COMMISSION DECISION

of 24 February 1999

relating to a proceeding pursuant to Article 85 of the EC Treaty

(Case No IV/35.079/F3 — Whitbread)

(notified under document number C(1999) 346)

(Only the English text is authentic)

(1999/230/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty [1], as last amended by the Act of Accession of Austria, Finland and Sweden, and in particular Articles 4, 6 and 8 thereof,

Having regard to the application for negative clearance and the notification for exemption submitted on 24 May 1994 by Whitbread PLC pursuant to Articles 2 and 4 of Regulation No 17,

Having published a summary of the application and notification pursuant to Article 19(3) of Regulation No 17 [2],

After consultation with the Advisory Committee for restrictive practices and dominant positions,

I. THE FACTS

A. INTRODUCTION

(1) On 24 May 1994 Whitbread PLC (hereinafter 'Whitbread') notified three standard forms of leases (hereinafter 'the Leases'), the subject of each of the Leases being a fully fitted-out, on-licensed [3] public house in the United Kingdom with a tie for beer as described below. The three standard forms are the 20-year lease, the pre-retirement lease and the five-year lease. Whitbread requested negative clearance or confirmation that the Leases qualified for the application of Commission Regulation (EEC) No 1984/83 of 22 June 1983 on the application of Article 85(3) of the Treaty to categories of exclusive purchasing agreements [4] (hereinafter 'the Regulation') or individual exemption pursuant to Article 85(3) of the EC Treaty, to take effect as from the date on which the agreements were entered into. The Regulation contains in its Title II special provisions for beer-supply agreements.

(2) In February 1995, the Office of Fair Trading (hereinafter 'OFT') started, upon the request of the Commission, an enquiry into the UK brewers' wholesale pricing policy. This enquiry, which included Whitbread, resulted in the internal OFT report on their 'enquiry into brewers' wholesale pricing policy' (hereinafter 'the OFT report'); it was adopted in May 1995 and a press release on the report was issued by the OFT on 16 May 1995.

(3) In addition to the OFT report, the information in the notification has been supplemented by way of a verification pursuant to Article 14(2) of Regulation No 17 at the premises of Whitbread and several requests for information.

(4) Following the publication in the *Official Journal of the European Communities* of the notice

[1] OJ 13, 21.2.1962, p. 204/62.
[2] OJ C 294, 27.9.1997, p. 2.
[3] On-licensed premises are those which are licensed to sell alcoholic beverages for consumption on and off the premises as opposed to off-licensed premises such as supermarkets which are licensed for off-premises consumption only.
[4] OJ L 173, 30.6.1983, p. 5.

pursuant to Article 19(3) of Regulation No 17 (hereinafter 'the Notice'), in which the Commission announced its intention to grant a retroactive exemption pursuant to Article 85(3), the Commission received 135 observations from interested third parties. Twenty of these observations were individually drafted replies from Whitbread lessees or their representatives arguing against the exemption; two lessees were in favour of exemption; 79 replies were submitted by Whitbread lessees following a model prepared by Group Action Limited, an action group for (originally Inntrepreneur) lessees. The Commission also received observations from the Bavarian Lager Company, and 23 lessees, of which nine indicated that they were Whitbread lessees, signed a standard reply put at their disposition by that company (with one lessee adding some personal comments to this reply). Furthermore, the Campaign for Real Ale (a UK beer consumers interest group), two accountants, three lessees' action groups, three lessees of other companies than Whitbread, and a law professor submitted observations.

(5) The information in these observations will be dealt with in the remainder of this Decision. 92 of the interested third parties requested the Commission to register their submission also as a formal complaint against Whitbread. Some of these complainants withdrew their complaint, but the 67 remaining complainants were informed in July 1998, pursuant to Article 6 of Commission Regulation (EEC) No 99/63 of 25 July 1963 on the hearings provided for in Article 19(1) and (2) of Regulation No 17 [5], of the Commission's intention to reject their complaint. 11 of them presented some further comments on this letter. These comments are also integrated in this Decision.

(6) The Commission services have supplemented the observations given by Whitbread lessees by visiting three of them at their premises.

B. THE PARTIES

(7) Whitbread is a UK food, drinks and leisure company. Its business includes the brewing, marketing and distribution of beer and the wholesaling of other drinks, the ownership of leased public houses and management of public houses, restaurants, hotels, off-licences and leisure clubs. The activities of the Whitbread Group are carried out through a divisional structure involving management by eight separate trading divisions. The division responsible for the leased estate is the Whitbread Pub Partnership (hereinafter 'WPP').

(8) In the fiscal year ending February 1997, Whitbread owned approximately 4 490 on-licences, of which 2 170 were managed (meaning that the operator is an employee of the company), 2 130 were leased with a beer tie to individual lessees and 190 were leased to multiple operators free of the tie. Of the leased estate, 1 970 outlets were let on permanent agreements and 160 by way of temporary tenancy agreements. Of the 1 970 permanently let outlets, 1 938 were let out according to one of the notified agreements (1 643 20-year leases; 276 five-year leases and 19 pre-retirement leases). Whitbread's total turnover in the 1997 fiscal year was approximately GBP 3 billion. In that year Whitbread accounted for 13 % of the UK beer market in volume production terms.

(9) In 1990/1991, Whitbread owned 6 162 houses, of which 1 871 were managed and 4 291 were leased to individuals.

(10) Details of the actual number of barrels [6] sold by Whitbread to and the relevant market shares on the UK on-trade beer market of (a) all tenanted/leased pubs, including those on temporary tenancy agreements, (b) managed houses, (c) pubs with a loan tie to Whitbread, (d) total of Whitbread's sales to property tied pubs, managed houses and loan ties, (e) Whitbread's total sales to the on-trade and (f) the total UK on-trade market are given in Table 1 below:

[5] OJ 127, 20.8.1963, p. 2268/63.

[6] 1 barrel equals 1,63659 hectolitre; 1 hectolitre equals 0,611026 barrels.

Table 1

Whitbread's position in the UK on-trade beer market

(thousand barrels)

	(a)	(b)	(c)	(d)	(e)	(f)
1990/1991	949	857	611	2 417	3 953	31 863
1996/1997	[...] [1]	[...]	[...]	[...]	[...]	[...]

[1] Business secret.

(%)

	(a)	(b)	(c)	(d)	(e)	(f)
1990/1991	2,98	2,69	1,92	7,59	12,41	100,00
1996/1997	[...]	[...]	[...]	[...]	[...]	[...]

(11) The average length of Whitbread's loan tie agreements has been, since 1990, about eight years. The average duration of these agreements before repayment or re-negotiation is three years. Whitbread estimates that it retains the business with the outlet after the loan is terminated in only 15 % to 20 % of instances following re-negotiation. Whitbread has no records of the prior arrangements of accounts entering a new loan agreement with the company. Whitbread's outstanding loan books has fallen from a figure of some GBP 180 million in 1990 to GBP 30 million in 1998.

(12) The Commission has only limited information on the barrelage/percentage of beer sold by Whitbread to other operators on the 'wholesale' level of the UK on-trade beer market, subject to some form of 'tying' such as a minimum purchasing obligations, a must stock obligation or a (limited) non-compete clause. These other operators include other brewers, traditional wholesalers or non-brewing pub companies. This limited information tends to indicate that the volume accounted for by agreements with minimum purchasing obligations accompanied by penalties is decreasing compared to the early nineties, as more recent agreements are more discount-driven, providing for discounts linked to certain volume or distribution targets. Stocking obligations (for the managed part of the estate) and listing obligations (for the leased part of the estate) still seem to be included in such agreements, although no estimate has been presented as to the volume that this might represent.

(13) The other party to the actual agreements, that are based upon the notified standard Leases, are individuals or their companies who, in general, have an interest in only one on-licensed site.

C. THE MARKET

(14) Since 1990, the date of introduction of the 20-year lease, significant changes have occurred in the structure and conduct of the UK on-trade beer market. These are for the most part the result of the Beer Orders made following the Monopolies and Mergers Commission's (hereinafter 'MMC') report on the supply of beer, together with a fall in both overall demand and particularly on-trade beer sales, shifts in consumer demand towards pubs offering a wider choice of drinks and food, the withdrawal of several companies from brewing and the redefinition of relationships between brewers

and pub retail chains on the one hand and tenants on the other.

The 1989 MMC report and the subsequent Beer Orders

(15) The 1989 MMC report into the supply of beer led to a number of recommendations being made which were aimed at relaxing the traditional tie (exclusive purchasing obligation and non-competition obligation) between brewers and pubs. Most of the MMC's recommendations were implemented, mainly by the Supply of Beer (Tied Estate) Order 1989 and the Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices) Order 1989 (hereinafter 'the Orders'). The Tied Estate Order imposed the following changes upon the 'national brewers', namely brewers having an estate of more than 2 000 on-licensed premises:

— their tenants/lessees would be free of tie for non-beer drinks and low-alcohol beers,

— their tenants/lessees would have the right to buy one cask-conditioned ale (a beer with fermentation in the cask) ([7]) from a source other than the brewer/landlord (hereinafter 'the guest beer clause')

and

— they were only allowed to tie a certain number of pubs. This forced them to sell or free of tie about 11 000 of the then estimated 60 000 UK pubs. Whitbread is allowed to tie a maximum of 4 311 pubs.

([7]) The UK Government extended the scope by also allowing for one bottle-conditioned beer from 1 April 1998.

The Bavarian Lager Company, a company that complained to the European Commission that the 'cask-conditioned' guest beer clause was in breach of Article 30 of the Treaty, commented in its observations to the notice on this footnote. The company requested that the footnote should mention that the 'bottle-conditioned' change was the result of procedure against the UK for breach of Article 30. With regard to the Whitbread notice, the company requested the Commission to publish an addendum to the above effect, containing a new deadline for observations.

Demand factors

(16) Beer can be sold through the on-trade, such as pubs, hotels and restaurants, or through the off-trade, such as supermarkets and off-licences. In addition, imports brought into the UK by private individuals on which duty has been paid, mainly from Calais, are estimated to account for almost 5 % of total beer consumption in the UK in 1997. Volume sales of all beer in the UK fell by some 4 % between 1989 and 1997 and volume sales of beer in the on-trade fell by some 20 % in the same period. The proportion of sales volume accounted for by the on-trade has thus fallen (from 79,3 % in 1989 to around 68 % in 1997) but, with the exception of Ireland, remains the highest proportion in the Community.

(17) Falling beer sales volume in the on-trade has been offset by:

(a) a rise, in real terms, in on-trade beer prices of 21 % between 1989 and 1996, only a negligible proportion of which was accounted for by tax increases

and

(b) a rise in the proportion of non-beer sales in pubs to 37 % of total revenues in 1996, largely as a result of the increase in catering sales.

