets to suppliers unable to access these outlets directly

¹ Pub-owning companies may be brewers which own pubs, or companies which do not have a brewing dimension and are not affiliated to a particular brewer.

² These companies are: Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle UK Limited, Greene King plc, Marston's plc and Trust Inns Limited.

³ Paragraph 1.5 of the super-complaint.

- the wholesale prices paid by tied pubs for beer and other tied drinks and the level of rent paid by tied lessees⁴
- the basis upon which rents for pub lessees are calculated
- barriers to entry at the retail level of the supply chain, particularly the use of restrictive covenants on the sale of premises by pub companies and the lack of free of tie premises available to prospective pub lessees, and
- arrangements for the provision of technical services equipment ('TSE') and technical services ('TS') in pubs.⁵

The super-complaint recommended that:

- the OFT should carry out a market study into the issues raised by CAMRA and, following this
- the OFT should consider making legally binding certain measures in the form of undertakings in lieu of making a market investigation reference ('MIR') to the Competition Commission ('CC'), and
- in the event that such undertakings cannot be agreed, the OFT should make a MIR to the CC.

⁴ Paragraph 1.3 of the super-complaint mentions the existence of exclusive purchasing obligations relating to other goods and services. Our assessment of the super-complaint has focused on the impact of supply ties relating to the supply of beer, given that this is the primary focus of the evidence provided in the super-complaint.

⁵ TSE is used to dispense draught beer and cider. TS comprises the installation and servicing of equipment, including maintenance and refurbishment, replacement and removal of equipment.

The super-complaint process

A super-complaint is defined under section 11(1) Enterprise Act 2002 ('EA02') as a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. CAMRA is a designated consumer body. Following the receipt of a super-complaint, the OFT has a statutory period of 90 days to respond to the super-complaint (see sections 1.5-1.7 below).

In considering the issues raised in the super-complaint, the OFT's focus is on whether effective competition can be expected to deliver choice and value to consumers within the beer and pub market. In markets where competition is working effectively, the OFT has no mandate to intervene in commercial negotiations of particular parties.

OFT assessment

Having considered the issues raised in the super-complaint regarding the operation of tied lease agreements, the OFT has not found evidence of competition problems that are having a significant impact on consumers.

At a national, regional and local level, the evidence indicates that there is a large number of competing pub outlets owned by different operators and that there is competition and a choice between different pubs. We consider that in a competitive market, any strategy by a pub company which compromises the competitive position of its lessees would not be sustainable, as this would be expected to result in sales and margin losses for the lessee and, in turn, for the pub company. To that extent, pub companies' commercial interests would appear to be aligned with the interests of their lessees.

Further, we do not consider that tied lease agreements prevent pub offering a wide choice to consumers. Generally, large pub companies source from a number of suppliers.

We are aware that some lessees are dissatisfied with the prices and rent

levels that they pay to their pub landlord, and/or with the rent assessment process more generally. We received a large number of submissions from individual pub lessees outlining such concerns.

Given the degree of competition between pubs and also between retail on-trade outlets more generally, we do not consider that issues relating to the negotiation process between pub companies and lessees can generally be expected to result in consumer detriment.⁶ As such, we consider that lessees' concerns regarding terms of supply, the conduct of negotiations with their pub company, or issues raised in the super-complaint regarding rental valuation methods used in the pub industry, are either matters for pub companies to address with individual lessees or are issues for industry or other relevant bodies to consider.⁷

Restrictions relating to the ongoing or future use of pub outlets which are imposed when those premises are sold ('restrictive covenants') can in certain circumstances give rise to competition concerns, but, on the basis of our assessment of the scale of this issue, we are of the view that any potential adverse effects on competition are not likely to be significant.

Overall, the OFT has reached a view that further investigation of competition problems within the beer and pub market is not warranted. In particular, we do not propose to undertake further investigation either in the form of a market study, or investigation under the provisions of the Competition Act 1998 ('CA98'). Further, we do not consider that the

⁶ We regard agreements between pub companies and their lessees as business-to-business contracts, and we have not considered further action under the OFT's consumer powers in response to these aspects of the super-complaint.

⁷ Since the super-complaint was made to the OFT, the British Beer & Pub Association has announced proposals for a revised Framework Code of Practice on the Granting of Tenancies and Leases. Further, the Royal Institution of Chartered Surveyors has published a report entitled: 'Pub Industry Forum Report and Recommendations' which sets out proposals for greater transparency regarding rent assessment methods used in the pub industry.

issues raised in the super-complaint warrant a reference to the CC under the market investigation provisions of the EA02 and as such, we would not be able to accept undertakings in lieu of making a MIR to the CC.⁸

A more detailed summary of our findings in relation to the issues raised in the super-complaint is set out below:

Impact of tied lease agreements at the brewing level

CAMRA argues that the cumulative impact of the operation of tied lease agreements by pub companies forecloses a substantial proportion of pubs in the UK to small brewers⁹ and other market entrants, as they are unable to supply to these pubs directly. The super-complaint also refers to a number of difficulties experienced by small brewers, including pub companies' requirements for minimum order quantities from brewers; the requirement to deliver to a centralised distribution network; and demands for unrealistic discounts on wholesale prices.

Having considered CAMRA's concerns, we have not found that tied lease agreements operated by large pub companies are foreclosing brewers seeking to secure access for the supply of beer to retail outlets, or prevent pubs offering a wide choice of drinks to consumers.

Small brewers appear to face significant scale and logistical difficulties in accessing wholesale and distribution markets. We do not consider that these difficulties result from the operation of tied lease agreements as such. Rather, these are issues inherent in smaller suppliers dealing with large retail chains with centralised distribution networks. Sales to the on-trade through a delivery scheme established by the Society of Independent Brewers indicates that there are market-led solutions to these issues.

⁸ As set out more fully in section 8, below.

⁹ The super-complaint defines small brewers as those producing less than 200,000 hectolitres of beer per annum.

Since 2004, there has been consolidation among national and regional brewers and we understand that their combined share of total volumes of beer supplied to the on-trade has increased. The market share of 'micro' brewers (those producing less than 60,000 hectolitres of beer per annum) has also increased between 2004 and 2008.

Wholesale prices and rents paid by tied lessees

CAMRA is concerned that because lessees are tied to a pub company for the supply of beer and/or other drinks, pub companies are able to charge excessive wholesale prices for beer/other drinks to their lessees. CAMRA suggests that pub companies are exploiting their position as a result of the tie, by increasing profits on sales of beer/other drinks to their lessees at the expense of their lessees' own profitability. CAMRA states that the beer prices and property rents charged by pub companies to their lessees together lead to higher retail prices in tied pubs; deprives tied lessees of the opportunity to invest in their pubs; leads to reduced levels of customer service; and ultimately leads to less choice for consumers as a result of pub closures.

The super-complaint refers in particular to: (i) retail beer prices increasing at a faster rate than wholesale beer prices (based on the Producer Price Index¹⁰) as evidence that pub companies are selling beer to their lessees at increasing margins and are not passing on the discounts that pub companies are able to negotiate with brewers; and (ii) retail beer prices being higher in tied pubs as evidence that tied pubs are paying higher beer prices than free of tie pubs and are passing these higher prices on to consumers.

In our assessment of the issues raised in the super-complaint, we have considered the competitive constraints faced by pub companies and, in

¹⁰ The Office of National Statistics Producer Price Index measures brewer prices and indicates changes in the prices that brewers charge for goods destined for the UK market (net of VAT and after discounts). These prices are an average across the on- and off-trade.

particular, whether the operation of tied lease agreements enables pub companies to act independently of competition in terms of the beer prices and/or rents charge to their lessees.

The evidence indicates that at a national, regional and local level, there is no significant concentration of pubs owned by an individual pub company and there is generally competition between a number of different pub operators. Further, we have not found evidence to suggest that pub companies are acting jointly to increase prices or rents for their lessees. In a competitive market, any strategy by a pub company which compromises the competitive position of its lessees would be expected to result in sales and margin losses for the lessee and, in turn, for the pub company.

In the last 10 years, retail prices have not increased at a faster rate than service sector inflation, which appears to be the appropriate measure of inflation relevant to increases in retail beer prices.¹¹ Although retail prices have increased at 10 per cent above the rate of brewery prices in the last 10 years, the evidence does not indicate that these increases are likely to be a reflection of pub companies increasing margins on sales of beer and other tied products to their lessees. Rather, the evidence suggests that the higher rate of increases in retail beer prices compared to brewery prices is the consequence of increased pub and service sector costs.

We have found marginal differences in the average retail prices for lager in tied pubs compared to free houses (we estimate that average retail prices for a pint of lager are 8 pence higher in tied pubs than in free houses, 3 pence higher for a pint of cider and at the same level for standard bitter prices).

Competition between pubs does not take place only on price. Customers look for a package of features when choosing a pub, which include the 'amenity' (for example, quality of surroundings and service), food

¹¹ Rather than RPI 'all goods' inflation, which is the measure referred to in the super-complaint. See further paragraph 3.23 below.

offering, value/prices, and choice of drinks offered by a particular pub. Given the degree of competition between pubs, we do not consider that differences in the average retail prices in tied, free of tie and managed pubs are likely to result from a lack of effective competition. Rather, these differences in average prices appear more likely to reflect many other factors that characterise the overall package of features offered by a particular pub. In addition, these average price trends disguise a significant variation in prices charged by different tied, free houses and managed pubs.

Rent assessment and the contractual relationship between pub companies and lessees

CAMRA has raised a number of concerns with the methodology and transparency of the 'profits valuation' approach to calculating a pub's rent, the use of upward-only rent reviews and the bargaining power of lessees in relation to their pub company landlord. Similar concerns were raised by the House of Commons Business and Enterprise Committee ('BEC') in its 'Pub Companies' report published in May 2009.¹²

Given the degree of competition between pubs, we do not consider that issues regarding the conduct of negotiations between pub companies and lessees, or specific issues regarding the assessment of rents, can generally be expected to result in consumer detriment. As we have noted above, in considering the issues raised in the super-complaint, the OFT's focus is on whether effective competition can be expected to deliver choice and value to consumers. In markets where competition is working effectively, the OFT does not have a mandate to intervene in commercial negotiations between particular parties.

We consider that individual lessees' concerns regarding the conduct of negotiations with their pub company and the assessment of rents are

¹² House of Commons Business and Enterprise Committee Seventh Report of Session 2008-09: 'Pub Companies', May 2009:

www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/26/2602.htm

either matters for pub companies to address with individual lessees or are issues for the industry and other relevant bodies to consider. These are not issues for the OFT to address or investigate further.

Restrictive covenants

CAMRA has argued that the imposition of restrictive covenants on the sale of a pub outlet by pub companies restricts competition in a local area, and removes a potential outlet for prospective pub lessees. CAMRA has also referred to barriers to entry at the retail level resulting from the planning and licensing regime, the lack of suitable premises for use as a pub, and also the lack of free of tie pubs available to prospective lessees.

We consider that in certain circumstances, the use of a restrictive covenant on the sale of a pub outlet may restrict or distort competition in a particular area. Restrictive covenants are most likely to give rise to anti-competitive effects where geographic markets are highly concentrated and localised, there are high barriers to entry and the number of suitable sites is limited.

Responses to the OFT's requests for information from the large pub companies which tie more than 500 pubs indicate that the use of restrictive covenants is not widespread in the pub sector. Further, certain of these pub companies have stated that they do not intend to impose restrictive covenants in future sales of pubs.

Given these factors, and in light of the degree of competition observed at the retail level, we do not consider that the potential impact on competition and consumers resulting from the barriers to entry referred to in the super-complaint (in particular the imposition of restrictive covenants by pub companies) is likely to be significant.

Our response to the super-complaint on this issue does not preclude further action being taken by the OFT in future in relation to the imposition of restrictive covenants, in particular if such practices become persistent and widespread.

Technical services equipment and technical services

CAMRA has argued that the bundling of prices for a barrel of beer with charges for TSE and TS results in ineffective competition for the provision of such services. CAMRA also states that charges for access to shared TSE represent a further barrier to entry or expansion for small brewers.

The OFT has previously considered the case for further action in this market under the MIR provisions of the EA02, in response to concerns raised by the CC regarding the same practice in its assessment of the acquisition by Serviced Dispense Equipment Limited of Coors' TS for dispensing draft beer and its TSE assets.¹³ We subsequently concluded that there were no grounds for a MIR to the CC in relation to the supply of TSE/TS.¹⁴ We also noted that we had not received any complaints about the provision of TSE/TS and that the provision of TSE/TS would be likely to have a relatively minor impact upon the cost of beer to consumers.

In terms of CAMRA's concerns regarding charges by pub companies to small brewers for the use of TSE/TS for cask ale provided by other suppliers, the evidence does not indicate that this issue represents a significant barrier to entry or expansion for small brewers.

¹³ Competition Commission: 'A report on the proposed acquisition by Serviced Dispense Equipment Limited of the Technical Services Function of Coors Brewers Limited', paragraph 37.

¹⁴ OFT Press Release: Supply of Beer, 20 July 2005:
www.offt.gov.uk/news/press/2005/beer

1. INTRODUCTION

Issues raised in the super-complaint

- 1.1. On 24 July 2009, the Campaign for Real Ale ('CAMRA') submitted a super-complaint to the Office of Fair Trading ('OFT') regarding the UK pub industry.
- 1.2. A number of the issues raised in the super-complaint relate to the operation of exclusive purchasing obligations by pub-owning companies ('pub companies')¹⁵ which require their tenant or lessee (both are referred to in this response as the 'lessee') to purchase beer and other drinks solely through the pub company (the 'beer tie'). CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK in relation to beer, and other drinks.¹⁶
- 1.3. The key issues that CAMRA recommended that the OFT investigates further are:
 - the foreclosure of tied outlets to suppliers unable to access these outlets directly
 - the wholesale prices paid by tied pubs for beer and other tied products and the level of rent paid by tied tenants lessees
 - the basis upon which rents for pub lessees are calculated

¹⁵ Pub-owning companies may be brewers which own pubs, or companies which do not have a brewing dimension and are not affiliated to a particular brewer.