(18) Consumption of draught beer accounted in 1996 for 63 % of total consumption. This is also, with the exception of Ireland, the highest figure in the Community. In contrast, the figure for Belgium, which has the third largest draught consumption in the Community, was 39 %. UK pubs also offer a bigger choice of draught beers than elsewhere in the Community, with an average of 6,5 brands per pub.

Supply factors

Brewing

(19) The main change since 1989 is that the brewing market has become more concentrated. The increased concentration has been caused by companies leaving the brewing market and

selling their brewing operations to existing competitors. In 1996, the four remaining national brewers, Scottish & Newcastle, Bass, Carlsberg Tetley Brewing and Whitbread, commanded 78 % of the UK beer market in terms of supply. The Herfindahl-Hirschmann index (hereinafter 'HHI'), used to help describe market concentration, for the UK beer market increased, on the basis of the market shares of the national brewers, from 1 350 in 1991 to 1 678 ([8]) in 1996. With an HHI of between 1 000 and 1 800, the market is described as 'moderately concentrated'. Some regional brewers ([9]) left the market between 1989 and 1996, reducing the number of regional brewers from 11 to eight.

Wholesaling

(20) The result of the Orders was the sale of some of the national brewers' tied estates. This was expected to lead to an increase in the free trade and to a greater role for traditional wholesalers. However in 1995/1996 traditional wholesalers still only accounted for some 6 % of distribution, compared to 5 % in 1985. The national brewers still dominate the wholesale sector, with a share of distribution similar to their share of production. As regional brewers do not require the services of traditional wholesalers either, this, combined with the general decline in sales of beer and the increased efficiency of national brewer-wholesalers, has resulted in marginal growth in the traditional wholesale sector.

(21) The pubs that were sold by the national brewers were purchased mainly by retail pub chains or by regional brewers. In general, pub chains either have their own wholesaling operations or are supplied directly by the brewers.

Retailing

(22) In the UK, the retail sale of beer and other alcoholic drinks for consumption on the premises requires a justice's (local law-court's) licence. Three distinct classes of licences are currently in operation ([10]):

— full on-licences: where a person can buy an alcoholic drink without being a resident or having a meal. There are approximately 83 100 full on-licences in issue, of which around 57 000 ([11]) are pubs. The remainder include hotels and wine bars,

— restricted on-licences: where it is a condition on buying a drink that the customer is either a resident or having a meal. Covers some 32 300 private hotels and restaurants,

— clubs: a person has to be a member before buying a drink. Covers some 31 500 outlets, mainly jointly owned by their members.

(23) By forcing changes in the ownership of pubs, the Orders have also had an effect on the proportion of beer sold through the different retail channels: (a) the tied estate of the brewers, (b) the managed estate of the brewers, (c) the tied estate of non-brewing pub companies, (d) the managed estate of non-brewing pub companies, (e) loan-tied premises and (f) untied or free premises. This can be seen from the following overview on beer sales (volume). The 1985 data come from the MMC report and can be considered as representative for the years 1985—1989; the 1997 data are from the Brewers and Licensed Retailers Association (hereinafter 'BLRA'), including estimates for non-members.

([8]) The Commission does not have precise information on the market shares of the other UK brewers. Nevertheless, it does not estimate that the HHI for all brewers would reach the 1 800 mark, above which a market is considered to be 'highly concentrated'.

([9]) Defined in the MMC report as brewers which 'have a business which is mainly, but not necessarily wholly, concentrated in a single region of the UK'. The number of regionals in 1996 is defined taking the number of owned pubs and production volume for the smallest regional in the MMC report as a benchmark.

([10]) The licensing system is slightly different in Scotland.

([11]) Other publications have estimated the number of pubs at 61 000.

Table 2

UK on-trade beer consumption

(%)

	(a)	(b)	(c)	(d)	(e)	(f)
1985	30,8	24,2	0,0	0,0	22,0	23,0
1997	10,0	17,2	11,4	8,3	18,1	35,0

(24) The 10 % figure for the sales going through the tied estates of the brewers in 1997 includes the tied purchases of the lessees and the cask-conditioned beer that the tenants and lessees of the national brewers purchase, with a discount, from their landlord-brewer ([12]). The figure does not include the purchases by the national brewers' tenants and lessees of a guest beer from another supplier.

(25) The 18,1 % figure for loan-tied premises' volume in 1997 does include the total volume that a loan-tied pub operator buys from the supplier with whom he has a loan tie. This volume may exceed the tied quantities laid down in the loan agreement. It is, however, not known what part of the 18,1 % represents purchases in excess of the loan-tied quantity. The 18,1 % figure does not include the 'free' purchases of a loan-tied pub operator with other suppliers.

(26) While the above table gives an idea of the throughput in the on-trade by describing the ownership situation of the premises, it can also be noted that if one refers to the category of on-licensed premises, 70 % of beer is sold through the estimated 57 000 pubs, 20 % through clubs and 10 % through restaurants, hotels, wine bars and so forth with full or restricted on-licences (1995 data).

(27) The Orders also reduced the restrictive scope of loan ties, by allowing their termination at any moment in time by the tenant on three months' notice. The Orders also introduced the guest-beer right for publicans with trade loans from the national brewers. From information supplied by the BLRA (following a specific survey undertaken in 1996), it appears that the usual period of a loan is five or 10 years, and the average actual length is almost four years. 31 brewers had some 37 000 loans outstanding at the end of the survey period (almost 35 000 at the start) with over the year almost 8 000 new loans entered into and over 5 000 repaid. The value of the loans repaid during the period exceeded the value of the new loans made (to existing or new customers); some 2 % of the outstanding capital was written off as bad debts. The average value of a loan is around GBP 30 000. There appear to be two types of loans, relatively small ones (a value of almost GBP 5 000 at the start of the period, but only an average value of less than GBP 2 000 at the end of the survey period) which are often made available to small free-trade pubs and they appear to be very volatile. On the other hand, there are much larger loans to large volume outlets such as clubs (average value around GBP 60 000) and these are usually non-exclusive. However, the purchasing obligations are usually for a specific quantity of beer. No estimate was made by the BLRA as to the volume split between small and big loans, the number of the non-exclusive (big) loans, the total on-trade volume-percentage accounted for by such non-exclusive loans, or the percentage of total throughput of the relevant premises accounted for by the quantity of beer stipulated in such loan ties. No information was given as to the proportion of loans which the publican pays back with money loaned to him by another brewer (in exchange for a new loan tie). Beer volumes sold through loan ties have fallen in the last couple of years and, for the years 1994-1997, the scale of loan repayments has exceeded the value of new loans.

Competition between brewers

(28) At the wholesale level, the major brewers have some guaranteed sales through their tied and managed estates. The brewers have to compete

([12]) This is also sometimes called a guest beer, although the legal definition of a guest beer refers to the purchase of a cask-conditioned beer from another supplier (see recital 15).

to supply the remainder of the market, through individual agreements with free houses (with or without loan ties) and supply agreements with pub chains and other brewers (with or without 'ties' such as minimum purchasing obligations, non-compete and must-stock obligations). The competitive parameters are mainly price and brand strength, although the brewers also try to gain sales by offering other benefits such as promotional support.

Market entry at brewing level

(29) The main hindrances to entry at this level are the need to secure outlets for supplies and to have access to a distribution system. A new entrant has to secure supplies to free houses, pub chains, or to the brewer's estates as part of their portfolio of beers or (in the case of a national brewer) as a guest beer. Possession by competitors of well-known brands may hinder the entry, or expansion, of existing brewers. This may be more important in lagers, which are normally marketed nationally, and where economies of scale in advertising may make small-scale entry less viable. The difficulties involved in small-scale entry may be increasing as the advertising spend for the national lager brands has increased substantially over the last couple of years, even on a brand basis.

(30) The need to secure outlets has been reduced since the implementation of the Orders, owing to the reduction of the proportion of the market subject to ties and to the emergence of pub chains (in so far as they are not tied — see recital 28). It is easier for a new entrant to enter supply agreements with a chain rather than with individual pubs. Whereas it is relatively easy to set up a distribution system limited to the supply of the wholesale depots of the other brewers and/or wholesalers, it is more difficult to reach the individual retail outlets.

(31) Most foreign producers of beer (mostly lager) have chosen to enter the UK market by entering into exclusive licensing agreements with existing national brewers whereby the beer is brewed in the UK and sold as part of the national brewer's portfolio of brands. These foreign lagers have often been marketed as premium brands and supported by substantial advertising spending. Whitbread has concluded such licensing agreements with Interbrew (Stella Artois), Heineken (lager and export Heineken) and for the Murphy's Irish Stout brand.

Market entry at retail level

(32) Pubs compete only with others in their locality. Broadly speaking, each area has a local price for a certain type of package, which comprises the total pub 'offer' (facilities, ambience) and not just the price of beer.

(33) Entry barriers in the retail market are relatively low. The only one of any significance is the presence of licensing laws, which can prevent new pubs from being opened unless there is a need for them. These laws are not applied strictly throughout the UK but, where it is, it can result in entry within that locality being difficult. Also, in some areas of the UK, licences are now being refused mainly on public order grounds. However, a particular pub company has succeeded in opening over 100 pubs on greenfield sites in recent years.

Changes in arrangements between pub tenants and their landlords

(34) Historically, pubs were let by means of 'traditional' short-term pub tenancies. Brewers retained responsibility for the fabric of the building and its fixtures and fittings, and tenants were responsible for selling beer supplied by the landlord plus other drink and food. Following the MMC report, pub tenants in England and Wales were provided with security of tenure [13] by being brought within the Landlord and

[13] Except for a limited number of specified reasons, i.e. the owner of the pub wants to use the outlet for his own purposes as a managed house, in which case the lessee receives compensation fixed by law, the parties can negotiate a new agreement. In the absence of a new agreement, the UK courts will renew the agreement on similar terms to the existing agreement with the exception of the rent and the duration which cannot exceed 14 years.

Tenant Act 1954. However, well before the MMC's recommendation, the first long full repair and maintenance leases, which provided some security of tenure and the ability to assign the lease, were offered.

D. THE AGREEMENTS

(35) The Leases are contracts between Whitbread and the lessee, whereby Whitbread makes available a licensed public house together with fixtures and fittings to a lessee for the purpose of carrying on the business of the public house and under which the lessee pays a rent to Whitbread and agrees to purchase the beers specified in the Lease from Whitbread or its nominee, and from no other source.

(36) The lessee has to sell trade fixtures and fittings, furniture and effects and stock, on termination of the lease, to Whitbread or to the new lessee.

(37) The lessee is not allowed to exhibit signs except those already on the premises without Whitbread's consent, provided that the lessee may advertise goods supplied otherwise than by Whitbread or its nominees in proportion to the share of those goods in the total turnover realised in the premises.

(38) The lessee is not to place amusement machines on the premises without the consent of Whitbread, which shall not be unreasonably withheld in the case of the 20-year lease. Whitbread has indicated that consent is given as a matter of course on condition that the amusement machine supplier is selected from an approved list and that qualification for inclusion of a machine supplier on the list is in accordance with objective qualitative criteria such as standards of service and financial strength.

(39) The differences between the 20-year lease and the other two standard leases are that in the case of the 20-year lease (i) the lessee has to put and keep the premises and the fixtures and fittings in good repair (under the other two leases the lessee is not liable for structural repairs or exterior decorations), (ii) the lessee is not allowed to make any alterations without Whitbread's consent (in the case of the pre-retirement lease alterations are prohibited, except that non-structural alterations to the interior may be made with Whitbread's consent; in the five-year lease alterations are prohibited), (iii) the lessee is not allowed to assign the lease during the first three years of the term and thereinafter if the lessee wishes to assign then, if so required by Whitbread, to assign to a nominee of Whitbread on open-market terms and not to assign the lease to a brewer (in the pre-retirement lease assignment is prohibited except, with Whitbread's consent, to the lessee's widow or widower; in the five-year lease, assignment is prohibited). Some 640 assignments have occurred in the four and a half years from March 1994 to August 1998 and in many cases the lessees obtain a premium on such an assignment. For 56 of the 91 assignments in the six months to August 1998, Whitbread was informed of the premium achieved (the lessees are not obliged to inform Whitbread of the premium). The average premium for these 56 outlets was GBP 59 000. The date of first use of a 20-year lease was on 1 January 1990.

(40) The five-year lease is used in circumstances where the 20-year is considered inappropriate, such as unstable local economic conditions, where too high a level of expenditure is required to put the property into a full state of repair, or where a refurbishment of the premises within the next three years is contemplated. The first such lease was entered into on 1 September 1991.

(41) The pre-retirement lease was used when existing tenants on annual agreements were converting to 20-year leases in the years 1990-1992. Some lessees saw themselves wishing to retire from the industry over the next five years but wanted to ensure their security of tenure up to retirement. The first such lease was entered in on 22 May 1992.

The beer tie

(42) The lessee agrees to buy all specified beers from Whitbread or its nominee with the exception of one brand of cask-conditioned draught beer, and as from 1 April 1998, also one bottle conditioned beer ('guest beer clause'). Specified beers are the beers of the type set out in the Appendix to the Schedule of the Lease which contains the Terms of Trading. These types are light, pale or bitter ale (known in Scotland as 70±, heavy special or Scotch ale), export or premium ale (also known in Scotland as 80±,

ale), mild ale (known in Scotland as 60±, light or pale ale), brown ale, strong ale (including barley wine), bitter stout or porter, sweet stout, lager, export or premium lager (also known as 'malt lager' or 'malt liquor'), strong lager, 'diat pils' (or premium low carbohydrate beer) and low carbohydrate (or 'lite') beer. These types are represented by the brands or denominations of beer listed in Whitbread's current price list.

(43) The lessee may sell any type of beer other than the specified types if it is packaged in bottles, cans or other small containers or if it is in draught form and the sale of that beer in draught form is customary or is necessary to satisfy a sufficient demand from the lessee's customers.

(44) A few parties making submissions commented on this issue. It was remarked that the 'specified' type definitions cover substantially all beer types sold in the UK. This is not disputed. One complainant has argued that the 12 specified types are too generic and thus not 'clearly distinguishable by composition, appearance or taste', the relevant criteria indicated in the Regulation to define 'different types of beer' ([14]). The complainant referred to the difference between 'cask-conditioned beer' (a beer with fermentation in the cask) and 'keg beer' (no fermentation in the cask) types and the absence of any reference to this difference in the specification of the 12 types. The Commission recognises that discerning drinkers can taste the difference between the cask-conditioned and the kegged version of the same brand. However, the Commission does not consider that this necessarily implies that specification of the types should take account of this difference. The definition of beer types is a matter for experts to decide ([15]). As the specification of the 12 types was originally agreed between the respective federations of brewers and licensed victuallers in the United Kingdom, experts with regard to beer, the Commission accepts this definition as an appropriate, workable way of defining beer types in the UK.

(45) One third party indicated that a brand may build up a favourable following to a lessee's consumers on a very local basis, but marketing decisions are taken by a national brewer on a national basis. So if sales are uneconomical overall, a brand is discontinued to the potential detriment of an individual's customer base. This was illustrated by a reference to a brand that Whitbread stopped brewing in 1980. This third party also indicated that Hoegaarden White Beer, licensed by the Belgian brewer Interbrew to Whitbread and forming part of Whitbread's price list (listed as 'lager') is of a different type than any of those specified in the Lease and should thus be free of tie. If a lessee considers that Hoegaarden White Beer, currently purchased by a couple of dozen WPP lessees from Whitbread, is of a different type from any of the specified beers, the procedure in the Lease for 'non specified' beers can be invoked.

(46) Another lessee stated that he faces the risk that if his tied house is sold on, he might be forced to buy unfamiliar products.

Rent

(47) Rent is paid quarterly in advance and the lessee will repay the premiums paid by the landlord for insuring the premises against (i) loss or damage by fire and including three year's open-market rent of the premises and expert's fees and (ii) loss of the justice's licence.

(48) Numerous lessees have indicated in their submissions that they consider that the insurance that they have to repay Whitbread is above market rates for similar coverage and that they are not entitled to see the contract. Whitbread has indicated that the building insurance cover is set out in a guide given to all lessees, and that there is no specific sum insured or limit per property on their policy. There are, furthermore, no warranties in their policy that might render any claim voidable, contrary to many other pub insurance packages. In addition, Whitbread manages the claim processes including dealing with the loss adjusters and, if the replacement building makes the rebuild 'better' than its pre-damage state; they do not pass this cost to the lessee although the full cost

([14]) Article 7(2).

([15]) See also recital 51 of the Commission notice concerning Commission Regulation (EEC) No 1983/83 and (EEC) No 1984/83 on the application of Article 85(3) of the Treaty to categories of exclusive distribution and exclusive purchasing agreements (hereinafter 'the Notice to the Regulation') (OJ C 101, 13.4.1984, p. 2).

of the works is not covered through insurance. They also indicate that the insurance is charged to lessees quarterly in arrears without penalty.

(49) Furthermore, the Whitbread insurance covers the entire risk portfolio of the group-buildings, motor, public liability and so forth. And that risk portfolio is tendered in the insurance market. This results in the policy and the total premium being commercially sensitive and not disclosed to lessees.

(50) Whitbread may require the rent to be reviewed at the end of each third year and on the day before the expiry of the term of the Lease or when the tie becomes unenforceable by Whitbread or when Whitbread reduces the tie. The reviewed rent is the higher of the existing rent or the market rental value of the premises at the relevant increased date. The market rental value is defined as either what the parties agree to be the current market rental value or the sum as determined by an arbitrator.

(51) Several submissions have indicated what they consider to be the negative effects of such an 'upward only rent review' (hereinafter 'UORR'), in particular when turnover in the individual pub goes down due to local circumstances or an overall recession in the country.

(52) The OFT report has looked into this issue and the OFT discussed this practice with the Department of the Environment which in 1995 conducted a major review of UK commercial property leases. It appeared that UORR is a widespread practice for all sorts of commercial property and thus not peculiar to pub leases. UORR can be said to encourage property investment because of the more predictable flow of income. It is also estimated that, in the absence of UORR, the level of rent at the time of entry into the lease could be higher to compensate for the increased uncertainties for income flow.

Discounts and countervailing benefits

(53) As individuals who are not tied for their beer purchases to another company (individual free-house operators) can obtain in the United Kingdom discounts for their beer purchases which are not available to the tied operators, the Commission has assessed (i) the net price differential for beer purchases from Whitbread between the price paid by individual free-house operators and Whitbread's tied lessees and (ii) the value of benefits which are granted by Whitbread to its lessees and which are either not readily available to the individual free-house operators or in excess of Whitbread's contractual obligations towards its lessees (hereinafter 'countervailing benefits'). The starting point for this assessment was the OFT report, which was supplemented by further investigations by the Commission.

(54) The price differential is the difference between the average discounts in GBP/barrel granted by Whitbread to its individual free-house operator-clients across a typical product mix, and the discounts granted to the WPP lessees which include the actual discounts on cask-ale purchases and the value of the lower WPP list prices as compared to the Whitbread price list.

(55) Most interested third parties have indicated that they are aware of higher discounts being granted by Whitbread to individual free traders than those indicated in Table 3 below at recital 93, and some of them have supplied copies of offers made by Whitbread to such clients. It is not disputed that in individual cases higher discounts are granted as Table 3 is based upon averages for all Whitbread's individual free-house operator-clients. It also follows from recital 54 that the relevant figure in Table 3 is the result of the average discount to the free trade minus the discounts granted to WPP lessees.

(56) Another party making a submission has questioned the number of accounts Whitbread has with free traders and therefore the reliability of the basis for the price differential. In this respect, it can be noted that, for the years

1995/1996 and 1996/1997, over […] clients have been supplied who purchased over […] barrels. In addition, the level of discounts given to the free houses that purchased a total barrelage similar to the average barrelage purchases by WPP lessees was very close to the overall average used in the comparison for the year 1996/1997 ([16]).

(57) An important countervailing benefit is the so-called rent subsidy, the benefit resulting from a comparison with the rent paid for a tied outlet and property equivalent costs to be paid by a 'free of tie' pub operator. There are a number of methodologies for calculating the rent subsidy. The OFT report has identified three main methods of comparison. The first is to take an 'average pub', estimating the value of the property and the divisible balance and comparing the resulting mortgage payments with the rent a brewer would take. The second is to look at the brewers' returns on capital employed from their pub estate and compare these to some estimate of a normal return. The third is by calculating the difference between the ratio rent/turnover for the tied estate with an estimated ratio rent/turnover for 'free of tie outlets'. This third method has been used in the OFT report, as the OFT had the most data available to use this method. The Commission has followed this methodology because it allowed the Commission to build on the work of the OFT, which yields an obvious economy in procedure.