¹⁶ These companies are: Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle UK Limited, Greene King plc, Marston's Pub Company plc and Trust Inns Limited.

- barriers to entry at the retail level of the supply chain, particularly the use of restrictive covenants on the sale of premises by pub companies and the lack of free of tie premises available to prospective pub lessees, and
 - arrangements for the provision of technical services equipment ('TSE') and technical services ('TS') in pubs.¹⁷
- 1.4. CAMRA's super-complaint focuses on the conduct of large pub companies which tie more than 500 pubs in the UK.¹⁸
- 1.5. The super-complaint made the following specific recommendations to the OFT:
- that the OFT should carry out a market study into the issues raised by CAMRA and, following this
 - the OFT should consider making legally binding certain measures in the form of undertakings in lieu of making a market investigation reference ('MIR') to the Competition Commission ('CC'), and
 - that if such undertakings cannot be agreed, the OFT should make a MIR to the CC.

The super-complaint process

- 1.6. The right to submit a super-complaint was created by section 11 of the Enterprise Act 2002 ('EA02'). A super-complaint is defined under section 11(1) EA02 as a complaint submitted by a designated

¹⁷ TSE is used to dispense draught beer and cider. TS comprises the installation and servicing of equipment, including maintenance and refurbishment, replacement and removal of equipment.

¹⁸ Enterprise Inns plc, Punch Taverns plc, Admiral Taverns Limited, Scottish & Newcastle Pub Enterprises, Greene King plc, Marston's plc and Trust Inns Limited.

consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. CAMRA is a designated consumer body.¹⁹

- 1.7. Section 11(2) EA02 requires the OFT, within 90 days after the day on which it receives a super-complaint, to publish a response saying whether it has decided to take any action, or take no action, in respect of the complaint and, if it has decided to take action, what action it proposes to take. The response must state the reasons for the OFT's proposals (section 11(3) EA02).
- 1.8. This document represents the OFT's response to the specific issues which are explicitly referred to in the super-complaint. We do not comment in this response on any wider issues affecting the pub industry.
- 1.9. We note that paragraph 5.8 of the super-complaint mentions the existence of exclusive purchasing obligations in relation to wine, spirits, games machines and insurance products. Given that the focus of the issues raised and the evidence presented in the super-relates primarily to beer, our response to the super-complaint focuses on the supply of beer in pubs.

Information gathering

- 1.10. In accordance with the focus of the super-complaint, the OFT's approach to information gathering has focused on the conduct of pub companies (both brewers and non-brewing pub companies, together referred to in this document as 'pub companies') which own more than 500 leased pubs in the UK that are 'tied' for the purchase of beer and/or other drinks.

¹⁹ Pursuant to UK Statutory Instrument 2005 No.2340, The Enterprise Act 2002 (Bodies Designated to make Super-complaints) (Amendment) Order 2005.

1.11. As part of our information gathering process, we have received responses to our information requests from stakeholders at all levels of the supply chain, including:

- pub companies which tie more than 500 pubs in the UK
- pub companies which own more than 500 free of tie pubs or managed pubs
- national brewers
- the Society of Independent Brewers (SIBA) and the Independent Family Brewers of Britain (IFBB)
- a major industry wholesaler
- a number of different industry associations and trade bodies, including the British Beer and Pub Association (BBPA), British Institute of Innkeeping (BII), the Royal Institution of Chartered Surveyors (RICS), the Association of Licensed Multiple Retailers (ALMR), the Federation of Small Businesses (FSB) and the Federation of Licensed Victuallers Associations (FLVA), and
- interest groups representing lessees including the Fair Pint Campaign, Justice for Licensees and the All Party Parliamentary Save the Pub Group.

1.12. We have also conducted meetings with a number of parties that have made submissions to us in response to our requests for information.

1.13. The OFT has received a number of submissions from interested parties who did not receive an information request from the OFT, including individual licensees. These submissions have been considered in the context of our information gathering process, although we are unable to respond to the specific facts or circumstances of the submissions provided to us by individual lessees.

1.14. We have also conducted background research and drawn upon previous reports and case law regarding this sector.

2. PREVIOUS ASSESSMENTS OF THE UK PUB SECTOR

- 2.1. The supply of beer in the UK and the operation of tied lease agreements have been the subject of a number of previous assessments in the UK and also by the European Commission and European courts.

Monopolies and Mergers Commission report, 1989

- 2.2. In 1989, a report by the Monopolies and Mergers Commission (MMC)²⁰ (under the Fair Trading Act 1973, which preceded the EA02) highlighted concerns regarding the vertical links between the brewing and retailing levels of the supply chain, at a time when brewers owned around 75 per cent of the public houses in Great Britain and specified which beers should be sold in those pubs (usually those of the brewer itself) under the terms of the lease. Around half of the 25 per cent of pubs that were not owned by brewers at that time were subject to 'loan ties', where a brewer offered a loan to the owner of the free house pub at below market rates of interest in return for the free house owner purchasing beer or other drinks exclusively from the brewer, or committing to a minimum purchase requirement.
- 2.3. The MMC noted in particular that in many towns and rural areas, one or two brewers owned a large proportion of public houses and therefore choice and competition was limited.²¹

²⁰ MMC report: 'The Supply of Beer: A report on the supply of beer for retail sale in the United Kingdom'

www.competition-commission.org.uk/rep_pub/reports/1989/245beer.htm#full

²¹ Paragraph 12.26 of the MMC report summarises the MMC's findings that in over half of the 'Petty Sessional Divisional' licensing areas in Great Britain, an individual brewer owned at least 25 per cent of all full on-licensed premises; in 29 per cent of such areas a brewer owned over a third of full on-licensed premises; and in six per cent of such areas, a brewer owned 50 per cent of full on-licensed premises.

- 2.4. The MMC found that a 'complex monopoly' existed between the brewers who operated tied lease agreements and loan ties and that these practices restricted competition because this prevented other brewers and wholesalers from supplying beer to those outlets and also prevented those outlets from responding to consumer demand for different brands/products.
- 2.5. The MMC found that the brewers' complex monopoly gave rise to higher wholesale prices than would have been the case if there had been greater competition between brewers, and that the higher wholesale prices would inevitably feed through into higher prices at the retail level.
- 2.6. The MMC found that consumer choice of beer and non-beer drinks within outlets owned by national and most regional brewers was limited, because practically all draught beer on sale in those outlets would have been produced by the brewer itself. The MMC found that brewer-owned or loan-tied premises would not be able to respond fully to consumers' demands for products and this would have particularly serious effects in particular localities of high concentration where an individual brewer or a small number of brewers owned a large proportion of retail outlets.
- 2.7. Further, the MMC stated that the lack of security of tenure for short-term tenants and the lack of an enforceable code of practice made it possible for brewers to limit the independence of their tenants and reinforce their position of economic strength in relation to their tenants.
- 2.8. The MMC made a number of recommendations which aimed to reduce the extent of vertical integration between the brewing and retail levels of the supply chain and to facilitate market access and increased competition between competing brewers, wholesalers and retailers.

2.9. The MMC report led to the Beer Orders,²² which placed a cap on the number of tied pubs owned by brewers owning more than 2,000 tied pubs. This cap on the number of tied pubs owned by brewers resulted in the disposal of around 11,000 pubs by brewers, mostly to independent pub companies not affiliated to a particular brewer. In addition, a 'guest beer' provision was introduced, pursuant to which brewers' tied and loan-tied lessees were permitted to source one brand of cask-conditioned beer outside of the tie and, by a later Order made in 1997,²³ one brand of bottle-conditioned beer from any supplier.

OFT report into the Supply of Beer, 2000

2.10. The OFT's 2000 report into the Supply of Beer²⁴ considered whether the existence of the Beer Orders was still justified. We found that as a result of the Beer Orders, a third of pubs in the UK had been transferred into the ownership of large pub companies and these pub companies had acquired a degree of countervailing buyer power in relation to the national brewers. Further, a decline in the overall volume of beer supplied in the UK, together with the increased buyer power of pub companies, had forced consolidation between brewers at both the national and regional level. We noted that independent wholesalers had not grown as anticipated as a result of the Beer

²² Statutory Instrument 1989 No.2390, The Supply of Beer (Tied Estate) Order 1989: www.opsi.gov.uk/si/si1989/Uksi_19892390_en_1.htm and Statutory Instrument 1989 No. 2258, The Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices) Order 1989: www.opsi.gov.uk/si/si1989/Uksi_19892258_en_1.htm).

²³ Statutory Instrument 1997 No. 1740, The Supply of Beer (Tied Estate) (Amendment) Order 1997: www.opsi.gov.uk/si/si1997/19971740.htm

²⁴ The Supply of Beer, December 2000, OFT 317: www.of.gov.uk/shared_of/reports/comp_policy/oft317.pdf.

Orders and national brewers still distributed the vast majority of beer sold to the on-trade sector.²⁵

- 2.11. We also found that increased buyer power at the retail level was contributing to a reduction in beer wholesale prices, although this was not matched by a decrease in the average retail price of beer in the on-trade. We found that above inflation retail price increases did not necessarily imply a failure of competition at the retail level and considered that these price increases could relate to improvements in amenity offered by pubs. We also noted that average retail prices disguised a considerable increase in the range of prices offered to consumers, and that consumers had a greater choice between different price/amenity combinations at the retail level.
- 2.12. We concluded in 2000 that the market for the supply of beer was very different at all levels of the supply chain compared to the 1980s and we recommended that many provisions of the Beer Orders should be revoked. The Beer Orders were repealed in their entirety in 2003.

Trade and Industry Committee report, 2004

- 2.13. The House of Commons Trade and Industry Committee ('TIC') 'Pub Companies' report of December 2004²⁶ investigated concerns regarding the extent to which the ownership of pubs in the UK was becoming concentrated in the hands of large pub companies and the operation of the tied model relationship between pub companies and their lessees. The report considered, in particular, the beer tie as

²⁵ That is, pubs, clubs, restaurants and other licensed premises where provision is made for the sale and consumption of alcoholic drinks on the premises.

²⁶ House of Commons Trade and Industry Committee Second Report of Session 2004-05 'Pub Companies', December 2004:
www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/128/12802.htm#evidence.

enforced by pub companies, and the basis on which pub rents were calculated.

- 2.14. The OFT made a submission to the TIC, which referred to the case law noted at paragraph 2.26 below and noted that we would take into account the application of European Community ('EC') law when applying provisions of UK competition law to similar questions raised under it. We also noted that a remedy could not be imposed under UK competition law (either the Competition Act 1998 ('CA98') or the EA02) if that remedy were inconsistent with the treatment of corresponding questions under EC law.
- 2.15. We concluded that action under the prohibition of anti-competitive agreements under Chapter I of the CA98 and the prohibition of abuses of dominance under Chapter II of the CA98 (which are both closely modelled on the equivalent prohibitions under Articles 81 and 82 of the EC Treaty) did not appear to be justified. We also considered that there was no case for action under the market investigation provisions of the EA02.
- 2.16. The TIC found that there was 'scope for eliminating the root causes' of contractual disputes²⁷ between pub companies and their lessees, in particular, recommending that the way that rent is calculated and the rights and obligations on both parties should be more transparent to potential tenants/licensees. The TIC also called upon pub companies to remove upward only rent reviews and recommended that rents should be reasonable and sustainable.
- 2.17. The TIC also recommended that the pub companies' voluntary codes of practice should be strengthened in areas including: rent reviews; the role of business development managers; fair and equitable complaint handling and dispute procedures; the disclosure and the availability of relevant information regarding rent assessment; and the need for prospective lessees to obtain legal and professional

²⁷ The TIC report on 'Pub Companies', December 2004, page 3.

advice before entering into lease agreements. The TIC did not consider that a legally binding code of practice was necessary but recommended that, if the industry did not adopt an adequate voluntary code, the Government should impose a statutory code.²⁸

OFT assessment of the technical services equipment and technical services market in 2005

2.18. In 2005 the CC blocked the acquisition by Serviced Dispense Equipment Limited ('SDEL') of Coors' TS for dispensing draft beer and TSE assets. In its report on the proposed acquisition, the CC suggested that the OFT should consider making a MIR to the CC in relation to the supply of beer to retail outlets, with specific reference to the market for TS and TSE.

2.19. The OFT subsequently examined the case for a making a MIR to the CC relating to the narrow market for TS and TSE. The OFT found that neither a narrow market investigation or a wider market investigation relating to the supply of beer in the UK were warranted.²⁹

Business and Enterprise Committee report, 2009

2.20. The House of Commons Business and Enterprise Committee ('BEC') reported in May 2009 on the relationship between pub companies (in particular those companies which operate a tied estate) and their lessees.³⁰

²⁸ In 2005, the BBPA published a Framework Code of Practice and this led to changes to companies' individual codes of practice.

²⁹ OFT press release dated 20 July 2005: www.oft.gov.uk/news/press/2005/beer.

³⁰ House of Commons Business and Enterprise Committee Seventh Report of Session 2008-09: 'Pub Companies', May 2009: www.publications.parliament.uk/pa/cm200809/cmselect/cmberr/26/2602.htm

2.21. The BEC report highlighted a number of concerns relating to the contractual relationship between pub companies and their lessees regarding the inequality of bargaining power between pub companies and their lessees, and the transparency of negotiations, in particular the assessment of rents.