(58) In practice, the rent subsidy is calculated by subtracting (a) the actual rental income from the tied estate from (b) 15 % of the turnover of the tied estate (the assumed rent for an untied outlet being 15 % of turnover). To arrive at the rent subsidy per barrel, the overall rent subsidy is divided by the total number of barrels sold to the estate. For the calculation of the rent subsidy as shown in Table 3, the following assumptions were made:

— the estimate of the total turnover for the tied estate was calculated on the basis of the rent paid being equal to 12,72 % of turnover. The figure of 12,72 % stems from internal Whitbread documents, mainly in preparation for rent or rent review negotiations, for a sample of 30 pubs chosen by Commission officials. Whitbread has informed the Commission that the average rent to turnover ratio for the entire WPP estate is 12,19 %,

— for the years 1990/1991 and 1991/1992 the data relate to the totality of Whitbread leased pubs on the basis of figures for the rental income and barrelage sold as supplied by Whitbread,

— for the years 1992/1993 up to 1996/1997, the data relate to the pubs let on notified agreements on the basis of figures for the rental income and barrelage sold as supplied by Whitbread with some estimates made by the Commission on the basis of this information.

(59) Several lessees have indicated that their rent is more than 15 % of turnover, or, alternatively, more than the average of 12,72 % calculated by the Commission. It resulted from submissions of a smaller number of lessees that their rent/turnover ratio was below the 12,72 %. However, none of these lessees have presented arguments against the methodology used by the Commission in calculating the average rent/turnover ratio for the WPP tied estate as described above.

(60) A trade federation stated in its submission that the Royal Institute of Chartered Surveyors, the UK's leading authority on commercial property, recommend the rent of a full repair and insurance commercial lease to be between 10 % and 15 % of the freehold bricks-and-mortar value. A Whitbread lessee has stated that it is widely known that the economic rent for an average public house free of tie is between eight and a half and twelve and a half per cent of turnover. One of the accountants who commented on the notice considers that, in practice, rents are determined on the basis of 50 per cent of the divisible balance, which means the net profit. It is therefore alleged that the assumption that rent is properly based on a percentage of turnover is false, and that the assumption that free-of-tie rent is based on 15 per cent of turnover is therefore also false. He considers that the total rent imposed by Whitbread, i.e. the lease rent and the cost of

([16]) This information is not readily available in such detail for previous years.

discounts denied (wet rent) result in the lessees' being disadvantaged financially.

(61) The Commission does not dispute the fact that actual rent (review) negotiations take place between the company and the (prospective) lessee on the basis of a shadow profit and loss account taking into account the performance achievable by a competent lessee; the market sector in which the site trades; the product sales mix; the tied product procurement terms; the size and condition of the property, and the complexity of the operation (e.g. number of bars). This is explained by Whitbread to the lessee prior to any rent negotiations and detailed in the recently published Code of Practice.

(62) The contractual rent negotiated by the parties is not automatically determined on the basis of 50 per cent of the divisible balance. Resulting from open competition on the market the parties negotiate a rent typically between 40 % to 60 % of the divisible balance.

(63) However, the purpose of the current assessment is not to describe how individual rents are negotiated, but to make a comparative analysis of the average rental levels between one part of the market and another. The advantage of using the rent/turnover ratio for this analysis as compared to a conceivable methodology based upon the differences in the average rent/divisible balance is that the comparison for the first methodology is based on fewer estimates of variable parameters. No estimates need to be made for the 'cost' structure of the pubs in working with rent/turnover.

(64) With regard to the result of the different methods, it would not be unusual to find that the average 'free of tie' rent as a percentage of turnover for a particular estate is 15 per cent and that the average divisible balance is 50 per cent.

(65) For the most important remaining variable in the Commission's methodology, namely that 15 per cent rent/turnover is the ratio for the 'free-of-tie' rent, the Commission relies on the following facts:

— Gerald Eve, Chartered Surveyors, (hereinafter 'Gerald Eve') have indicated in a letter of 17 March 1997 to Whitbread that, when they reported in January 1994 on estimated tied and free-of-tie rents at a valuation date of November 1993 on a sample of 36 public houses throughout the country, they found that the aggregate free-of-tie rents were 28 % higher than the aggregate tied rents. They anticipate that the relationship between tied and free-of-tie rents would be broadly similar in March 1997,

— Gerald Eve and Christie & Co, Surveyors, Valuers and Agents (hereinafter 'Christie'), both indicated in December 1997 that there is a difference of 3 % to 4 % in the rent/turnover ratio (expressed as a percentage of gross turnover excluding VAT) for tied and free-of-tie pubs,

— Gerald Eve and Christie have indicated to another brewer that most of the free-of-tie reviews should see a free-of-tie rent of between 13 and 17 per cent. In addition, they have also informed that brewer that in their expert opinion, the average rents in the sector are generally around 50 per cent of the average competent operator net profit with the remaining 50 per cent attributable to the tenant. In cases where the 50 per cent attributable to the tenant produces an inadequate living for the tenant this could be a lower percentage. Conversely, on outlets where the discount level and profits are higher, rent in excess of 50 per cent are not uncommon and they would consider that 60 per cent would be the upper end of the scale,

— these findings confirm the facts presented to the OFT that free houses pay 2 to 3 percentage points more of their turnover in rent than the tied tenants of brewers and that in the free trade rent equivalents amounted to between 14 and 15 per cent of turnover. This enabled the OFT in their report to base their methodology for the calculation of the 'rent subsidy' upon the difference paid in actual rent by the tied lessees with an estimate of between 14 per cent and 15 per cent of turnover.

(66) The Commission therefore considers that for all the reasons set out above, the rent/turnover methodology is appropriate for assessing the rent subsidy to tied tenants.

(67) Whitbread has estimated the average value and benefit of the professional services per lessee for each of the relevant years. This value has then been multiplied by the total number of pubs let on notified agreements (with the exception for the years 1990/1991 and 1991/1992, where data are used for all WPP pubs) and then divided by the number of barrels supplied to these houses.

(68) Whitbread has used two different methodologies to support its estimates. The first consisted in calculating the cost to Whitbread of services provided free of charge to lessees' management resource (area managers, property surveyors, leasing managers and catering managers). This cost was then 'marked up' (doubled) to replicate the cost to the individual free trader. From this sum was then deducted the doubled cost of Whitbread's sales executives for the individual free-trade operators.

(69) The second methodology used an estimate of annual Whitbread management days spent supporting lessees. For instance for the year 1994/1995, for which the estimate of the benefit for each lessee was set at GBP 2 500, eight man/days (five for the area manager for the monthly 'business' day-time visit, the quarterly evening visit, training sessions and development work, two for the property manager reflecting the annual property inspection, development work and legal type property advice and one for other managers) were considered a benefit for all pubs and on average an additional 2,5 man/days of catering advice for food-oriented pubs reflecting the monthly visit and formal training sessions.

(70) The WPP subsidy cost for various training, marketing and catering related services provided to lessees is not included in this estimate. Whitbread estimates that the subsidy cost for the year 1996/1997 is equal to a further GBP 180 benefit to WPP lessees.

(71) The commenting law professor stated that the management time spent on the above activities will not only have the effect of decreasing the costs of the tied tenants, but will also have the effect of decreasing Whitbread's own costs, increasing its turnover and its overall return on investment. He therefore argues that the whole of the costs should not therefore be ascribed to the tied tenants.

(72) This view has been reiterated in almost all other replies from lessees or their representatives indicating that the primary role of the business development managers is to police the beer tie and the other lease obligations. Other lessees pointed out that professional advice is mainly necessary over conflicts of interest with Whitbread.

(73) Several lessees have indicated that the cellar service they receive from Whitbread is of excellent quality, although some of them have stated that free-trade Whitbread clients receive as good a service.

(74) In reaction to these observations, it should be explained that the basis for this calculation is not the total cost of the personnel providing the services, but what Whitbread considered to be the proportion of time spent by these employees working directly in the interests of the lessee. For the two most important functions in this respect, the business development manager (hereinafter 'BDM') and the property function, the percentage of the proportion of time supporting lessees was 78 % and 55 % respectively. This information is supported by details of the actual BDM visits in the period of January to November 1997 to the 30 pubs that Commission officials have selected for the rent subsidy calculation (recital 58), quarterly and annual time surveys for the property function, examples of submitted 'time sheets', and job descriptions for all lessee facing functions within WPP.

(75) Three lessees have commented on the training provided. They state that training is always at a cost of GBP 30 per participant with an average of 15 delegates per session so that at least the marginal costs are covered. Some of the courses are covered free of charge at local councils or institutes.

(76) The subsidy cost for the training is not taken into account for the calculation of the professional services benefit. However, Whitbread has indicated that they operate a

policy of subsidised training, covering the core elements of running a pub. From an induction programme attended prior to taking a pub, which lasts for several days, to a range of one-day workshops with an average number of participants of 6 to 10 per workshop. The average charge is GBP 25, aimed at recovering a proportion of the costs of the venue, materials (which the lessees take away to use in their business) and tutor (in-house experts and external consultants). Whitbread does not dispute that health and safety or food hygiene training may be available elsewhere at a lower cost, but this would not be pub-specific. Whitbread disputes that the vast majority of the other workshops are available at a lower cost externally. It also indicated that at the time of pub capital developments, a range of training covering customer care, food hygiene, merchandising and chalk-boarding are provided free to lessees and staff.

(77) The Commission considers on the basis of all of the above considerations relating to the 'professional services' that the two methodologies presented by Whitbread to give an indication of the value of the professional services granted by WPP to its lessees, as compared with professional services granted to individual free traders, represent a reasonable estimate. The Commission recognises in particular the comparison between the costs involved as described in the first methodology and accepts that doubling such costs to achieve an estimated price/value of such services on the free market is reasonable. With regard to the second methodology, particular reference is made to the percentages indicated in recital 74, supported by documentary evidence. However, in order to reduce the margin of possible error as much as possible, the Commission will base its assessment of the value of this 'countervailing benefit' on a slight reduction of the benefits as indicated by Whitbread. The amount of the benefit is therefore reduced by 10 % and the relevant GBP/barrel figures for professional services of Table 3 are adapted accordingly.

(78) To calculate the value of the procurement benefits, Whitbread supplied a 'support value' per lessee which was then multiplied with the total number of pubs let on notified agreements and then divided by the number of barrels supplied to those pubs. The methodology followed by Whitbread consisted of calculating the advantages for pubs that are 'major food outlets', 'limited food outlets' and 'non-food outlets', to arrive at the overall average. For instance, for the year 1996/1997 the overall average was GBP 3 580. Such procurement benefits are not offered to the free-trade clients of Whitbread and have never been so offered for the period under consideration.