2.22. In addition, the BEC was concerned that the operation of tied lease agreements was giving rise to competition problems and considered that a MIR to the CC was justified. The BEC considered that the position of market power exercised by brewers prior to the Beer Orders had been replaced by a powerful group of pub companies and that certain market conditions present at the time of the MMC report could be observed in the market today.

2.23. BEC referred to evidence which it considered to be an indication of a lack of effective competition in the retail market. In particular:

- the price of a pint of beer in pubs rising too quickly compared to brewery beer prices and compared to off-trade beer prices; and average prices per pint of lager being higher in leased pubs compared to managed pubs
- consumer choice being restricted because lessees are obliged to source from a pub company's approved list of suppliers rather than source directly from independent suppliers
- the weaker bargaining position of lessees compared to that of their pub company landlord and lessees being unable to negotiate discounts, guest ale provisions or lower rents, which would benefit consumers through lower prices and wider choice, and
- the pub market being foreclosed to small brewers who are unable to supply minimum volumes, discounts and logistics demanded by large wholesale and pub owning companies.

2.24. The BEC report also raised concerns about the pub companies' use

of restrictive covenants to prevent the continued use of premises as a pub and recommended that the Government make the use of such restrictions illegal.³¹

Consideration of tied lease agreements by the European Commission and European courts

2.25. The European Commission and the European courts have previously considered in detail under Article 81 EC tied pub lease arrangements that are operated in the UK.

2.26. The European Commission and European courts have concluded that the beer tie agreements between pub companies and their tied lessees do not infringe the prohibition of anti-competitive agreements within the meaning of Article 81(1) EC where pub companies (be they brewing or non-brewing pub companies) buy their drinks from a number of sources rather than predominantly from one source, or are not of a scale that would significantly contribute to the foreclosure of retail outlets to suppliers.³²

³¹ The BEC's conclusions are set out at paragraphs 193-194 of its report on 'Pub Companies', May 2009.

³² Case T-25/99 Roberts v Commission [2001] ECR II-1881 and European Commission decision of 29 June 2000 relating to a proceeding pursuant to Article 81 of the EC Treaty – Inntrepreneur/Spring OJ [2000] L 195/49, [2000] 5 CMLR 948. In Inntrepreneur/Spring, the Commission found that tied lease agreements were not caught by the provisions of Article 81(1) EC in circumstances where a pub company sourced a diversified portfolio of brands from national and regional brewers and the duration of contracts with supplying brewers (typically two to five years) were typically structured so that a proportion of purchases were retendered at frequent intervals. The Commission found that this multi-sourcing had the effect of mitigating rather than reinforcing any network effect of brewers' tied agreements in the UK on-trade beer market.

2.27. The European Courts and the European Commission have also previously found that tied lease agreements caught by Article 81(1) EC (on the basis that the agreements in question contributed to the foreclosure of on-trade outlets to other producers of beer) may fulfil the conditions for individual exemption set out in Article 81(3) EC, where the agreements in question lead to an improvement in the distribution of goods and provide countervailing benefits for tied lessees.³³

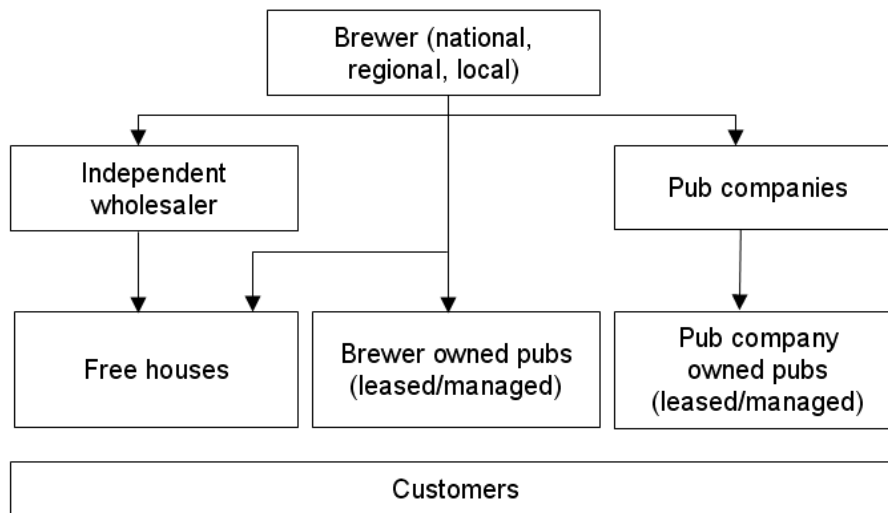
³³ See, for example: Case T-131/99 *Shaw v Commission* [2002] ECR II-2003, [2002] 5 CMLR 81; Case T-231/99 *Joyson v Commission* [2002] ECR II-2058, [2002] 5 CMLR 123; *Scottish and Newcastle OJ* [1999] L 186/28 [1999] 5 CMLR 831. In order to qualify for individual exemption under Article 81(3) EC, agreements must give rise to an improvement in the production or distribution of goods, allow consumers a fair share of the resulting benefit of an agreement, any restrictions on competition must be indispensable, and the agreement must not give rise to an elimination of competition in a substantial part of the relevant market.

3. OVERVIEW OF SUPPLY CHAIN

- 3.1. Pubs form part of the on-trade sector, which is comprised of premises which have a licence to serve alcoholic drinks for consumption on the premises, including outlets such as hotels, restaurants, clubs and cinemas.
- 3.2. The focus of this section, and of the response more generally, is the supply of draught beer to pubs in the on-trade.³⁴ Draught beer comprises both ales and lagers. Ales are a diverse group of beers which can be further sub-divided into cask-conditioned and keg ales, and tend to be regionally/locally produced. Lager is a more homogeneous product than ale, with a large proportion of sales attributable to international brand names.
- 3.3. The following diagram provides a simplified overview of the supply chain regarding the supply of beer to pubs in the UK. The section below provides a further outline of the brewing, wholesale and retail levels of the supply chain for the supply of beer to pubs.

³⁴ Draught beer is still the most popular type of beer consumed by on-trade customers in the UK, accounting for approximately 92 per cent of beer sales to the on-trade. Source: BPPA submission to the OFT.

Figure 3.1: UK supply chain for supply of beer to pubs



3.4. As demonstrated in Figure 3.1 above, brewers supply (either directly or indirectly) to a number of different pub outlets at the retail level of the supply chain:

- leased pubs – pubs which are owned by a landlord and are rented or leased to a pub tenant, who runs the pub as a stand-alone business and pays rent to the landlord
- managed pubs – pubs which are operated by a manager employed by a pub company, and where the pub company will set retail prices, and
- free houses - pubs owned on a freehold basis by the individual running the pub.

The supply of beer - brewing

3.5. There is no standard approach to sub-dividing different sizes of brewers operating in the UK. Brewers can be divided into the following groups, based mainly on the geographic coverage of their business:

- global/national brewers - brewers with operations in the UK which are owned by international companies, and brewers operating exclusively in the UK, who produce many of the major branded lagers present in pubs, bars and supermarkets
- regional brewers - brewers whose business is generally concentrated within a single area of the UK, with a proportion of production volumes being sold through the brewer's own pubs, and
- micro brewers - brewers whose production is typically focused on supplying to pubs and bars in a particular local area.³⁵

3.6. Table 3.2 below sets out shares of beer sales to the on-trade and off-trade³⁶ at the brewing level of the supply chain in 2008. This table demonstrates the degree of concentration at the brewing level of the supply chain, with the largest five brewers in the UK supplying around 89 per cent of beer to the on-trade and off-trade, by value of sales.

³⁵ BBPA's submission to the OFT categorised global brewers as brewers selling more than one million barrels of beer per annum, national brewers as brewers selling between 250,000 and 500,000 barrels per annum, regional brewers as those producing over 60,000 hls per annum (but less than 250,000 barrels) and micro brewers as those producing less than 60,000 hls per annum.

³⁶ The 'off-trade' sector is comprised of premises which have a licence to sell alcoholic drinks for consumption off the premises, including supermarkets and off-licences.

Table 3.2: Shares of beer sales by value across on-trade and off-trade (per cent), 2008

Brewer	Per cent
Scottish and Newcastle	30
Molson Coors	20
Inbev	20
Carlsberg	14
Diageo	5
Others (regional and local brewers)	11

Source: Key Note³⁷

- 3.7. As demonstrated by Table 3.3 below, the largest group of direct customers for brewers are pub companies which own pubs (which may be either managed or leased pubs) and are not affiliated to any particular brewer. A pub company which owns tied leased pubs acts as an intermediary, supplying beer at a margin to its pubs at a separately negotiated price; generally at the brewer's wholesale list price (less any discount) or at the pub company's own standard wholesale price list (less any discount).
- 3.8. Independent wholesalers also act as an intermediary, purchasing beer from a number of brewers and selling on to retail customers.
- 3.9. Brewers also sell beer directly to their own tied or free of tie lessees and directly to independent free houses.³⁸ Free of tie lessees and free house pubs do not generally receive the size of discounts from brewers that are offered to other larger purchasers such as pub companies and wholesalers, as they do not buy the same kinds of annual volumes.

³⁷ Key Note report: 'Brewers and the Beer Market', 2008.

³⁸ We note that a small proportion of free houses may still be tied for beer under a 'loan tie' arrangement with a national brewer, as set out in paragraph 5.50 below.

Supply of beer – retail level

Ownership of retail outlets

3.10. Table 3.3 sets out the total number of pubs in the UK according to the different type of ownership model, in 2009.

Table 3.3: Number of pubs in the UK by type of ownership (2009)

Ownership type	Number	Per cent
Non-brewing pub companies		
- leased	23000	41.6
- managed	6250	11.3
- total	31259	56.5
Free houses	17000	30.7
Brewing pub companies		
- leased	6750	12.2
- managed	2350	4.2
- total	9100	16.4
Total	55350	100.0

Source: Key Note³⁹

3.11. Approximately 54 per cent of pubs in the UK are leased pubs owned either by a brewing or non-brewing pub company. Around 15 per cent of pubs in the UK are operated as managed pubs by either a brewing or non-brewing pub company, and 31 per cent of pubs in the UK are free houses.

³⁹ Key Note Market Report: Public Houses 2009 (Publican data).

3.12. A small proportion of leased pubs are not tied to their pub company in relation to the purchase of beer and/or other drinks and therefore operate on a 'free of tie' basis.⁴⁰

Competition between pubs

3.13. Table 3.4 below sets out the sizes of the estates of the largest pub companies (both brewing and non-brewing companies) in the UK.

⁴⁰ A number of pub companies lease a very small proportion of their estate on a free of tie basis. Other companies, for example Wellington Pub Company, own estates which are leased entirely on a free of tie basis.

Table 3.4: number of pubs in the UK owned by pub company (2004 and 2009)

Pub company	Number of pubs 2004 (per cent of all pubs)	Number of pubs 2009 (per cent of all pubs)	Pub type
Punch Taverns	8300 (14)	8425 (15)	Leased and managed
Enterprise Inns	8575 (14)	7765 (14)	Leased
Mitchells & Butlers	2000 (3)	2050 (4)	Managed
JD Wetherspoons	650 (1)	715 (1)	Managed
Wellington Pub Company	850 (1)	850 (2)	Leased
Avebury Taverns	750 (1)	n/a	Leased
Spirit	2025 (3)	n/a	Managed
London and Edinburgh Inns	825 (1)	n/a	Leased
County Estate Management	1400 (2)	1195 (2)	Leased
Greene King	2075 (3)	2585 (5)	Leased
Marston's	2125 (4)	2250 (4)	Leased
S&N UK Limited	1500 (3)	2200 (4)	Leased
Total pubs (UK)	60000	55,300	

Source: Key Note⁴¹

3.14. The largest leased pub estates in the UK are owned by Enterprise Inns plc ('Enterprise Inns') and Punch Taverns plc ('Punch Taverns') (both non-brewing pub companies), each owning over 7,500 pubs, or 14-15 per cent of the total number of pubs in the UK in 2009. The largest brewer-owned leased pub estates are operated by Marston's Pub Company plc ('Marston's'), Greene King plc ('Greene King') and

⁴¹ Key Note reports: 'Public Houses', 2005 and 2009.

Scottish & Newcastle UK Limited (S&N UK Limited), which each own around 4-5 per cent of pubs in the UK in 2009.

3.15. The largest managed pub operator is Mitchells and Butlers plc which owns approximately four per cent of the pubs in the UK. JD Wetherspoon plc owns approximately one per cent of pubs in the UK in 2009.