(79) Whitbread supported the figures for the food and non-food pubs by supplying detailed information for each of the individual items for which procurement benefits existed and estimates of their value. For 1996/1997 these details were provided for the following items: gas, insurance, credit cards, glassware, crisps and nuts, frozen food, water-saving device, mixed gas, LPG, butchers, washroom services and pest control.

(80) Almost all lessees have commented on this issue. Most have indicated that these procurement benefits represent no value whatsoever for their business. Others have indicated that better terms are almost always available elsewhere and have thus placed, in general, a minimal value to it (in the range of GBP 1 to 5/barrel for the recent years). A few respondents have actually indicated that one or two specific items were advantageous and referred to other specific items that they could obtain cheaper elsewhere. Several lessees pointed out that similar schemes were also available for free traders, but only two lessees have indicated such alternatives, one being 'Les Routiers', while the other lessee referred to a scheme of his local Victuallers' Association. However, this latter scheme was from a private profit-making organisation offering bulk-purchasing advantages to its members. For the few suppliers that figure on the WPP list as well as on the private company's list, the WPP discounts were better in all cases. The lessee that referred to 'Les Routiers' gave no details. Whitbread has indicated that 'Les Routiers' offers bulk purchasing, but it has a restricted membership and an annual fee. Purchasing terms on offer appear limited and Whitbread understands that suppliers report low levels of uptake and sales.

(81) One lessee indicated that these benefits were first negotiated and put into place for the managed houses so as to provide uniformity and accountability within the company and then also offered to the leased estate. Another lessee said

that these benefits were only of interest for the lazy lessee who could not bother to conduct the negotiations himself. Whitbread has indicated that the majority of terms offered to lessees are negotiated on the back of Whitbread's managed business contracts, which has the advantage that, in view of the substantial business arrangements with Whitbread, WPP can secure advantageous terms for lessees. However, separate negotiations by WPP with suppliers are required, as the profile of business from individual leased houses is different to that for the Whitbread management estate in view of factors such as debt, administration, individual order size and delivery frequency. Furthermore, WPP requests the suppliers to demonstrate why lower prices, if they apply at all, should apply to the managed estate.

(82) Several specific comments from lessees on bulk purchasing do not relate directly to the procurement benefits described. A lessee commented on a recent purchase of an ice-maker and a glass-washer at a cheaper price than the one on the WPP list. Although the lessee recognises that the WPP-advised products are of a very good standard and that such advice in itself can already be considered a benefit, these two products, although on the WPP list, were not taken into account for the above calculation, which is based on a selection of the (most important) offers. Other lessees have referred to 'plus pounds', a form of discounts offered by Whitbread on purchases of non-tied and cask-conditioned ales. These discounts can be paid out, used in settling the trading account, or compensated for by air miles. They are not considered to be procurement benefits. In one of the few cases where the lessees have provided details about the better rates obtainable elsewhere, verification with the actual WPP offer has shown that the offer for credit/debit cards referred to by the lessee was almost identical to the WPP offer.

(83) The Commission recognises that it may be possible to negotiate individually better terms with the same supplier than those offered by WPP. However, even if this were to be the case for all items, the fact that an interested lessee has a reference point, based on a negotiated rate for a large estate, to start price discussions is already an advantage in itself.

(84) It is self-evident that for each of the items listed there may be cheaper alternatives from other firms on the market. It is, however, virtually impossible to compare the WPP offer with possible alternative individual quotes from other suppliers in view of the number of areas to consider that have an impact on the true value of any supplier offer such as the quality of goods and services, the detailed terms comparison, the supplier's commercial concern with awareness of (confidential) terms in the market place, the range of terms per account-size, and time involved in researching the market, the geographic availability, the supplier confidence and problems resolution and so forth.

(85) The above-described methodology for calculating the procurement benefits compares the WPP terms with the wholesale list price of the same supplier, thereby reflecting the benefit that an individual lessee would receive if he/she did not actively seek improved terms or services and bought at the published price list. The Commission accepts that at least a significant proportion of lessees will actively look for cheaper deals, at least for some of the more important cost items, in operating the pubs. On the other hand, a large number of lessees have actually taken up the WPP offer: 1 010 frozen food, 988 the insurance, 842 bulk LPG, 384 credit and debit cards, 251 glassware, 177 gas (extreme volatility in the market), 158 crisps and nuts (WPP may not publish the prices in view of the supplier's sensitivity), 98 LPG (out of an estate potential of 130 to 140 accounts), 239 butchers (primarily used by concept houses), 50 to 200 washroom services, and a dozen on preventive pest control (the majority of usage is on a call-out basis which is not specifically recorded by the supplier). In addition, reference is made to the results of a recent survey among lessees on the 1997 Buying Guide. Of 155 responses, 37 (24 %) gave the best mark, 49 (32 %) gave a two, 42 (24 %) a three, 13 (8 %) gave mark 4 and 11 (7 %) gave the lowest mark 5 'not useful' (three lessees gave no reply).

(86) The Commission considers on the basis of all of the above considerations relating to the 'procurement benefits' that a reduction should be made to the value of the benefit as calculated by Whitbread and represented in the Notice in order to take into account the fact that, as was

stated in recital 85, a significant proportion of lessees will actively look for cheaper deals than the list price quoted by the supplier. However, in view of the references in recital 85 on uptake and satisfaction, and, in addition, to the fact that the availability of a list with suppliers with proven track-records in Whitbread's large managed estate is a benefit in itself (even if there are no additional discounts offered [17]), this reduction should be moderate. Therefore, and in order to reduce the margin of possible error as much as possible, the Commission will base its assessment of the value of this 'countervailing benefit' on a reduction by 25 % of the benefits as indicated by Whitbread and in the Notice. The relevant GBP/barrel figures for procurement benefits, in Table 3, are adjusted accordingly.

(87) The benefit which is attributed to capital expenditure carried out with existing lessees is calculated by subtracting from this expenditure the additional income for Whitbread which can be expected over five years as a result of the expenditure. This additional income consists of the average rent increase following the expenditure, multiplied by the number of projects, multiplied by 5.

(88) Almost all lessees who benefited from capital expenditure have given details of the total investment made by Whitbread and by themselves and the rent increase resulting from WPP's investment. They indicated that the rent increase is for the rest of the lease (which has a 20-year duration) and not only for the five years indicated in the above methodology. Some indicated that the full benefit of the investment will always go back to Whitbread after the end of the lease.

(89) One lessee indicated that WPP has a policy whereby for a capital investment of less than GBP 20 000, the annual rent increases with 20 % of the expenditure. For investments of more than GBP 20 000, the increase is 10 %. The figures presented by the lessees that had a capital expenditure confirm this overall policy. One lessee has indicated that the rent increase percentage will be higher for investment that is not aimed at increasing the consumption of drinks.

(90) It is, of course, correct that the rent increase is for longer than five years, but so is the benefit of the investment to the lessee. After the end of the Lease, the lessee in England and Wales has security of tenure (Landlord and Tenant Act, see recital 34) unless Whitbread wants to use the premises for its own purpose.

(91) However, the result of the above-described methodology is consistent with two possible alternative methodologies for calculating the 'countervailing benefit' element of the capital expenditure. The first alternative is a refinement. It consists of a reduction of the average rental increase used above by a post tax position (as the rental payments will be tax allowable). Then the discounted cash flow methodology is used in calculating the cost to lessees of their rental payments over time compared with the 'upfront' investment cost of Whitbread. Using a 'modest' [18] discount rate of 10 % and an average lessee tax rate of 30 %, the relevant benefit per barrel indicated in Table 3 can be extended up to 16 years without diluting the benefit per barrel. Such a period would thus cover the rest of the lease duration in almost all cases and will be actually longer than the rest of the lease duration for a lot of investments.

(92) The second alternative would be to consider the benefit from a lessee's perspective. It is based upon 11 projects completed by WPP in its designated east area from March to September 1997. The data contain the WPP spend (average of GBP 92 000), the known or estimated expenditure by the lessee (average GBP 17 500), the estimated post-rent lessee profit increase (average GBP 11 700) and the lessee's return upon investment rate (average 67 %). The average incremental profit is then compared with a 'normal' return of 15 % on the lessee's

[17] This is challenged by one of the complainants, who stated that the majority of the suppliers are household names well known to the licensed trade or readily available from any trade directory. With regard to the reference to trade directories, it is noted that in such directories all firms can list themselves and that this is no indication whatsoever as to the quality of the service. It is recognised that some of the suppliers are household names, well known to the licensed trade. For such firms, the main benefit is that the lessee receives a discount-offer based on the negotiated rate for the Whitbread managed estate.

[18] This is modest, as the required rates of return in most investments in the UK are in excess of 10 %.

investment to arrive at an average benefit of GBP 9 100. Relating the average WPP spend in the sample to the actual average would result in an average lessee 'countervailing benefit' of GBP 6 900 per annum. Taking five years as an appropriate period over which to measure this profit, this would produce a profit per barrel consistent with the one indicated below in Table 3.

(93) The result of this assessment of the price differential and the countervailing benefits are shown in the following table:

Table 3

Price differential and countervailing benefits

(GBP/barrel)

Year end 26 February		1990/1991	1991/1992	1992/1993	1993/1994	1994/1995	1995/1996	1996/1997
Pris differential	circa	21	27	31	32	34	36	40
Rent subsidy	circa	9	11	15	15	16	17	19
Professional services	circa	6	7	9	9	10	10	10
Procurement benefits	circa	3	3	3	3	10	11	12
Capital expenditure	circa			0	1	3	7	10
Conclusion	circa	– 3	– 6	– 5	– 3	5	9	11

(94) In addition to these quantifiable 'countervailing benefits', Whitbread has, in circumstances relating to the lessee's personal as well as business conditions, agreed to several hundreds of cases in which the lessee has surrendered the Lease. In a limited number of cases, Whitbread has agreed to a reduction of the rent [19]. These 'partnerschip' elements and the fact that the rent paid is lower than a free-of-tie rent support the claim that tied lessees face a risk return situation differing from that of free traders.

II. LEGAL ASSESSMENT

A. ARTICLE 85(1)

1. *The relevant market*

1.1. The relevant product market

(95) The relevant product market includes, in principle, all goods or services which are perceived by the consumer, on the grounds of their characteristics, price or intended purpose, as being reasonably interchangeable with each other [20]. As the Court of Justice has stated in the Delimitis judgment [21], 'the relevant market is primarily defined on the basis of the nature of the economic activity in question, in this case the sale of beer. Beer is sold through both retail channels and premises for the sale and consumption of drinks. From the consumer's point of view, the latter sector, comprising in particular public houses [22] and restaurants, may be distinguished from the retail sector on the grounds that the sale of beer in public houses does not solely consist of the purchase of a product but is also linked with the provision of services, and that beer consumption in public houses is not essentially dependent on economic considerations. The specific nature of the public house trade is borne out by the fact that the breweries organise specific distribution systems

[19] 36 cases in the period 1993-95; 20 cases in the financial year to February 1997 with an average reduction in rent of 24 %.

[20] Case 27/76, United Brands, [1978] ECR 207, paragraph 12.

[21] Case C-234/89, Stergios Delimitis v. Henninger Bräu, [1991] ECR I-935, paragraph 16.

[22] The German (procedural language) version of the judgment uses the term 'Schankwirtschaften'. In the French version, being the working language within the Court, the term 'cafés' is used.

for this sector which require special installations; and that the prices charged in the sector are generally higher than retail prices.'

(96) In view of the specific licensing system in the UK, it has to be specified which sections of the three distinct classes of on-licences (recital 22) form the relevant product market of 'public houses and restaurants'. In this respect, reference is made to recital 43 of the Notice to the Regulation where it is stated that 'the concept of "premises for the sale and consumption of drinks" covers any licensed premises used for this purpose. Private clubs are also included'. This is understandable, as all these outlets, including the restricted on-licenses, have the common feature that the drinks are purchased for consumption on the premises and that there is an important service element provided. The Commission recognises that the beer price in clubs, being in December 1994 some 82 % to 83 % of that prevailing in pubs, is lower than that charged in pubs ([23]). However, this reflects to a large extent the fact that these clubs operate on a non-profit basis. It remains the case that, in view of the service element, the price in clubs is still in excess of the price of beer in supermarkets. Furthermore, the specific distribution system for the whole on-trade, including clubs, is the same: the special installations for draught dispense, the brewers' beer list prices, and the operation of loan ties.

(97) It follows that the reference market is that for the distribution of beer in premises for the sale and consumption of drinks (the whole on-trade market). As was held in the Delimitis judgment ([24]), that finding is not affected by the fact that there is a certain overlap between the on- and off-trade, inasmuch as retail sales allow new competitors to make their brands known and to use their reputation in order to gain access to the market constituted by premises for the sale and consumption of drinks.

1.2. **The relevant geographic market**

(98) The objective competitive conditions of supply and demand for the supply of beer to the on-trade vary considerably in the different parts of the Community. As the Court of Justice has noted in the Delimitis judgment at paragraph 18, most beer supply agreements are still entered into at a national level. It follows that, in applying the Community competition rules to the agreement, account is to be taken of the UK market for beer distribution in premises for the sale and consumption of drinks.

(99) The UK market is also distinct from beer markets in other Member States in view of the Orders (recital 15), the high consumption of draught beer (recital 18), the presence of pub-management companies (recital 21), the pub licensing regulations (recitals 22 and 33) and the variety in types of ale offered (recital 42).

2. *Agreement between undertakings*

(100) Whitbread and the lessees are undertakings within the meaning of Article 85(1).

(101) The individual leases, in a form similar to the standard Leases described above, between Whitbread and each of its lessees are agreements within the meaning of Article 85(1).

3. *Restrictive effect on competition of the principal restrictions*

3.1 **Description and nature of the principal restrictions**

(102) A beer supply agreement such as the Leases is generally qualified by referring to the exclusive purchasing obligation which is generally backed by a non-competition obligation ([25]). These clauses are formulated in the Lease as follows (recitals 42 and 43 above):

— the tenant shall purchase from Whitbread or its nominee and from no other person or firm such specified beers (with the exception of the guest beer clause) as he shall require for sale in the premises; in practice, the brewer is free to add, replace or delete the actual brands of a specified type in the company's price list (exclusive purchasing obligation),

([23]) Extracts from Stats MR's survey of retail prices, submitted by a national brewer to the OFT.

([24]) See footnote 21; at paragraph 17.

([25]) See footnote 21; at paragraph 10.

— the tenant shall not sell or expose for sale in the premises or bring on to the premises for the purpose of sale therein: (a) any beer which is of the same type as a specified beer but which is not supplied by Whitbread or its nominees; or (b) any other beer unless (i) either it is packaged in bottles, cans or other small containers, or (ii) it is in draught form and the sale of that beer in draught form is customary or is necessary to satisfy a sufficient demand from the lessee's circumstances (non-competition obligation).

(103) It may be noted that, apart from the explicit non-competition obligation with regard to specified types of beers, the exclusive purchasing obligation is so formulated that it already includes implicitly a non-competition obligation by reference to the general wording 'such specified beers'.

(104) Because of the exclusive purchasing obligation, the lessees are precluded from accepting offers of contract goods from other suppliers. Competition for the lessees between the brewer and other beer wholesalers who offer the same brands is precluded (restriction of intra-brand competition).

(105) The explicit and implicit non-competition obligation for specified types of beer — that is, the prohibition on the lessees against purchasing other brands of specified types from other producers of beer, restricts inter-brand competition. The contractual provisions on the purchase of non-specified types impose certain administrative constraints on the lessees but do not in effect restrict their ability to offer such non-specified types on their premises. These clauses therefore lack a restrictive effect on competition.

3.2. **Restrictive effect**

(106) Having identified the nature of the restriction of competition brought about by the network of the brewers' leases, the restrictive effects on retailers and suppliers in the relevant market need to be demonstrated [26].

(107) In the case of Brasserie De Haecht v. Wilkin [27], the Court of Justice held that the effects of a beer supply agreement had to be assessed in the economic and legal context in which they occur and where they might combine with others to have a cumulative effect on competition. It is therefore necessary to assess, as a first step, the overall effect of all networks in the UK. However, it also follows from that judgment that the cumulative effect of several similar agreements constitutes one factor amongst others in ascertaining whether competition is prevented, restricted or distorted [28].

3.2.1. *Cumulative effect of several similar networks*

(108) The purpose of this assessment is to measure the degree of foreclosure of the UK on-trade market, thereby measuring the hindrance of the opportunities for other producers of beer, national or foreign, to reach the on-trade market independently, resulting from the cumulative effect of all brewers' networks. In other words, the assessment relates to the opportunities open to such other brewers to reach the final consumer in competitive conditions [29] defined independently by the brewer in question.

(109) Furthermore, as Whitbread notified the Leases in order to obtain an exemption to take effect from the date on which the agreements were entered into, this assessment must go back to 1990, the year of introduction of the 20-year lease.

(110) The foreclosure resulting from the brewers' networks has different forms. First, there is the vertical integration by UK brewers down to the retail level. This vertical integration takes the form of managed houses and property tied

[26] See also paragraph 13 of the Delimitis judgment: 'If such (exclusive beer supply) agreements do not have the object of restricting competition within the meaning of Article 85(1), it is nevertheless necessary to ascertain whether they have the effect of preventing, restricting or distorting competition.'

[27] Case 23/67, ECR 1967, p. 407.

[28] See footnote 21; at paragraph 14.

[29] With regard to competition policy, the main parameters are what is called the 'above the line' parameters: overall positioning of the brand (including pricing), general marketing policy (advertising concept, national advertising, promotions) as opposed to 'below the line' which is more 'point of sale'-related marketing.

houses. Secondly, the network includes 'vertical agreements' on either of two levels: either, directly with retail outlets via loan ties, or on the wholesale level, by 'tying' supply agreements, namely agreements containing exclusive purchasing obligations, minimum purchasing obligations, must-stock obligations and so forth with 'traditional' wholesalers, non-brewing pub companies or other brewers in their wholesale function.

(111) From Table 2 (recital 23) it can be seen that sales of the property tied and managed houses of brewers represented in 1985 about 55 % of sales in the on-trade. Loan ties foreclosed another 22 % of the on-trade market in that year. As there have been only limited changes in the situation on the UK on-trade beer market prior to the Orders, the 1985 data are considered representative for at least the years 1985 to 1989. In 1990, the Orders were still not fully implemented so that, although the situation was starting to change compared to the previous years, it can be estimated that still around 70 % of consumption of beer in the UK on-trade occurred in tied outlets.

(112) For the year 1997, the last year for which this kind of data is available, brewers' property tied and managed houses account for 27,2 % of volume throughput. Loan ties account for 18,1 %. An unidentifiable part of the volume for loan ties is not supplied subject to a legally binding commitment on the part of the retailer to buy the volume of the tying brewer (see recital 25) ([30]), but it is most likely that the binding commitment will at least cover 10 % of on-trade volume throughput. Accordingly, the conclusion must be that the UK brewers tie themselves directly to a maximum extent of 45,3 % (but most likely at least 37 %). This volume throughput of the UK on-trade market offers no direct opportunities for independent access by other brewers direct to the retail level.

(113) It has been argued that since the Orders made it possible to terminate a loan tie upon three months' notice, such ties should no longer be regarded as hindering any opportunities for access.

(114) The Commission accepts that independent access to the loan-tied outlets in question is not always excluded, as there are an unidentified number of non-exclusive loan tie agreements ([31]). However, for the volume covered by non-exclusive loan ties, the possibility for other brewers to reach directly the final consumer in competitive conditions defined independently by the brewer in question is limited.

(115) The Commission also recognises that the Orders make it easier to terminate a loan tie. However, the average duration of four years indicates that the contractual relationship is not a temporary one. Furthermore, the brewer wanting to enter independently into loan-tied premises needs to offer the individual pub operator the finance to pay back the first loan (by way of, most likely, a new loan tie). Competition between such brewers is thus not restricted to the quality and (direct) price of the beer, but requires the other brewer also to offer loan ties. In addition, it needs to be remarked that such an independent entry into loan-tied premises would only make sense for a brewer that offers all or most types of beer typically offered by a pub retailer to the public, because otherwise the total finance cost of the loan would need to be recouped by the sale of one brand (or a limited number of brands).

(116) It is not disputed that the tied volume might still offer indirect access for other brewers in so far as the (property or loan) tying brewer/wholesaler is prepared to supply to its tied outlets beer from other brewers. However, the assessment on foreclosure focuses on opportunities for independent access for other brewers which clearly does not result from 'horizontal' cooperation between actual competitors. Such cooperation may limit the level of inter-brand competition between the brewers in question and the tying brewer will

([30]) The intrinsic link between the loan tie and the actual volume purchased cannot be denied, the best evidence for this link is the inability of the brewers to dissociate the two in their internal accounts.

([31]) This access could be excluded in practice by way of multiple non-exclusive loans.

only allow an other brewer's beer in his outlets when this is in the tying brewer's interest.