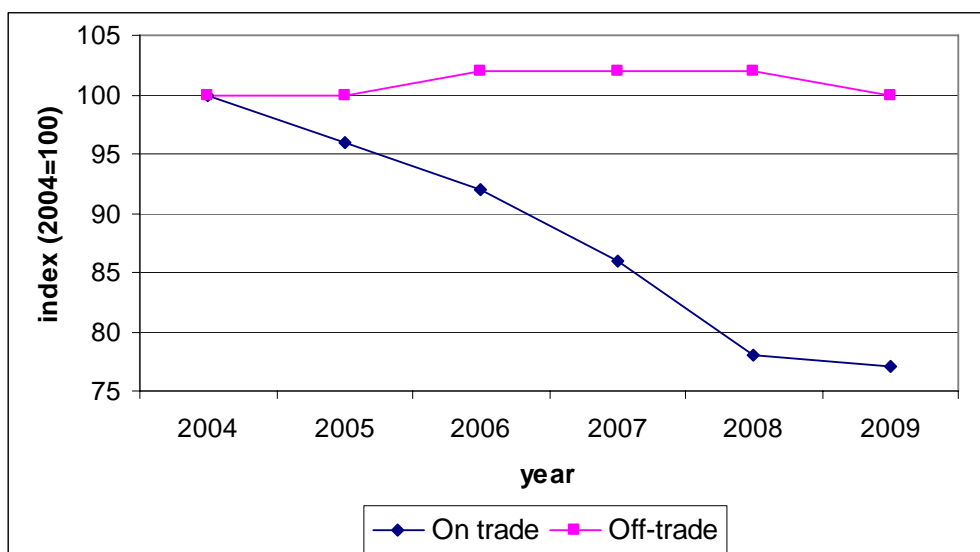
3.16. Pubs compete on the basis of a number of different factors which together form the overall 'experience' offered to customers. It has previously been found that factors such as the food offering, amenity and the convenience of the location of a particular pub rank highest among the most important factors from a consumer's view point in terms of determining choice of pub. Conversely, the range of drinks on offer and the price of drinks have previously been found to be of less importance to customers.⁴²

Sales trends since 2004

3.17. Since 2004, there has been a continuing decline in the volume of beer sales to the on-trade, which follows a period of declining sales over the last two decades. BBPA statistics show that on-trade sales of beer have fallen significantly year on year since 2004, while sales to the off-trade have been relatively constant over the same period, albeit with modest declines in 2008. These trends are illustrated in Graph 3.5 below.

⁴² As set out in a MORI survey, which was reproduced at Table 9 in Annexe E of our 2000 report on the Supply of Beer.

Graph 3.5: On-trade beer volumes (2004-2009)



Source: BBPA statistical handbook, 2009

- 3.18. Falling on-trade beer sales have coincided with increasing numbers of pub closures. According to the ALMR figures,⁴³ the net number of pub closures in the UK (the number of total pub closures, less the total number of pub openings) reached 1866 in 2008⁴⁴, an increase from 1409 in 2007 and 316 in 2006.
- 3.19. A number of parties commented on the range of pressures facing pubs, including the current economic climate, the impact of the smoking ban, competition from supermarkets, increases in duty, social and demographic changes and a trend towards drinking alcohol at home.⁴⁵

⁴³ ALMR evidence submitted to the BEC report on 'Pub Companies', May 2009: Volume II, Evidence 94, Appendix 1 (based on CGA pub opening and closing data).

⁴⁴ The figure presented for 2008 is our estimate, based on ALMR data to September 2008.

⁴⁵ See, for example, 'Pub Companies and Tied Tenants' FSB Policy Paper; pub company submissions to the OFT and the ALMR submission to the OFT.

3.20. An ongoing trend within the pub sector generally has been the growth of food sales within pubs. The value of food sales within pubs increased by around 33 per cent between 2003 and 2008, and now accounts for around 30 per cent of total pub turnover by value.⁴⁶ Over the same period the proportion of pubs' turnover that is accounted for by sales of alcoholic drinks has fallen from 55 to 48 per cent.⁴⁷

Beer prices

3.21. Between 1998 and 2008, the retail price of a pint of beer has increased by 38 per cent. Over the same period, the standard retail price index (RPI all goods) has increased by 32 per cent, whilst the RPI all services index has increased by 50 per cent.⁴⁸

3.22. We were told by a number of parties responding to OFT information requests that increases in retail on-trade prices have been driven by increases in duties on alcohol, utility and raw material costs, increases in business rates and Sky TV subscriptions, the costs of implementing legislative changes (such as the Licensing Act 2003 and the Health Act 2006), and above inflation increases in the minimum wage.

3.23. As we noted in our 2000 report on the Supply of Beer, it is more likely to be appropriate to compare retail price increases for beer to service sector inflation than to RPI all goods, as there is a significant service element in relation to the running of a pub.

⁴⁶ Mintel report: 'Pub Visiting', September 2008.

⁴⁷ Mintel report: 'Pub Visiting', September 2008.

⁴⁸ Source: Office of National Statistics ('ONS') data.

- 3.24. According to the 'Producer Price Index',⁴⁹ wholesale beer prices charged by brewers increased by 28 per cent between 1998 and 2008.
- 3.25. Between 1998 and 2008, off-trade prices fell by around 5 per cent. Although we note that the BEC report referred to the widening gap between off-trade and on-trade beer prices,⁵⁰ we do not consider the off-trade to represent a suitable benchmark for comparison with retail price increases in the on-trade, given the differences between the two retail channels, and in particular, the different costs of on- and off-trade operators. At paragraph 6.1 of the super-complaint, CAMRA notes that:

'The fact that the price of alcohol in pubs is substantially higher than the price of alcohol purchased in the off-trade reflects the provision of services beyond simply the supply of beer.'

The operation of tied lease agreements

- 3.26. Pub companies which own leased pubs operate different versions of the tied lease agreement and some companies offer a number of different types of tenancy or lease agreements. Different pub companies will tie different combinations of products, although lessees are generally tied in relation to the purchase of beer and cider, and are often tied to other products such as 'minerals' and flavoured alcoholic beverages. In some cases, lessees are able to choose whether to be released from the tie in respect of certain non-beer products.

⁴⁹ Source: ONS Producer Price Index MM22 June 2009. The Producer Price Index measures brewer prices and indicates changes in the prices that brewers charge for goods destined for the UK market (net of VAT and after discounts). These prices are an average across the on- and off-trade.

⁵⁰ At page 62 of the BEC report on 'Pub Companies', May 2009.

3.27. Although the precise nature of the obligations of the pub company and lessee will vary between agreements, there are two main types of tied agreement:

- short-term tenancies – agreements which are typically of a duration of three to five years, normally with an opportunity to renew the agreement, where the pub company will generally carry out repairs (or structural repairs at least) and the tenancy will not be assignable, and
- longer-term lease agreements – agreements which are typically for a duration of 10 to 25 years, pursuant to which a lessee would be required to carry out full repairs and decoration of the premises and the lease would generally be assignable. A lease agreement will therefore allow a lessee to build up goodwill in a property and achieve a return on their investment. This also provides an exit route for a lessee, who is able to assign the lease.⁵¹

3.28. Under the tied model, pub companies derive income from two sources:

- profit made on the wholesale price charged to lessees for tied products (also known as the 'wet rent'). For non-brewing pub companies this equates to the difference between the discounted wholesale price they pay to brewers, and the higher prices they charge to lessees, and
- the property rent charged to lessees, which is determined at the beginning of the agreement and is subject to review at fixed intervals (also known as the 'dry rent').⁵²

⁵¹ BBPA submission to the OFT.

⁵² BBPA submission to the OFT.

4. BARRIERS TO ENTRY AT THE BREWING LEVEL

Issues raised in the super-complaint

- 4.1. CAMRA is concerned that small brewers,⁵³ and other brewers seeking to gain access to wholesale and distribution markets for beer are unable to sell directly to tied leased or managed pubs, which together represent a large proportion of pubs in the UK (as shown in Table 3.4, above). The nature of the exclusive purchasing obligation within the tied lease agreement means that tied pubs are unable to purchase tied products from other suppliers, or, therefore, to negotiate different terms of supply with those suppliers.
- 4.2. In particular, paragraph 1.3 of the super-complaint states that the operation of tied lease agreements and other exclusive purchasing obligations means that suppliers are:
- 'denied independent access to tied pubs and this prevents, restricts or distorts competition by establishing a substantial barrier to market entry'.
- 4.3. In addition to the existence of tied lease agreements, CAMRA refers to a number of difficulties that such brewers experience in accessing the market, including:
- pub companies' requirements for minimum order quantities from brewers
 - the requirement to deliver to a centralised distribution network
 - demands for unrealistic discounts on wholesale prices, and

⁵³ CAMRA defines 'small brewers' at paragraph 11.1 of its super-complaint as brewers producing fewer than 200,000 hls of beer per year.

- the absence of a 'thriving' network of independent wholesalers, which is an additional means of distribution for small brewers.

4.4. The super-complaint refers to SIBA's Direct Delivery Scheme (DDS) which was developed as a way of facilitating supplies by small brewers to multiple retailers (that is, retailers owning a number of retail outlets, including pub chains and supermarkets). The DDS processes orders on behalf of small brewers, and is a single point of contact for multiple retailers and acts as a one-stop buying point that enables retailers to buy from over 350 small brewers which participate in the scheme. Small brewers who receive orders under the scheme deliver directly to a local outlet owned by a participating retailer.

4.5. CAMRA states that, while the DDS has had some success in improving market access for small brewers, it is not currently the solution to the difficulties faced by those brewers. CAMRA suggests that the success of the DDS can easily be limited by pub companies, either by:

- limiting the number of pubs within their estate which are allowed to participate in the scheme, or
- by adopting discriminatory pricing in respect of the terms on which small brewers' brands are supplied by the pub company to its tied pubs.

OFT assessment of issues raised in the super-complaint

4.6. In order to inform our response to the super-complaint, we sent information requests to pub companies which tie over 500 pubs in the UK regarding their distribution arrangements and the range of brewers supplying to their estate.

4.7. As part of our information gathering process, we have considered:

- the issues raised in the super-complaint regarding access to

downstream wholesale and distribution markets for the on-trade (in particular, the supply of beer to pubs), and

- market trends and factors affecting small brewers' sales in recent years.

Access to wholesaling and distribution

Economies of scale in brewing and distribution

- 4.8. Successful market entry or expansion in relation to the supply of beer to pubs by brewers is dependent on securing on-trade retail outlets for the supply of beer.
- 4.9. As noted in section 3 above, brewers supply to free houses directly, or through the distribution networks of independent wholesalers (many of which are regionally focused). Non-brewing pub companies generally outsource their distribution requirements to the national brewers (or their distribution arms). The national brewers operate centralised distribution networks and suppliers to these networks are required to deliver to central or regional depots, for onward distribution throughout the network.
- 4.10. As a result of their size, small brewers face difficulties in accessing the centralised distribution networks of tied and managed pub estates, because of the distance that they are required to travel to regional depots.
- 4.11. In addition, small brewers are generally unable to match the discounts offered by national brewers to pub companies because they do not benefit from the production and logistical economies of scale of larger brewers.
- 4.12. Some lessee groups told us that the price at which pub companies sell brands of small brewers' beer to their lessees means that the lessee is not able to sell the beer at a profit. On the other hand, we were told by some pub companies that they are prepared to accept

lower margins on the sale of small brewers' cask ale to their estate, because they consider that cask ale produced by small brewers is an important part of the competitive offering for certain pubs where there is consumer demand.

Minimum purchase requirements

- 4.13. Some pub companies told us that they require brewers supplying to their central distribution network to meet minimum volume requirements, in order to ensure that the pub company holds sufficient stocks of the product to meet the needs of its estate. We were told that this is particularly important for cask ales, which have a shorter shelf-life than other beers and thus are more prone to wastage.⁵⁴

Listing/marketing fees

- 4.14. Pub companies do not generally require fees from brewers in order to list their products. It is, however, common for pub companies to require contributions from brewers towards the costs of marketing, advertising or promotional support, or for a brewer to offer this. Such fees range from a fixed annual contribution from a brewer to a fee paid per barrel supplied to the pub company's estate. A number of pub companies stated that these fees are not a fixed requirement and are negotiated between the pub company and the brewer, in many cases depending on the brewer's marketing strategy.
- 4.15. SIBA told us that such marketing fees, whilst relatively significant to a small brewer, are generally considered by brewers to be part of the negotiation of wholesale prices with pub companies.

⁵⁴ Some pub companies noted within their submissions to the OFT that minimum order requirements are low compared to the volumes supplied by most brewers, and they did not consider that these requirements represented a material barrier to entry for smaller brewers.

Trends in sales by small brewers to the on-trade since 2004

- 4.16. The total number of breweries in the UK has increased from 500 in 2004 to 725 in 2008. The BBPA suggested in its submission to the OFT that given the consolidation between national and regional brewers over this period, a large proportion of this increase can be expected to be accounted for by market entry by smaller brewers.
- 4.17. This appears to be supported by SIBA's submission to the OFT, which stated that since 2004, the total volume of beer sales by small brewers producing less than 30,000 hls per year has increased by 50 per cent (and that the vast majority of these volumes are attributable to draught beer sold only to the on-trade).
- 4.18. In 2002, a system of relief from excise duty was introduced in the UK, which applies to brewers producing up to 60,000 hls of beer per annum.⁵⁵ A number of respondents told us that this relief has made a significant contribution to the growth of smaller brewers since its introduction.⁵⁶ HM Revenue & Customs data⁵⁷ indicates that volumes of production by brewers receiving Progressive Beer Duty relief are increasing. Brewers entitled to this relief produced 1.45 million hectolitres in 2008, an increase of 11.5 per cent since 2007.⁵⁸

⁵⁵ HM Revenue & Customs Reference Notice, 226 (August 2009) paragraph 8. Progressive Beer Duty was originally introduced by the Finance Act 2002 and was extended to apply to brewers producing no more than 60,000 hls per annum in the Small Brewers (Extension of Reduced Rates of Excise Duty) Order 2004.

⁵⁶ According to SIBA's 'Local Brewing Industry Report 2009', Small Breweries Relief has been crucial for smaller brewers' business development, allowing many of these brewers to purchase new equipment, invest in marketing and increase capacity.

⁵⁷ Source: BBPA's submission to the OFT.

⁵⁸ We were told by the BBPA that earlier figures are not comparable, due to a change of methodology by HM Revenue & Customs in 2006. Nevertheless, the BBPA considers it very likely that volumes of production by small brewers receiving duty relief have increased significantly since 2004.