(117) In addition to the direct (managed and leased houses and loan ties) ties by UK brewers of retail outlets, reference has to be made to the 19,7 % (in 1997) going through the non-brewing pub companies' property tied and managed houses. It is estimated that around 13 % is accounted for by 'tying' supply agreements between pub companies and brewers. This percentage includes the volume throughput of Inntrepreneur Pub Company Limited, Spring Estates Limited and Allied Domecq Retailing, all of which had to buy in 1997 ([32]) almost all the beer requirements of their estate from one national brewer. Also included are the estimates of the four national brewers of their supplies subject to contractual restriction to other pub companies.

(118) It can thus be concluded that a maximum of some 58 % (but most likely at least 50 %) of the UK on-trade volume was still accounted for in 1997 by tying restrictions of brewers. Therefore, the bundle of tying agreements of UK brewers has since 1990 had considerable effect on the opportunities for gaining independent access to the UK on-trade beer market.

3.2.2. *Other factors*

(119) The Court of Justice also held that, as was last confirmed in the abovementioned Delimitis judgment, the effect of the network of exclusive purchasing agreements is only one factor, amongst others, pertaining to the economic and legal context in which an agreement must be appraised. The other factors to be taken into account are, in the first instance, those also relating to opportunities for access and, secondly, the conditions under which competitive forces operate on the relevant market.

3.2.2.1. Opportunities for access

(120) Paragraph 21 of the Delimitis judgment referred to the 'real concrete possibilities for a new competitor to penetrate the bundle of contracts by acquiring a brewery already established on the market together with its network of sales outlets, or to circumvent the bundle of contracts by opening new public houses. For that purpose, it is necessary to have regard to the legal rules and agreements on the acquisition of companies and the establishment of outlets, and to the minimum number of outlets necessary for the economic operation of a distribution system. The presence of beer wholesalers not tied to producers who are active on the market is also a factor capable of facilitating a new producer's access to that market since he can make use of those wholesalers' sales networks to distribute his own beer.'

(121) It is not easy to open a substantial number of new pubs within a couple of years in view of the licensing laws (see recital 33). Moreover, although there is an active trade in UK pubs, and although substantial numbers of pubs have been sold off in single deals, it has to be remarked that the investment that would need to be borne by a new competitor to acquire a network of sales outlets or to open new public houses is a considerable one ([33]) and would, in fact, involve a change in focus from being a brewer to also being a UK retailer. This would, furthermore, require additional horizontal links with other UK brewers to provide all the different types of beer that a retail outlet would need to offer as new competitors (and especially foreign competitors) will tend to offer individual brands rather than the whole range of types of beer common in the UK.

(122) Direct takeovers of UK brewers (and their tied estate) by foreign brewers have occurred a few times in recent years, but in most cases the foreign brewer has since divested itself of its interest again (the Dutch brewer Grolsch in

([32]) The exclusive supply agreement for the Inntrepreneur and Spring estates ended on 28 March 1998; that for the Allied Domecq estate on 12 December 1997.

([33]) The average sales price of a private freehold UK pub is around GBP 200 000 (*source:* Fleurets).

Ruddles, and the Australian brewer Foster's in Courage).

(123) In addition, the relatively small role played by 'traditional' wholesalers in the distribution of beer in the UK (recital 20), make it difficult for a foreign brewer, or for a new brewer, to enter the market independently.

(124) Therefore, in most cases, foreign breweries license a major UK brewer to brew and distribute their products within the UK, thereby gaining access to their public houses and distribution facilities to free houses. In such circumstances, the UK brewer will have a strong influence on the positioning and the marketing (advertising) of the foreign brewer's brand.

(125) The Commission accepts that the increased importance of retail sales volume in outlets operated by non-brewing pub companies offers, at least theoretically, an increased possibility for other brewers to gain an access to the UK on-trade beer consumer. It is indeed a lot easier for a newcomer on the market to conclude an agreement with a pub company, even if the newcomer would only have one brand, and thereby gain access to all the pubs in that network, in preference to concluding agreements with individual outlets. However, as was stated above in recital 117, the concrete opening of this segment of the market cannot be estimated accurately. In addition, a brewer wishing to supply a pub company without its own distribution facilities would need to organise the distribution (see also recitals 21 and 30).

3.2.2.2. Competitive forces on the market ([34])

(126) The UK brewing industry has been going through a process of concentration (recital 19). Furthermore, the overall demand for beer as well as the on-trade market are likely to continue to decline or remain, at best, static (recital 16). Moreover, the ever-increasing advertising expenditure to support a single brand (a sunk cost), gives a further incentive to foreign brewers to enter via licensing agreements. Finally, the possibilities of building upon a reputation in the off-trade beer market to gain access to the on-trade market is more limited in the UK than in most other European countries in view of the fact that the off-trade represents only 27 % of total beer sales (recital 16).

3.3. **Conclusion on first Delimitis test**

(127) It can thus be concluded that an examination of all tying agreements, including but not limited to beer-supply agreements entered into, and the other factors relevant to the economic and legal context of the UK on-trade market shows that the brewers' tying agreements had in 1990 and still have today, on the basis of the most recent available information, the cumulative effect of considerably hindering independent access to that market, for new national and foreign competitors.

3.4. **Significant contribution**

(128) It is now necessary to assess, as the Court explained in paragraph 24 of the Delimitis judgment, 'the extent to which the agreements entered into by the brewery in question contribute to the cumulative effect produced in that respect by the totality of the similar contracts found on that market. Under the Community rules of competition, responsibility for such an effect of closing off the market must be attributed to the breweries which make an appreciable contribution thereto. Beer supply agreements entered into by breweries whose contribution to the cumulative effect is insignificant do not therefore fall under the prohibition under Article 85(1)'. Therefore, in assessing the extent of the contribution made by the brewery in question, in this case Whitbread, the brewer's total tied network, including but not limited to the exclusive purchasing obligation and the inherent non-competition obligation in the Leases, must be assessed. In other words, it is the network that, according to the Delimitis judgment, 'must make a significant contribution to the sealing-off effect brought about by the totality of the brewers' tying agreements in their economic and legal context' ([35]).

(129) In so doing, consideration will be given to the effect of the network of Whitbread as a whole;

([34]) See footnote 21; at paragraph 22.

([35]) Penultimate sentence of paragraph 1 of the operative part of the judgment.

the finding of a restrictive effect for the network would then apply equally to each of its constituents ([36]).

3.4.1. *The beer* de-minimis *Notice* ([37])

(130) Whitbread is clearly not a 'small brewer' as defined by the Notice, as it produces more than 200 000 hl, its market share is more than 1 % of the UK on-trade market and the standard 20-year Lease is longer than the maximum of 15 years indicated in the Notice.

3.4.2. *Individual assessment*

(131) The Court has ruled in the Delimitis judgment ([38]) that 'the extent of the contribution made by the individual agreement depends on the position of the contracting parties in the relevant market and on the duration of the agreement.' In paragraphs 25 and 26 of the judgment, the Court has held that 'that positiion is not determined solely by the market share held by the brewery and any group to which it may belong, but also by the number of outlets tied to it or to its group, in relation to the total number of premises for the sale and consumption of drinks found in the relevant market'. As to the duration, the Court indicated that 'if the duration is manifestly excessive in relation to the average duration of beer supply agreements generally entered into on the relevant market, the individual contract falls under the prohibition under Article 85(1). A brewery with a relatively small market share which ties its sales outlets for many years may make as significant a contribution to a sealing-off of the market as a brewery in a relatively strong market position which regularly releases sales outlets at shorter intervals.'

(132) In the German ice-cream cases, the Court of First Instance, in assessing the significant contribution of the companies in question, referred to 'the strong position occupied by the (company concerned) in the relevant market, and, in particular, its market share' ([39]). The CFI has thus based itself primarily on the broader concept of the overall market share.

(133) An assessment of the contribution by the brewer therefore needs to take into account its position on the relevant market, and in particular his contribution by way of tying arrangements to the foreclosure and, secondly, the duration of his restrictive agreements, and in particular his standard agreements.

(134) The assessment of the contribution of the brewer takes into account the managed estate of the brewer, although this latter part in itself does not fall under Article 85(1), as it does not concern an agreement between independent operators. In considering the notified agreements (as part of the brewer's network), it is particularly important that due account be given to the foreclosure resulting from the managed estate of a national brewer, since the total number of property ties is limited by the Orders. However, within that number the brewer is free to choose whether he wants to operate the house by way of a tenancy/lease agreement or by way of a managed house. The brewer has thus the possibility of offering at any time a lease agreement for a currently managed house, and, after the end of a Lease, the brewer may turn the leased house into a managed house.

(135) The other segments of the 'tied network' of Whitbread are Whitbread's loan ties and amounts of beer for which its 'wholesale partners' are under an obligation to buy (exclusivity, minimum purchasing, must-stock, non-compete and so forth). However, as was indicated at recital 12, the Commission does not have any precise data for this 'channel'. Furthermore, in assessing any brewer's role on the market, account can also be given to his overall market share of the UK on-trade market, and its share on the related UK beer production market.

(136) The 6 162 pubs (of which 4 291 were operated by way of tenancies/leases) owned by Whitbread

([36]) The Court of First Instance pointed out in Cases T-7 & 9/93, Langnese-Iglo and Schöller, [1995] ECR II-1539 and II-1611, paragraphs 129 and 95 respectively (hereinafter 'the German ice-cream cases') that 'where there is a network of similar agreements concluded by the same producer, the assessment of the effects of that network on competition applies to all the individual agreements making up the network.'

([37]) Paragraph 40 of the Notice to the Regulation (OJ C 121, 13.5.1992, p. 2).

([38]) Last sentence of paragraph 1 of the operative part of the judgment.

([39]) See footnote 36; at paragraph 87 for Schöller and paragraph 112 for Langnese-Iglo.

in 1990/1991 and the 4 490 (2 130 leased) owned in 1996/1997 account for 4 % and 3 % respectively of the total number of on-licensed premises. Moreover, they account, as was indicated in Table 1 (recital 10), for 5,67 % and 4,92 % respectively of the on-trade volume in 1990/1991 and 1996/1997 (the property tied part accounting for 2,98 % and 1,70 %). The Whitbread tied sales for which the Commission has the data, namely the above and including the loan tie sales, account for 7,59 % and 6,12 % respectively of the UK on-trade market volume. The 'tied' part (property, loan and managed) thus accounts for half of Whitbread's total sales on the on-trade market share of 12 % to 13 %. To these already significant 'tied' market shares should be added the 'wholesale partners' ties' as described in recital 135.