Range of brewers sourced by pub companies

- 4.19. As stated above, non-brewing pub companies operating leased and/or managed pub estates offer access to a distribution network that is not tied predominantly to any one brewer and which provides an opportunity for a brewer to achieve national distribution of their brand(s). Brewing pub companies also source beer from a range of other brewers, although a proportion of the beer sold in their pubs will be supplied by their own brewery.
- 4.20. Generally speaking, pub companies' supply contracts with larger brewers are typically for a term of one to five years (although some are for up to 10 years) and supply contracts with smaller brewers are for significantly shorter terms.
- 4.21. We have found that pub companies which tie more than 500 pubs are sourcing from a range of national, regional and smaller brewers, either by sourcing through their centralised distribution networks, or through schemes such as the DDS (see below).
- 4.22. We were told by pub companies which tie more than 500 pubs that they generally do not enter into exclusive purchasing obligations or minimum purchasing commitments with brewers supplying to their estates. Two pub companies told us that they have entered into a minimum purchasing commitment with a national or regional brewer, but that these commitments are not capable of significantly restricting access to the pub company's estate of pubs by other brewers.
- 4.23. On the basis of pub company submissions, we estimate that pub companies which tie more than 500 pubs in the UK (including both brewers and non-brewing pub companies) purchased on average 7.8-8.1 per cent of total annual beer volumes sold through their estate from micro and regional brewers in 2008. We estimate that non-brewing pub companies purchased on average 9-9.6 per cent of their total annual beer volumes from micro and regional brewers in 2008. Micro and regional brewers supplied approximately 11.5 per cent of

total beer volumes sold to the on-trade in 2008.⁵⁹

- 4.24. Some pub companies also submitted evidence to us which showed a doubling of the volumes purchased from micro and regional brewers since 2004.

SIBA DDS

- 4.25. As mentioned above, the DDS enables small brewers who are SIBA members to deliver directly to pubs owned by participating multiple retailers. SIBA told us that its DDS was established because the majority of small brewers find supplying to the pubs of large pub companies difficult because they do not have the resources to deliver in large quantities to central or regional distribution depots.
- 4.26. Volumes of sales through DDS have grown annually since the beginning of DDS in 2003, although this is primarily due to participation in the scheme by three large pub companies. SIBA told us that total volumes of beer sales to the on-trade through the DDS have increased from 12,434 hls in 2005 to 49,359 hls in 2008.
- 4.27. SIBA told us that 95 per cent of total on-trade sales through the scheme in 2008 were to pub companies which own tied pubs and the remaining five per cent were to managed pub chains. SIBA also told us that the DDS can serve as a 'spring board' for a brewer to supply directly to a pub company.⁶⁰
- 4.28. Pub companies using the DDS told us that they will determine which pubs within their estate source through the DDS on the basis of a pub demonstrating that there is sufficient customer demand to

⁵⁹ Source: BBPA and pub company submissions to the OFT. Admiral Taverns was unable to provide data that separately highlighted purchases from national, regional and micro brewers.

⁶⁰ For example, SIBA told us that five SIBA members that began by supplying through DDS have secured independent supply contracts with pub companies.

generate sufficient sales volumes in order to maintain product quality (given the shorter shelf-life of cask-conditioned ale compared to other beers).

Conclusion

- 4.29. Having considered CAMRA's concerns, we do not consider that that tied lease agreements prevent pubs offering a wide choice for consumers, as we have found that large pub companies (both brewers and non-brewing pub companies) generally source drinks from a range of brewers.
- 4.30. Given the degree of competition between pubs, it would also appear to be in pub companies' best interests to supply particular products to their tied leased pubs where there is consumer demand, and at a price which enables the lessee to sell those products profitably.
- 4.31. As CAMRA has indicated in its super-complaint, smaller brewers face scale and logistical difficulties in accessing wholesale and distribution markets. However, we do not consider that these issues result from the operation of tied lease agreements. Rather, these difficulties are inherent in smaller suppliers dealing with retail chains with large-scale distribution networks. It should be noted that centralised distribution networks can themselves provide for efficiencies and lower prices for consumers and enable some brewers to achieve national distribution, thereby facilitating market entry. In addition, sales to the on-trade through the SIBA-run DDS indicates that there have been successful market-led solutions to the scale and logistical issues faced by small brewers.

5. IMPACT OF TIED LEASE AGREEMENTS AT RETAIL LEVEL

A. Wholesale prices and rents

Issues raised in the super-complaint

- 5.1. CAMRA states that as a result of the operation of tied lease agreements, pub companies are protected from competition in the supply of beer and other tied products to their pub estates and are therefore able to charge excessive wholesale prices to their lessees.
- 5.2. As evidence of this, CAMRA notes that although the discounts offered to pub companies by brewers have been increasing, these discounts are not being passed on to tied lessees. CAMRA suggests at paragraph 4.4 of the super-complaint that the OFT adopts a principle of ensuring that a tied lessee is 'no worse off' than a free of tie pub business as a way of ensuring that a 'fair share' of the benefits of a tied lease agreement (such as the discounts available to pub companies as a result of the large volumes of beer that they purchase from brewers) are passed on to their lessees in the form of lower prices for beer and other tied products.
- 5.3. CAMRA states that the higher prices for beer paid by tied lessees are being passed on to consumers in the form of higher retail prices in tied pubs. CAMRA adds that the prices for beer paid by tied lessees deprives tied lessees of the opportunity to invest in their pubs; leads to reduced levels of customer service; and ultimately leads to less choice for consumers as a result of closures of valued community pubs.
- 5.4. The super-complaint also states that the operation of tied lease agreements is inflating wholesale prices for beer (which would lead to higher retail prices). CAMRA refers to the OFT's previous assessment that large pub companies were driving down wholesale prices for beer and also to views that there is little pressure from pub companies to resist increases in beer list prices (upon which the price charged to lessees is based) because pub companies' discounts

increase pro rata with brewery list price increases.

OFT assessment of issues raised in the super-complaint

5.5. Although pub companies supply beer and other tied drinks exclusively to their lessees, we would not expect tied lease agreements to restrict competition to the detriment of consumers unless pubs face relatively low levels of competition in the downstream retail market. Otherwise, consumers could easily switch to alternative pubs in the event that a pub's 'offer' to consumers is no longer competitive (in terms of the amenity (for example, quality of surroundings and service), food offering, value/prices and choice of drinks). In considering the issues raised in the super-complaint, we have assessed:

- the concentration of pubs owned by different operators, and the competitive constraints faced by pub companies
- the rate of increases in the price of beer, and differences in the average prices of a pint of beer in different types of pubs
- whether there is evidence that tied pubs are being placed at a competitive disadvantage compared to free of tie pubs which is affecting competition in the supply of beer, and
- pub closure rates.

Competition at the retail level

5.6. For the purposes of responding to the super-complaint, we have considered the competitive constraints faced by pubs (and therefore, pub companies) at the retail level. In the on-trade sector, this involves considering the extent to which different types of premises selling alcoholic beverages compete directly and within which geographic areas.

- 5.7. CAMRA has argued that pubs form a discrete market as pubs do not compete directly with other on-trade outlets such as restaurants and clubs. CAMRA also states that competition between pubs takes place within relatively local geographic areas.
- 5.8. Our 2000 report on the Supply of Beer noted that there was an increased blurring in the distinction between pubs and other types of on-trade outlet as the types and ranges of on-trade offerings to consumers had increased in response to consumer demands. In our submission to the TIC in 2004 we referred to market reports⁶¹ which suggested that a significant proportion of visits to pubs were to eat a meal. We also noted that the degree of substitutability appeared to vary considerably between pubs and other on-trade outlets according to their individual characteristics. We did not reach any conclusions on market definition in 2004 on the basis of our conclusion of the extent of competition at the retail level, but we noted that there were at least significant doubts as to whether pubs form a discrete market.
- 5.9. We have considered the level of competition between pubs as the framework for our assessment, for the purposes of responding to the super-complaint. However, we have not needed to reach any conclusions on market definition and this does not necessarily preclude that pubs may compete in a wider retail market, including other on-trade premises.
- 5.10. Nevertheless, we note that pubs often position themselves within the retail market in order to attract a particular type of customer. While, in one area, food-led pubs may compete with local restaurants, in a neighbouring area, pubs which are drink-led may not compete with restaurants to the same extent.

⁶¹ OFT submission to the TIC report on 'Pub Companies', December 2004: Volume II, Ev 232, paragraph 6. Our submission referred to a Key Note report of April 2004 which indicated that, in 2002, 64 per cent of the occasions on which pubs were visited regularly were to eat a meal.

- 5.11. We noted in our 2000 report on the Supply of Beer that it was probable that local markets exist within the on-trade sector. However, we also noted that conditions of competition were likely to be similar across local markets due to the operation of retail pub chains across the country, the easing of entry restrictions at a local level, and the wider catchment areas of on-trade outlets, as seen in the development of town and city centre pubs across the country.
- 5.12. There is no entirely satisfactory basis for assessing competition between pubs at a sub-national level. In previous UK merger cases, the OFT has used the boundaries of local authority licensing areas (formerly known as Petty Sessional Divisions) as the most appropriate proxy for assessing local competition. The UK merger control regime has historically prevented acquisitions taking place which would result in a pub company owning more than 25 per cent of pubs within a local licensing area.⁶²
- 5.13. For the purposes of responding to the super-complaint, we have assessed the level of competition between pubs at the national, regional and local level in order to determine whether, on any basis, pub companies may own a proportion of pubs within the retail market which is consistent with a position of market power.
- 5.14. The evidence indicates that individually, pub companies do not generally own a large proportion of pubs within a particular locality and therefore appear to be constrained by a high degree of competition at the retail level.⁶³
- 5.15. At a national level, the largest pub companies, Enterprise Inns and Punch Taverns, own 14 and 15 per cent of the total number of pubs

⁶² Most recently, the OFT's decision dated 9 August 2004: Completed acquisition by Greene King plc of Laurel Pub Holdings Limited.

⁶³ We note that this situation differs from market conditions considered by the MMC in 1989, there existed a number of areas of significant concentration of a particular brewer's outlets (paragraph 12.31 of the MMC's report), see footnote 20 above.

in the UK respectively. The largest brewer-owned tenanted/leased estates each represent around 4-5 per cent of the total number of pubs in the UK.

5.16. Since 2004, there have been a number of acquisitions within the pub industry.⁶⁴ However, these acquisitions have not significantly altered the number of pubs owned by the largest pub companies, as demonstrated in Table 3.4 above.

5.17. For the purposes of our information gathering process, we considered local authority licensing areas and television broadcasting regions⁶⁵ as two possible frameworks for assessing competition between pubs at a sub-national level. Responses to our information requests indicated that no individual pub company which ties more than 500 pubs in the UK owns more than 22 per cent of pubs within any television broadcasting region in the UK. There are only three local authority licensing areas (of a total of 690 in Great Britain) where a pub company operating a tied estate owns more than 30 per cent of pubs.

5.18. At a more local level, we analysed a sample based on a total of 8000 pubs owned by one pub operator. The sample provided to the OFT considered a radius of one mile around pubs in city centre locations, a radius of two miles around pubs within other urban locations and a radius of five miles around pubs in rural locations.⁶⁶ The analysis

⁶⁴ The acquisition by Punch Taverns of Spirit Group Holdings Ltd (2006); the acquisition by Greene King of Laurel Pub Holdings Limited (2004); and the sale of 750 pubs by Avebury Holdings Limited to Punch Taverns and Marston's in 2005.

⁶⁵ On the basis that parties suggested that market data was available on this basis. We considered the following television broadcasting areas: London, South East, North East, North West, East Anglia, Midlands, Wales, Scotland and South West.

⁶⁶ A wider radius was used in rural locations on the basis of the assumption that customers are more likely to travel a greater distance between pubs in rural locations than in city centres.

showed that less than 0.1 per cent of pubs in the sample competed with less than three competing pubs owned by different operators. Taking a radius of only one mile around pubs in an urban location, around 4.7 per cent of pubs in the sample competed with three or less pubs owned by different operators. Overall, on the basis of this sample, it would appear that there is significant competition between pubs at a local level, although we would not rule out that there may be particular local areas which are more concentrated than those sampled.

- 5.19. In addition, there is no evidence to suggest that pub companies are jointly in a position to raise prices to their lessees. In particular, we have not been made aware of any evidence to suggest that there is transparency between pub companies in relation to the net price of tied products sold to lessees such that would enable them to co-ordinate price increases to lessees.⁶⁷
- 5.20. Moreover, other factors that might ordinarily facilitate co-ordination between different undertakings operating in a market, such as high market concentration or homogeneity of product offering, are not characteristics of this market.

⁶⁷ Paragraph 8.9 of the super-complaint refers to the provision of pricing data by CGA strategy as giving rise to increased transparency and providing a possible means for pub companies to co-ordinate price increases. We consider that beer prices charged by tied lessees to customers would not generally be expected to provide an accurate basis for determining the charges that competing pub companies charge to their lessees, and is unlikely therefore to facilitate co-ordination between pub companies.

5.21. Despite the current challenging economic conditions, there has been entry to the retail level of the supply chain through the opening of new pubs. Our estimates based on evidence presented by ALMR to the BEC, are that pub openings for 2008 totalled 537 (although there were 2,404 pub closures in 2008 and therefore net pub closures were 1,803).⁶⁸ Entry of new pubs into local markets could increase competition in specific areas, although we note that pub openings are more likely to be focused within urban and city centre locations where there are premises, such as shops, that are easier to convert into pubs.

5.22. Evidence provided to the OFT by pub companies which tie more than 500 pubs in the UK indicates that sales volumes per tied pub have fallen on average by 17 per cent between 2007 and 2009,⁶⁹ compared to an industry average fall in beer sales by volume of around 10 per cent over the same period.⁷⁰ To the extent that this is the result of customers switching between pubs, this also indicates that competition is strong at the retail level.

Pub company incentives

5.23. It is suggested in the super-complaint that pub companies would be able to earn greater profits from inflating prices to their lessees than from facilitating increased sales by their lessees through lower wholesale prices, and that therefore pub companies' incentives are not aligned with those of their lessees.

⁶⁸ ALMR submission to the BEC report on 'Pub Companies', May 2009: Volume II, Ev 94, Appendix 1 (based on CGA pub opening and closing data). Our estimates are based on ALMR data to September 2008.

⁶⁹ Source: figures regarding average of sales declines across estates owned by Enterprise Inns, Punch Taverns, Marston's, Trust Inns, Green King and S&N UK Limited.

⁷⁰ Source: Mintel report: 'Independent Pubs, Leisure Intelligence', 2009.

- 5.24. We do not consider that such a strategy would be sustainable in the context of this sector, where an individual pub company generally faces significant competition from other pub operators and where consumers benefit from significant choice.
- 5.25. If pub companies do not ensure that lessees are well placed to provide a competitive offer to customers, those pubs risk losing custom to other tied, free house and managed pubs in their locality. For these reasons, we do not consider that it would be sustainable for pub companies to charge prices to their lessees at a level that would compromise the competitive position of pubs within their estate.
- 5.26. Furthermore, we note that any strategy by a pub company which results in sales and margin losses for its lessees will, in turn, result in sales and margin losses for the supplying pub company. To that extent, pub companies' commercial interests would appear to be aligned with the interests of their lessees', and it would not appear to be profitable for pub companies to inflate their beer prices and rents charged to their lessees to a level that would undermine their lessees' ability to compete effectively.
- 5.27. We have not received evidence supporting the contention that pub companies are not incentivised to drive down the wholesale price of beer because they receive increased discounts from brewers in proportion to increases in wholesale list prices. Further, as noted above, it is apparent that pub companies do have an incentive to ensure that the prices it charges to its lessees enables lessees to competitively effectively with other pubs.⁷¹

⁷¹ We also note that certain pub companies sell to lessees at a separate list price, which we understand is typically below brewers' wholesale list prices. In these circumstances, there is no automatic correlation between increases in brewers' wholesale list price increases and the prices that pub companies charge to their lessees.

- 5.28. Some pub companies have stressed that they have a strong incentive to ensure that their lessees remain viable as, in the event that one of its pubs is unable to compete effectively and is forced to close, the pub company will incur significant costs. Such costs relate to securing and maintaining a closed pub, and can include: (i) lost sales during temporary periods of closure; (ii) the costs of refurbishment after vacancy; and (iii) debt write-off and loss of goodwill.⁷² As such, pub companies consider that it is not in their interests to allow their pubs to close.
- 5.29. Nevertheless, other parties noted that a significant proportion of these costs may be offset by substantial deposits retained by pub companies when lessees are unable to continue to trade ('lessee failure'). The overall cost of lessee failure to a pub company may therefore be offset to some degree.⁷³
- 5.30. Pub companies have also argued that their incentive to ensure that lessees remain viable is further demonstrated by the financial assistance that has been provided to lessees experiencing financial difficulties over the last year. Information provided to the OFT by pub companies which tie over 500 pubs in the UK regarding the estimated cost of providing non-contractual financial assistance to lessees suggests that the cost of providing such assistance to lessees was on average £3,000-4,000 per pub in 2009.⁷⁴
- 5.31. Some parties suggested that financial assistance is often made contingent on lessees agreeing to extend the products for which they are tied to the pub company. In such circumstances, the cost to pub

⁷² Source: pub company submissions to the OFT.

⁷³ Source: FSB submission to the OFT.

⁷⁴ This figure is an average of total payments made by pub companies which tie more than 500 pubs, divided by the size of their total estate. It does not represent an average of the payments made to lessees who actually receive financial support, which will be larger than this figure.

companies of providing support may be lower than the estimates provided.

- 5.32. There are clearly very different perceptions within the industry regarding the relationship between pub companies and their lessees and the impact of tied lease agreements. In the context of our assessment of the issues raised in the super-complaint, we have received around 70 submissions from pub lessees, many of whom raised concerns relating to prices for beer, also levels of rent paid to their landlord. FSB submitted research to the OFT which indicated that many lessees are dissatisfied with the tie.⁷⁵
- 5.33. Whilst we appreciate these concerns, we are unfortunately unable to comment on individual cases. Our analysis has focused more generally on whether the operation of tied lease agreements gives rise to a lack of effective competition, to the detriment of consumers.

Beer price increases

- 5.34. CAMRA refers to the following evidence in relation to its concerns regarding the impact of tied lease agreements on beer prices:
- the retail price of beer rising faster than brewery beer prices over the last ten years,⁷⁶ which CAMRA contends is an indication that pub companies are not passing on discounts received from brewers to their lessees and is attributable to increasing margins

⁷⁵ For example, 'Pub Companies and Tied Tenants': FSB Policy Paper; also we note the CGA Strategy survey annexed at Volume II of the BEC report on 'Pub Companies', May 2009.

⁷⁶ CAMRA refers at paragraph 8.10 of the super-complaint to an increase in the UK Producer Price Index (excluding duty rises) for beer of 31.8 per cent between April 1998 and April 2008, compared to an increase in the retail price index for beer on-trade sales of 39.4 per cent over the same period.

made by pub companies on the sale of beer and other tied drinks to their lessees, and

- the average pub price of a pint of beer increasing at a rate that exceeds the average increase observed for all drinks sold in the on-trade between 1990 and 2007.

5.35. As noted in the super-complaint, retail prices have increased at a rate that is 10 per cent above the increase in brewery prices (as measured by the Producer Price Index) since 1998. However, we do not consider that this is necessarily a result of pub companies increasing margins by charging inflated prices to their lessees.

5.36. Firstly, we noted above that the price of a pint of beer in pubs has not risen above service sector inflation since 1998 (see paragraph 3.21 above). Further, there have been greater increases in service sector inflation than RPI all goods inflation. This implies that: (i) service sector industries such as pubs may have experienced higher cost increases than other sectors of the economy; and (ii) increases in beer retail prices that are above brewery price increases may reflect increases in pub operating costs rather than increases in the beer prices charged by pub companies.

5.37. Secondly, although certain parties have provided evidence suggesting that the wholesale prices charged by pub companies to their lessees have increased significantly, the evidence does not indicate that net beer prices charged by pub companies to tied lessees (including discount) have risen at a significantly faster rate than brewery beer prices (measured according to the rate of increase in the Producer Price Index). On the basis of data provided by pub companies which tie over 500 pubs, between 2004 and 2008 the average net price for a barrel of beer charged by pub companies to tied lessees increased by 16 per cent,⁷⁷ whereas over the same period, prices charged by

⁷⁷ Source: pub companies submissions to OFT.

brewers, as measured by the Producer Price Index, for beer rose by 15 per cent.

- 5.38. This is supported by evidence that pub companies' gross percentage margins⁷⁸ on beer sales to tied lessees have not increased overall since 2004. Pub company estimates of average percentage gross margins on sales of beer to their lessees between 2004 and 2009 demonstrate that there were small increases in pub company margins to 2007, before margins fell to below 2005 levels in 2009 (year to date).
- 5.39. Overall, it is likely that the retail price of beer has risen at faster rate than brewery beer prices primarily as a consequence of increases in costs at the pub level of the supply chain, and not because of increases in the beer prices charged by pub companies to their lessees.

Beer prices in different types of pub outlet

- 5.40. The super-complaint refers to a price survey carried out by CAMRA⁷⁹ which shows higher average beer prices in tied pubs than in free of tie and managed pubs.
- 5.41. Our own analysis of average beer prices in different types of pub outlet has focused on the difference in average prices between tied pubs and free houses, rather than managed pubs.⁸⁰ Using CGA data,

⁷⁸ Gross margins are defined as sales revenues minus the direct cost of sales. We are aware that over the period of comparison a number of pub companies engaged in disposals and acquisitions of pubs. Gross margins may not therefore be comparable over time on a like for like basis.

⁷⁹ Referred to at paragraph 8.7 of the super-complaint.

⁸⁰ We do not consider managed houses to be an appropriate benchmark for pricing in tied pubs because managed pub outlets are often located in city centre locations and often provide very different offerings to those of 'local' pubs in urban and rural locations.

our comparison of the average retail prices charged by tied and free of tie pubs suggests that excluding tax and duty, average retail prices in tied pubs are 3.7 per cent (8 pence) higher than free houses for a pint of beer within the 'standard lager' and 'premium lager' categories; around 1-1.5 per cent (3 pence) higher for a pint of cider; and are the same for a pint of 'standard bitter'.⁸¹

- 5.42. Pricing within the pub sector has been the subject of considerable commentary and other parties have reached different conclusions in relation to price differentials between tied pub, free houses and managed pubs.⁸² All of these estimates appear to show a relatively small difference in the average retail prices charged in tied pubs and free houses. According to these estimates, the average price for a pint of lager in tied pubs is between 0-14 pence higher for a pint of lager, and 0-13 pence higher for a pint for bitter, when compared to free houses.
- 5.43. The difference in the estimates within these ranges highlights the difficulties in comparing average prices across all pubs or between different types of pub. A common issue relevant to all of these surveys is that they do not take account of factors which may affect prices across different pubs.

⁸¹ CGA Strategy, a marketing information company, conducts a quarterly pricing and distribution survey of about 5,500 premises licensed for on-trade sales, of which about 4,000 are pubs. The sample of pubs is designed to be representative by UK region, ownership group and outlet segment (such as 'circuit' pub or 'food' pub). Each pub in the CGA Strategy sample is classified into one of three outlet types: managed, non-managed (leased) and independent (free houses). The data covers only the four most popular brands of lager in the UK.

⁸² Including CAMRA's price survey annexed to its super-complaint (using CGA data), research carried out by GMB in 2009 using a sample of over 5000 pubs across 10 regions, BBPA pricing analysis set out in the BBPA statistical handbook 2009, and an analysis of pricing set out in a Numis Securities report: 'Travel & Leisure: Licensed Retail Sector Survival of the Fittest', 2008.

- 5.44. On the basis of the evidence regarding the degree of competition between pubs, we consider that higher average retail prices for beer in tied pubs could be explained by factors relating to the package of features offered by a particular pub, including levels of amenity (such as quality of surroundings, service) food offering, location,⁸³ and the range of drinks products offered) and are not likely to be attributable to a lack of effective competition, or to the tied model specifically.
- 5.45. Further, average retail prices disguise the variation in the range of prices offered by individual pubs. A GMB pricing survey submitted to the OFT⁸⁴ demonstrates that, within particular regions of the UK, there is significant variation between the average retail prices charged by pubs owned by different pub companies operating the tie. Further, the GMB survey shows that within eight out of ten of the regions considered, certain tied pubs are charging lower prices than the average price charged by pubs within that region.

Comparison of position of beer prices and rents paid by tied and free of tie tenants

- 5.46. We have considered whether the wholesale prices and rents paid by tied lessees are placing those lessees at a competitive disadvantage that can be expected to impact upon competition in the supply of beer and upon consumers.

⁸³ Either in terms of the convenience of a particular location from a customer's point of view, or the effect of the relative concentration of outlets in city centre, urban or rural locations within a particular region.

⁸⁴ Source: GMB submission to the OFT using CGA data relating to prices charged by managed, tied and free of tie pubs, covering the following regions: Norfolk, Suffolk, Cambridgeshire, Bedfordshire, Northamptonshire, North Essex, South Eastern Lincolnshire, Northern Hertfordshire and Northern Buckinghamshire.

- 5.47. It is widely acknowledged that tied lessees ordinarily pay a higher price for beer from their pub company landlord than free houses and free of tie lessees. However, past assessments⁸⁵ have found that the higher beer prices paid by tied lessees are generally reflected in a lower level of property costs. Therefore to understand the financial position of tied lessees, both elements must be considered.
- 5.48. We note that this analysis is characterised by various methodological difficulties, which mean that it can only be regarded as a basic approximation of the differences in costs faced by tied and free of tie tenants.
- 5.49. In particular, we are unable to ascertain whether the information available regarding tied and free of tie lessees is based on a comparable population of pubs, either in terms of the profit and turnover of the tied and free of tie leased pubs considered, the type of contract entered into (lease or tenancy) and the 'offer' of these pubs in terms of the various factors that consumers take into account when choosing a pub.
- 5.50. In addition, on the basis of submissions, we estimate that at least 20 per cent of free houses are subject to loan ties or exclusive purchase obligations directly with brewers, thereby limiting their ability to choose between the entire range of beers available across brewers.

⁸⁵ The OFT considered the effects of the differentials in the wholesale price of beer on competition between tied and free of tie pubs in 1995 and concluded that there were no grounds for a reference to the MMC – see OFT press release No 22/95, 16 May 1995. In a number of subsequent EU cases where brewers' beer tie agreements were considered to be caught by the provisions of Article 81(1) EC, the European Commission and European courts have considered the countervailing benefits of the agreements when assessing whether the criteria for exemption under Article 81(3) EC were met (see paragraph 2.27 above). The TIC report on 'Pub Companies', December 2004, also considered the competitive position of tied pubs and free of tie pubs, using the same approach established by the OFT and subsequently followed by the European Commission and European courts.

Comparing tied pubs against such pubs will not be a like-for-like comparison, as the range of drinks offered will differ significantly.

5.51. Notwithstanding these issues, our high level analysis indicates that the price charged by pub companies to tied lessees for draught beer is 40-45 per cent higher than the price paid for beer by free houses (taken as a proxy for prices paid by free of tie lessees) to the major UK brewers.⁸⁶ This equates to an average difference of around £19,000-21,000 per year per pub for beer.⁸⁷

⁸⁶ Estimated by comparing the average price charged by brewers to free of tie pubs to the average price charged by pub companies to tied lessees for 2006 to 2009. Source: submissions by pub companies and major brewers to the OFT. The average prices estimated for individual free houses may understate the prices actually paid (thereby exaggerating the difference between the prices paid by tied pubs and free houses). This is because it is not always possible for brewers to distinguish between the prices charged to individual free houses and prices charged to larger free trade purchasers.

⁸⁷ Consistent with past investigations, we have focused on draught beer sales in our assessment of the wholesale prices charged to tied pubs and free houses. In particular, we note that: (i) volumes of cider sales are unlikely to materially affect this calculation, given that draught cider sales amount to less than four per cent of beer sales in the UK by volume in 2008 (source: BBPA Statistical handbook 2009); and (ii) pub company submissions to the OFT indicates that the prices charged by those pub companies to their tied lessees and free of tie lessees for bottled beers, wines and minerals would not materially affect this calculation.

- 5.52. Pub companies which own tied pubs also generally take a share of the revenues derived from AWP machine income. Taking pub company revenues as a proxy for the payments made by lessees in relation to the AWP machine tie, we estimate that this tie costs tied lessees around £2,000-3,000 per year.⁸⁸
- 5.53. We considered the difference in property rents paid by tied and free of tie lessees. Estimates provided to us by certain pub companies tying more than 500 pubs and publically available data,⁸⁹ suggest that tied lessees benefit from rents that are approximately £10,000-12,000 per annum lower than for a free of tie lessee.⁹⁰ We also compared the rents paid by tied lessees to the property costs faced by free houses, based on previous assumptions that the property 'rents' of a free house pub are generally 15 per cent of total turnover.⁹¹ We estimate that on the basis of this assumption, a tied

⁸⁸ Some pub companies stated that AWP machine revenues are higher in pubs where a tie exists because there is a greater willingness to invest in higher quality machines. If this is the case, the actual cost of the AWP machine tie to lessees may be lower than the revenues generated by pub companies in relation to the income from AWP machines, such that the figure used in this analysis may overstate the cost of the AWP tie to tied lessees.

⁸⁹ Source: submissions to the OFT by pub companies which own more than 500 pubs; Wellington submission to the OFT; and the Fleurets Rental Survey, 2009. Wellington noted in submissions to the OFT that average rents within the Wellington estate included closed houses, those on temporary and short-term lettings and are not therefore representative of the average rent from the typical long-term free of tie Wellington lessee.

⁹⁰ Estimated by comparing the average rent of tied tenants against average rents of free of tie lessees for 2008 and 2009, on the basis of the evidence cited in the footnote above.

⁹¹ 15 per cent of turnover is the estimate of the property 'rents' of a free house that has been adopted previously (see footnote 85 above). We note that we have been unable to confirm whether the assumption that the property rents of a free house pub equate to 15 per cent of turnover is still accurate.

lessee would pay approximately £17,000 less in property rent per annum.

- 5.54. The evidence suggests that the property rent differential for tied lessees, free of tie lessees and free houses provides a considerable offset to the higher wholesale prices paid by tied lessees. In addition, tied lessees generally benefit from a range of support available from their landlord including, for example, buying discounts (for items other than drinks), business development assistance, such as training and legal support through a business development manager; investment; and centralised technical and compliance services. Pub companies have estimated that the annual financial cost of providing such benefits to their lessees is on average £6,000-8,000 per pub, per annum.⁹² The value of these benefits to lessees has been the subject of much debate and we note that different lessees may not receive the same level of benefits in each case. Given the subjectivity of this valuation, we have focused on the costs that pub companies incur in providing these benefits rather than on the estimated value of such benefits to tied lessees.
- 5.55. Pub companies also stated that that the flexibility of the tied model (which provides that an element of the 'rent' paid by a lessee to a pub company will decrease as sales volumes decreases) is itself a benefit to lessees in economic conditions where beer sales are declining.
- 5.56. Overall, and depending on which estimate of property rents is adopted, our estimates imply that there is either an overall relative cost advantage to tied lessees of around £1,500, or a relative cost disadvantage of around £4,500, compared to free of tie lessees.
- 5.57. As noted above, assessing the average beer prices and property costs paid by tied lessees, free of tie lessees and free houses involve

⁹² Source: pub company submissions to the OFT.

significant methodological problems⁹³ and this high level assessment should be viewed in conjunction with our more general conclusions regarding the sustainability of conduct by pub companies which would compromise the competitive position of their lessees.

Pub closure rates

- 5.58. We considered CAMRA's concern that the operation of tied lease agreements by pub companies is leading to less choice for consumers as a result of closures of valued community pubs.
- 5.59. This matter has been the subject of some commentary within the industry and both the ALMR and BBPA submitted evidence to the BEC enquiry, which suggests that, from 2007 onwards, the number of net pub closures (that is, the number of closures compared to the number of openings) by free of tie pubs are greater than net closures by tied pubs, when compared to the share of all pubs operated as free of tie and tied pubs in the UK.⁹⁴
- 5.60. It was suggested to us that the rates of pub closures does not take into account the rate of lessee failures and therefore does not provide a full picture of the impact of tied lease agreements on the financial position of tied pubs.⁹⁵ We have been unable to verify these

⁹³ In relation to the average dry rent assessment, we have been unable to determine whether the average tied and free of tie pub generates similar turnover and profits, such that this can be considered a suitable comparison.

⁹⁴ ALMR and BBPA submissions to BEC Report on 'Pub Companies', May 2009: Volume II, Ev. 94 and Ev.184. ALMR's research suggested that between 2003 and 2008 the number of pub closures within pub company and regional brewer estates accounted for approximately 46 per cent of all net pub closures, which is lower than the combined market share of tied pubs in the UK. In contrast, the decline attributable to the independent free houses was 37 per cent, which is higher than the market share of free house pubs in the UK. The BBPA submission stated that in 2009, 33 per cent of net pub closures in the UK were attributable to the leased/tied sector, compared to 55 per cent attributable to free house pubs.

⁹⁵ For example, Fair Pint's submission to the OFT.

concerns, because although information regarding lessee failure rates⁹⁶ and low levels of lessee profitability⁹⁷ is available for tied lessees, equivalent information is not available for free houses.

Conclusion

- 5.61. At a national, regional and local level, the evidence indicates that there is a large number of competing pub outlets owned by different operators and that there is competition and a choice between different pubs. On this basis, we do not consider that pub companies could sustainably charge prices for tied products and/or rents to their lessees at a level which would undermine their lessees' competitive position.
- 5.62. Further, the evidence suggests that increases in beer retail prices are more readily explained by increased pub and service sector costs, rather than pub companies increasing margins on sales of beer and other tied products to their lessees.
- 5.63. Given our assessment of competition at the retail level, we consider it likely that differences in the average prices of tied, free of tie and managed outlets are attributable to differences in factors such as levels of amenity (for example, quality of surroundings or service) food offering, location,⁹⁸ and the range of drinks products offered, rather than a consequence of a lack of effective competition between pubs. Indeed, the range of prices sustained by different pubs competing at the retail level also demonstrates that price is one of many factors for consumers in determining their choice of pubs.

⁹⁶ Source: Fair Pint and pub company submissions to the OFT.

⁹⁷ BEC Report on 'Pub Companies', May 2009: Volume II, Ev 304.

⁹⁸ Either in terms of the convenience of a particular location from a customer's point of view, or the effect of the relative concentration of outlets in city centre, urban or rural locations within a particular region.

5.64. We have found that, when beer prices paid by tied and free houses are taken together with estimates of property rents, there does not appear to be a significant difference in the overall costs faced by these different types of pub outlet. Further, as set out above, our conclusions in this respect should be viewed in conjunction with our assessment that in a competitive market any strategy by a pub company which compromises the competitive position of its lessees would not be sustainable.

B. Rent assessment and the contractual relationship between pub companies and lessees

Issues raised in the super-complaint

5.65. CAMRA has raised a number of concerns with the 'profits valuation' method of calculating rent that is used for pubs and which uses the anticipated profit of a hypothetical 'reasonably efficient' lessee as the basis for setting rent.

5.66. Specifically, CAMRA considers that:

- the methodology results in tied lessees paying rent at a level which does not take sufficient account of the higher beer prices they pay compared to free of tie pubs
- the estimation of the return of a reasonably efficient lessee under this method (and the lack of transparency of this assessment) enables pub companies to over-estimate the likely profits that a pub may generate, and therefore to inflate rents, and
- the use of upward only rent reviews, and the lack of an affordable dispute mechanism for lessees who are dissatisfied with the rent assessment further hinder tied lessees in their ability to secure affordable rents.

OFT assessment of issues raised in the super-complaint

5.67. The OFT received submissions from a number of pub lessees who considered that they were unfairly prejudiced as a result of the method of calculating rents used in the pub sector, because their rent did not adequately take into account the higher beer prices that they paid compared to free of tie pubs; others considered that the system of calculating rent linked to lessee turnover punished successful lessees.

- 5.68. We recognise that a number of lessees are dissatisfied with the outcome or conduct of negotiations with their landlord, and that rents or beer prices or rents may be higher than had been expected for certain lessees.
- 5.69. Given the degree of competition between pubs, we do not consider issues regarding the negotiation process between pub companies and their lessees, and/or the assessment of rents, can generally be expected to result in consumer detriment. As such, we consider that these are matters for pub companies to address with individual lessees, or are issues for industry and other relevant bodies to consider, rather for the OFT to address or investigate further.⁹⁹

⁹⁹ Since the super-complaint was made to the OFT, the British Beer & Pub Association has announced proposals for a revised Framework Code of Practice on the Granting of Tenancies and Leases. Further, the Royal Institution of Chartered Surveyors has published a report entitled: 'Pub Industry Forum Report and Recommendations' which sets out proposals for greater transparency regarding rent assessment methods used in the pub industry. We also note that in its report on the relationship between pub companies and their lessees, the BEC recommended that the Department for Business, Innovation and Skills (previously the Department for Business, Enterprise and Regulatory Reform) consider whether further action should be taken by Government regarding what the BEC considered to be an inequality of bargaining power between pub companies and their lessees, see paragraph 158, of the BEC report on 'Pub Companies', May 2009.

6. RESTRICTIVE COVENANTS

Issues raised in the super-complaint

- 6.1. The super-complaint sets out CAMRA's concerns that the use of restrictive covenants on the sales of pubs limits the future use of these premises and reduces competition within a particular area, leading to higher prices and reducing choice for consumers.
- 6.2. CAMRA suggests that the use of restrictive covenants reinforces existing barriers to entry at the retail level. In particular, CAMRA refers to the difficulties in entering the market at the retail level by opening a new pub, which include the need for planning and licensing approvals and identifying premises that can accommodate the unique requirements of a pub (for example, premises of a sufficient size and with a cellar).
- 6.3. CAMRA argues that the use of restrictive covenants is particularly problematic in areas where there are few free of tie pubs. CAMRA states that by removing an existing pub outlet, pub companies reduce a potential opportunity for market access by a free of tie operator and remaining pubs in the area are able to charge higher prices.¹⁰⁰

OFT assessment of issues raised in the super-complaint

- 6.4. In certain circumstances (see paragraph 6.5 below), the use of restrictive covenants on the sale of a pub has the potential to harm consumers. In particular, the use of restrictive covenants can act as a barrier to market entry for pub operators, which can limit competition within a particular area, potentially leading to higher prices and reduced choice and quality for consumers.

¹⁰⁰At paragraphs 14.1-14.4 and paragraph 16.5 of CAMRA's super-complaint, CAMRA illustrates this concern by reference to a case study relating to the use of a restrictive covenant on the disposal of a pub in a small town in England where only three pubs out of a total of 20 in the town are free of tie.

- 6.5. Restrictive covenants are most likely to give rise to significant consumer detriment where geographic markets are highly concentrated and where the number of suitable sites is limited (for example, as a result of the unique requirements of a pub, or due to licensing or planning restrictions).
- 6.6. The OFT has heard a number of arguments in relation to the rationale for the use of restrictive covenants. Some pub companies have suggested that restrictive covenants have been used where there is an over-population of pubs in a particular area; and in such circumstances, using a restrictive covenant on the sale of a pub may improve the viability of other pubs within that area. The BBPA has stated that historically, restrictive covenants have been used where there is persistent over-capacity in a particular area and that since the outlet concerned would have been unable to survive, the use of restrictive covenants would not have restricted competition. Some pub companies have told us that it is not their policy to support the permanent closure of pubs in locations with limited competition.
- 6.7. We asked pub companies which tie over 500 pubs in the UK to confirm what proportion of their pub disposals had involved the use of restrictive covenants since 2004. Generally speaking, these pub companies have invoked restrictive covenants in a relatively small proportion of pub disposals since 2004, if at all:
- S&N UK Limited and Trust Inns responded that, since 2004, they have not sold any pubs with restrictive covenants
 - Punch Taverns, Admiral Taverns, Greene King and Marston's told us that restrictive covenants were used in between one and five per cent of pub disposals since 2004, and
 - Enterprise Inns has used restrictive covenants in approximately 20 per cent of pub disposals since 2004.

6.8. Table 6.1 below sets out the number of restrictive covenants imposed on total pub disposals by pub companies which tie more than 500 pubs (which in some cases are estimates):

Table 6.1: pubs sold 2004-2009 and use of restrictive covenants

Pub company	Total number of pubs sold	Number of pubs sold with restrictive covenants	Per cent
Punch Taverns	3,000 ¹⁰¹	150	5
Enterprise Inns	2,002	374	19
Greene King	221	11	5
Admiral Taverns	1,000 ¹⁰²	50	5
Marston's	426	1	0.2

6.9. Recently, Punch Taverns and Enterprise Inns have stated publicly that they do not intend to impose restrictive covenants in relation to any future pub disposals.¹⁰³

6.10. In addition, Marston's stated in its submissions to the OFT that it has committed not to impose restrictive covenants on future pub disposals. Admiral Taverns has stated that it is reviewing its position regarding the imposition of such restrictions and it considers that it is a practice that is unlikely to continue.

6.11. We note that generally, we have found that there is no substantial concentration of pubs owned by individual pub operators at a national, regional, or local level, and as such, the use of restrictive

¹⁰¹ Punch Taverns stated that it has sold in excess of 3,000 pubs since 2004.

¹⁰² Admiral Taverns stated that it has sold in excess of 1,000 pubs since 2004.

¹⁰³ Enterprise Inns Media Brief June 2009: www.enterpriseinns.com/News/Articles/Documents/ETI%20Media%20Brief%20-%2024%2006%. Punch Taverns 2009 Preliminary Results: www.punchtaverns.com/NR/rdonlyres/93BB8A21-D271-4C87-94C8-0748B707F9A1/0/Prospectus.pdf

covenants would not generally be expected to result in a lack of choice or higher prices for consumers.

- 6.12. As noted above, it may be the case that factors such as planning and licensing restrictions, and the lack of suitable premises for use as a pub, may cause difficulties in opening new pub outlets in specific areas. Some respondents told us that the UK planning and licensing regimes¹⁰⁴ involve costs and there may be difficulties in obtaining licences and/or planning permission for new premises, particularly in town centres and in green belt areas.
- 6.13. There have been recent examples of new pub openings (see paragraph 5.21 above). Parties told us that these pub openings have been predominantly located in new residential areas, or have been food-led pubs located on the edge of towns, in town centres, in out-of town leisure centres and retail parks.¹⁰⁵
- 6.14. On the basis of the scale of the use of restrictive covenants by large pub companies, and our general assessment of the extent of competition at the retail level, we do not consider that the potential adverse effect on competition resulting from the use of restrictive covenants by pub companies is likely to be significant. For the purposes of this response, we have not therefore undertaken an analysis of the extent of competition in each particular area in which a restrictive covenant has been imposed by a pub company which ties more than 500 pubs in the UK.
- 6.15. We note that certain lessee groups also expressed concerns similar to those raised in the super-complaint that there is a lack of free of tie pubs available to prospective lessees, due to the structure of the market and the unwillingness of pub companies to make a range of

¹⁰⁴ We have not specifically considered the impact of the changes brought about by the Licensing Act 2003.

¹⁰⁵ It was noted, however, that such pubs are likely to be managed operations, given the high cost of construction.

different lease arrangements available to lessees. Parties argued that this acts as a significant restriction of the choice offered to new entrants into the retail market.

- 6.16. Given our conclusion that we consider that the retail market is broadly competitive and that the operation of tied lease agreements does not appear to be giving rise to competition problems, we do not consider that concerns regarding the perceived lack of free of tie pubs available to prospective lessees, or the difficulties experienced in certain areas in opening new pubs, warrant further consideration by the OFT.

Conclusion

- 6.17. We have found that restrictive covenants are not being used in a significant proportion of pub disposals by pub companies which tie over 500 pubs in the UK (and which are the focus of the super-complaint). Certain of these pub companies have recently stated that restrictive covenants will not be used in future. There also generally appears to be a high level of competition between pubs at a national, regional and local level and some parties have referred to the relative ease of opening new pubs in certain areas.
- 6.18. On this basis, it does not appear likely that the imposition of restrictive covenants by pub companies gives rise to a significant adverse effect on competition.
- 6.19. However, our response to the super-complaint, as outlined further in the 'Possible Outcomes' section, below, does not preclude further action being taken by the OFT in future in relation to the use of restrictive covenants, in particular if such practices become more persistent and widespread.

7. TECHNICAL SERVICES

Issues raised in super-complaint

- 7.1. The super-complaint refers to the practice of major UK brewers charging a single 'bundled' price in respect of the provision of TSE/TS and the supply of beer in pubs. CAMRA argues that price bundling has led to a situation where prices charged for TSE and TS are not reflective of the costs incurred in servicing specific brands or specific premises.
- 7.2. CAMRA also states that the charges made to small brewers for access to shared TSE in pubs owned by larger brewers and for the provision of TS act as a barrier to entry for small brewers.

OFT assessment of issues raised in the super-complaint

- 7.3. The practice of bundling the provision of TSE and TS with the supply of beer is a legacy of the vertical integration of brewers prior to the Beer Orders.
- 7.4. In the case of non-brewing companies, the provision of TSE/TS in their pubs is provided by a 'principal supplier' under the 'Four Brewers Initiative' ('FBI'). The FBI is an arrangement between major brewers for the ownership and servicing of TSE/TS in pubs, which followed from the vertical disintegration of the national brewers' on-trade activities after the Beer Orders. Under the FBI, the brewer with the most taps on the bar of a particular pub is identified as the principal supplier and owns the shared generic TSE¹⁰⁶ for lager and keg beer in that pub and also has responsibility for servicing the equipment.¹⁰⁷

¹⁰⁶ There are two main types of TSE for draught beer. Generic shared TSE is used to dispense any brand of beer, whereas branded TSE is specific to a particular brand of beer.

¹⁰⁷ Other brewers (such as Diageo) own the TSE for their particular brands and provide their own TS in respect of that equipment.

- 7.5. Other brewers pay a one-off charge for use of the TSE owned by the principal supplier, inclusive of service and maintenance. If the principal supplier changes or brands are switched in a particular pub, 'Must Buy Must Sell' arrangements ensure that generic TSE is sold to the incoming principal supplier or new brand owner.
- 7.6. Principal supplier arrangements do not apply in pubs owned by the regional brewers (such as Greene King and Marston's), who remain vertically integrated and own and service their own beer dispense equipment. When purchasing beer for their own estates, the regional brewers pay the major brewers an unbundled price that is exclusive of charges for TSE/TS.
- 7.7. TSE/TS regarding the supply of cask ale is subject to different arrangements for lager and keg beer, mainly because less equipment is involved, and generally cask ale brewers service equipment used to dispense their beer in a pub. In some cases, brewers supplying to a pub company's estate pay a charge of approximately £4.50-5 per barrel of beer in respect of TSE/TS provided by another supplier.
- 7.8. SIBA stated in a response to a request for information from the OFT that:
- 'although cask ale does not require [access to certain TSE], it does piggy back other [shared] equipment such as multiarc coolers and insulated pipelines. Small brewers have not had to pay for these capital items, so a £5 [per barrel] charge could be considered reasonable at the moment.'
- 7.9. SIBA also commented that because the continuity of sale of a brewer's beer is not guaranteed in a particular outlet, smaller brewers are reluctant to invest in dispense equipment and specialist services for a short term period. SIBA has recently set up SIBA Technical Services as an independent third party supplier of TS, which will provide TS in respect of equipment used for the supply of beer by its members.

Conclusion

- 7.10. The super-complaint refers to a statement made by the CC in the course of its report regarding the SDEL/Coors merger in 2005,¹⁰⁸ where the CC expressed concerns regarding the practice of bundling the supply of beer with providing TSE and TS in pubs and suggested that the OFT consider making a MIR.
- 7.11. The OFT's subsequent examination of the market for the provision of TSE/TS in 2005 found that there was inconclusive evidence of the presence of features which were preventing, distorting or restricting competition in connection with the supply of TSE/TS; and as such we did not consider that there were grounds for a MIR in relation to this market.¹⁰⁹ We also noted that the scale of the potential issues was not likely to be significant, as the provision of TSE/TS would be likely to have a relatively minor impact upon the cost of beer to consumers, given the relatively small proportion of a barrel of beer accounted for by the provision of TSE/TS.¹¹⁰ We also found that pub companies would be well placed to secure significant discounts from brewers and as a result of their purchasing position. The evidence that we have gathered in the context of the super-complaint does not suggest that we should depart from the conclusions reached in 2005.
- 7.12. In addition, in response to CAMRA's concerns that charges by pub companies to small brewers for the use of TSE/TS, the evidence

¹⁰⁸ Competition Commission – A report on the proposed acquisition by Serviced Dispense Equipment Limited of the Technical Services Function of Coors Brewers Limited, paragraph 37.

¹⁰⁹ OFT Press Release: Supply of beer, 20 July 2005.

¹¹⁰ On the basis that the Competition Commission had estimated that the costs of provision of TSE and TS represented less than five per cent of the price of a barrel of beer.

does not indicate that these charges are giving rise to a significant barrier to entry for small brewers.

8. POSSIBLE OUTCOMES

8.1. The possible outcomes of a super-complaint include:

- enforcement action under the OFT's competition or consumer powers
- the OFT launching a market study into the issue or issues raised in the super-complaint
- the OFT making a MIR to the CC
- the OFT accepting undertakings in lieu of a MIR to the CC, or
- the OFT finding that the complaint requires no further action.

8.2. CAMRA suggests that the outcome of its super-complaint should be as follows:

- that the OFT should carry out a market study into the issues raised by CAMRA and, following this
- that the OFT should consider making legally binding certain measures in the form of undertakings in lieu of making a MIR to the CC, and
- that if such undertakings cannot be agreed, the OFT should make a MIR to the CC.

Market study

8.3. The main benefit of any market study would be to provide an opportunity for the OFT to investigate further the issues raised in the super-complaint. Possible outcomes of a market study include the OFT taking enforcement action under the CA98, making a MIR to the CC, accepting undertakings in lieu of making a MIR to the CC, encouraging firms to take voluntary action, making recommendations to Government, or taking no further action.

8.4. On the basis of our assessment that the issues raised in the super-complaint are not giving rise to a significant impact on consumers, we do not consider that launching a market study is merited.¹¹¹

Making a MIR to the CC

8.5. Under section 131 EA02, the OFT may make a MIR to the CC where it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, or part of the UK.

8.6. The OFT will only exercise its discretion to make a MIR to the CC when the test for making a reference set out in section 131 EA02 is met and, further, where, in its view, each of the following criteria is met:¹¹²

- it would not be more appropriate to deal with the competition issues identified by applying CA98 or using powers available to the OFT or, where appropriate, to sectoral regulators
- it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference
- the scale of the suspected problem, in terms of its adverse effect on competition or customer detriment arising from it, is such that a reference would be an appropriate response to it, and
- there is a reasonable chance that appropriate remedies would be available.

¹¹¹ In prioritising its work, the OFT takes into account a range of factors, including the impact on consumers of our work, as set out in our published guidance: OFT 953 'OFT Prioritisation Principles', October 2008.

¹¹² OFT guidance: 'Market Investigation References', March 2006.

8.7. Given our conclusions in sections 4 to 7 above, we do not consider that a MIR to the CC would be merited, either regarding specific issues raised in the super-complaint, or a wider reference relating to the supply of beer in the UK. In particular, in relation to the issues raised in the super-complaint:

- we do not consider that there are reasonable grounds for suspecting the existence of features that prevent, restrict or distort competition in relation to barriers to entry at the brewing level¹¹³ or the operation of tied lease agreements, and
- in respect of restrictive covenants which, as we have noted, may potentially restrict competition, the scale of any adverse effects on competition and consumers does not appear sufficiently significant, widespread or long-lasting to merit a MIR.¹¹⁴

8.8. We also note that pursuant to Article 3 of Council Regulation No1/2003,¹¹⁵ national competition law cannot prohibit agreements, decisions or concerted practices which may affect trade between Member States and which do not restrict competition within the meaning of Article 81(1) EC or which fulfil the conditions of Article 81(3) EC. As noted in our published guidance 'Market Investigation References',¹¹⁶ this has the effect of limiting the circumstances in which the OFT would make a MIR to the CC.

¹¹³ Including issues raised in the super-complaint in relation to charges to small brewers for TSE/TS.

¹¹⁴ As outlined above, restrictive covenants are not widely used and in general the evidence indicates that the retail market is broadly competitive. The proportion of the market adversely affected is therefore likely to be limited. Further, in light of the commitments given by certain pub companies not to use restrictive covenants in future, this may not be a persistent feature leading to potential adverse effects on competition.

¹¹⁵ Council Regulation (EC) No1/2003 of 16 December 2002 (OJ L 1/1 2003).

¹¹⁶ OFT 511: 'Market Investigation References', paragraphs 2.9 to 2.18.

8.9. On the basis that we consider that a MIR is not warranted, it is not possible for us to consider accepting undertakings from parties regarding issues raised in the super-complaint, in lieu of making a MIR to the CC, pursuant to section 154(1) EA02.

Further investigation under CA98

8.10. We have not undertaken a detailed analysis of agreements or conduct that could fall within the scope of CA98, nor have we reached conclusions on relevant market definition for the purposes of responding to the super-complaint.

8.11. However, on the basis that we have not found evidence that the issues raised in the super-complaint are giving rise to a significant impact on consumers, we do not consider that further investigation under the CA98 is merited.¹¹⁷

¹¹⁷ See 'OFT Prioritisation Principles' OFT953, October 2008 and footnote 111 above. In addition, the OFT would, by virtue of section 60 CA98, take into account the application of European Community law when applying provisions of UK competition law to similar questions that have been raised under it.