(137) With regard to the duration of the segments of Whitbread's tied network, it has to be understood that all the houses that Whitbread owns are, in principle, always 'locked in' to the company. This is not only the case for the managed house, but also the leased houses will after the end of one (short- or long-term) lease, be re-let to another operator on a tied basis. In addition, the most important of the notified leases, the 20-year lease, is amongst the longest in the UK. Whitbread's loan ties last on average three years.

(138) It is therefore concluded that Whitbread's tied sales, of which the notified agreements are a part, contribute significantly to the foreclosure of the UK on-trade market. The exclusive purchasing obligation and the non-competition obligation in the Leases therefore have a restrictive effect on competition.

4. *Restrictive effect on competition of other restrictions*

4.1. Description

(139) The Leases contain the following clauses for which it has been argued by some of the respondents to the Notice that they have a restrictive effect on competition:

— to put and keep the premises and the fixtures and fittings in good repair in the case of the 20-year lease (different obligations in the two other standard leases),

— to use the premises only as a fully licensed public house,

— restrictions on assignments (recital 39),

— to sell trade fixtures and fittings, furniture and effects and stock, on termination of the lease, to Whitbread or to the new lessee,

— not to place amusement machines without the consent of Whitbread, and

— to avoid advertising goods supplied by other undertakings in a higher proportion than the share of those goods in the total turnover realised in the premises (hereinafter 'the advertising clause').

4.2. Evaluation

(140) The first four of the above clauses cannot be considered to have the object or the effect of restricting competition in a particular market. The clause with regard to the amusement machines is not restrictive in view of the influence of amusement machines on the character of the premises ([40]).

(141) Whether or not the advertising clause falls foul of Article 85(1) is only relevant to the market for the distribution of beer. With regard to all other neighbouring markets for the supply of goods to on-licensed premises in the UK, such as non-beer drinks, crisps and amusement machines, the clause is not restrictive. The Leases, in the absence of an exclusive purchasing obligation and a non-competition obligation for the supply of such products, do not restrict competition on such markets, if such were considered to exist, to an appreciable extent by the mere imposition of an advertising clause.

(142) With regard to the supply of beer, the advertising clause has the object of limiting

([40]) See also paragraph 53 of the Notice to the Regulation; see footnote 15.

the advertising of beer supplied by other undertakings. The only beer that the Whitbread lessee is entitled, pursuant to his Lease, to buy from other undertakings is the guest beer and beer of non-specified types. In particular, the brands of beer of non-specified types may not be well known to the UK consumer and therefore would require specific on-the-spot advertising. The letter of the clause would make advertising for these new products impossible, as the clause requires the advertising to be proportionate to the turnover of these goods, which, by definition, is virtually zero as the goods are new. However, the Commission possesses no information that the advertising clause has been as strictly applied as this. On the contrary, Whitbread has confirmed in a letter dated 26 October 1998 that 'Whitbread does not enforce this clause as it relates to competing products, and has no intention to enforce it, as will immediately be apparent from the fact that lessees have freedom to advertise, promote and market according to the marketing mix of their choice as appropriate to their chosen business plan'. This is confirmed by what several lessees have indicated in their submissions, namely that they consider that they receive more 'promotional support' from their guest beer supplier. None of them has indicated that Whitbread has ever opposed the use of that material in the pub.

In these circumstances, the advertising clause is not considered to be an appreciable restriction of competition.

5. *Effect on trade between Member States*

(143) Where, for the reasons described above, the effect of the exclusive purchasing and non-competition obligations in the Leases in question is to eliminate the freedom of the lessees to stock and offer for sale to the consumer specified beers of competing suppliers, those suppliers are impeded, irrespective of their geographical location and the origin of the goods, in gaining access to the premises concerned unless they have concluded a specific agreement with Whitbread. This restriction has the effect that the level of trade in beer may be at a lower level than would otherwise be the case. The opportunities for foreign suppliers to establish themselves independently in the UK on-trade beer market are in particular affected; the 'tying' agreements, including the exclusive beer-supply agreements, are likely to protect a substantial part of the UK market from direct competition from competing goods originating in other Member States. Indeed, as was noted in recital 31, most foreign producers have chosen to enter the UK market by entering licensing agreements with existing brewers, including Whitbread, to gain access to their on-trade network ([41]). Accordingly, the Leases affect trade between Member States.

6. *Appreciability*

(144) The exclusive purchasing and non-competition obligations only infringe Article 85(1), however, if they affect competition and trade between Member States to an appreciable extent.

(145) The quantification of the restrictive effect of the cumulative networks and the other factors contributing to the foreclosure of the UK on-trade beer market, and of the significant contribution made by Whitbread's network to that effect, as laid out in recitals 108 to 143, demonstrate their appreciable nature in restricting competition and trade between Member States with respect to the UK on-trade beer market.

7. *Conclusion*

(146) The exclusive purchasing and non-competition obligations of the Leases fall foul of Article 85(1) since the introduction of the Leases in 1990.

B. ARTICLE 85(3)

1. *Regulation (EEC) No 1984/83 (the Regulation)*

(147) The Court has confirmed in the Delimitis judgment (paragraph 36) that Article 6(1) of the Regulation requires that the exclusive

([41]) Commission Decision 90/186/EEC — Moosehead/Whitbread (OJ L 100, 20.4.1990, p. 32, at recital 16).

purchasing obligation on the part of the reseller shall relate solely to certain beers or to certain beers and drinks specified in the agreement. The purpose of requiring that they be so specified is to prevent the supplier from unilaterally extending the scope of the exclusive purchasing obligation. A beer supply agreement which refers, for the products covered by the exclusive purchasing agreement, to a list of products which may be unilaterally altered by the suppliers does not satisfy that requirement and thus does not enjoy the protection of Article 6(1). The Court thus concluded (paragraph 37) that the conditions for the application of Article 6(1) of the Regulation are not satisfied if the drinks covered by the exclusive purchasing terms are not listed in the text of the agreement itself but are stated to be those set out in the price list of the brewery or its subsidiaries, as amended from time to time.

(148) The standard Leases provide for a specification of the beer tie by type which allows Whitbread to add to, delete or substitute the brands of beer that it supplies to the lessees by amending the contents of its price list from time to time for specified beers. The specification of the beer tie by type thus allows Whitbread unilaterally to extend the scope of the exclusive purchasing obligation and therefore does not fulfil the conditions of Article 6, which requires a specification by brand or denomination ([42]).

(149) It is for this reason that the standard Leases do not fulfil the conditions of the Regulation.

2. ***Individual exemption***

2.1. ***Improvement in distribution***

2.1.1. *General considerations*

(150) A beer supply agreement generally leads to an improvement in distribution as it makes it significantly easier to establish, modernise, maintain and operate premises used for the sale and consumption of drinks (see also recital 15 to the Regulation). This is true for the brewer/supplier who does not need to integrate vertically as well as for the lessee. The letting of premises at an agreed rent as in the Whitbread standard Leases, particularly in view of the restrictive UK licensing system, is a method of providing the means for a lessee to operate such premises and, as such, allows a low-cost entry of a newcomer on the on-trade market for the distribution of beer. The system whereby brewers in the UK allow an independent business person to operate a licensed property owned by the brewer thereby increases the options for entry into the market. In a way, property tied houses and sometimes described as a 'half-way house' between being a manager (in a managed pub owned by the brewer/pub company) and owning their own pub (which may be loan-tied or totally free).

(151) The incentive on the reseller, following from the exclusive purchasing and the non-competition obligation, to devote all the resources at his disposal to the sale of the contract goods will thereby generally lead to an improvement in the distribution of those contract goods. In other words, as is stated in recital 15 to the Regulation, such agreements lead to durable cooperation between the parties allowing them to improve or maintain the quality of the contract goods and of the services to the consumer and sales efforts of the reseller. They allow long-term planning of sales and consequently a cost-effective organisation of production and distribution, and the pressure of competition between products of different makes obliges the undertakings involved to determine the number and character of premises used for the sale and consumption of drinks in accordance with the wishes of customers.

(152) With regard to the long-term duration of the exclusivity obligation and non-compete clause contained in the Lease, it has to be noted that special rules are applied in cases where the premises used for the sale and consumption of drinks are let by the supplier to the reseller. In this respect reference is made to Article 8(2)(a) which states that 'exclusive purchasing obligations and bans on dealing in competing products specified in the Title may be imposed on the reseller for the whole period for which the reseller in fact operates the premises'. On this basis, the long-term duration of the exclusivity obligation and the non-compete clause contained in the Lease therefore do not

([42]) See footnote 15.

constitute an obstacle to exempting the exclusive obligation and non-compete clause.

(153) Furthermore, the specification of the tie by type is considered to enable a more practical operation of exclusive beer-supply arrangements in the UK than the specification provided for in the Regulation. The specification of the tie by type makes it easier to introduce the brands of foreign or new brewers to their price lists because it does not require the consent of all the tenants ([43]). This is particularly the case in view of the large number of beers supplied by Whitbread to the lessees and of the frequency with which Whitbread adds or substitutes a beer on its price list, including foreign brands. This is important in view of the high percentage of all beer sold in the UK as draught beer in pubs, and the foreclosure of some 70 % (in 1989) or a maximum of some 58 %, but most likely at least 50 % (in 1997) of the UK on-trade by UK brewers: nevertheless, foreign or new brewers may still find it particularly difficult to penetrate the UK market independently. It is further to be noted that in any case the tenant is not in a position to add brands because the brewer would have been allowed to prohibit sales by the lessee of other brands of the same type in his outlet in the same way as the non-compete clause is exempted under Article 7(1)(a) of the Regulation. The tenant is therefore in no position to affect, whether positively or negatively, the level of foreclosure in the UK on-trade beer market.

(154) It is correct that a lessee might be forced to buy unfamiliar products when Whitbread sells his tied house to another company. Where this change takes place 'overnight', it may have a considerable impact on turnover in the relevant house, and thus for the individual lessee concerned. However, from a competition point of view, the contractual structure offers in such circumstances an opportunity for new or increased entry for other brewers, national or foreign. If such a change takes place on a gradual basis, it might not have a detrimental impact on the individual lessee's position. In this respect, it can be noted that a gradual change of brand portfolio will probably even occur in a declining market in order to take new or changing consumer preferences into account. Furthermore, it would not be in the long-term commercial interest of the 'new'owner to ruin the profitability of his newly owned premises by offering brands in which the customers would not be interested.

([43]) In so far as the underlying agreements are in conformity with Article 85.

2.1.2. *Price differentials*

(155) However, the Commission considers that where there are appreciable price differences, faced by the tied lessee, it has to be further assessed whether the above-described advantages can materialise.

(156) Price discrimination is an important element in the economic justification for an exemption to exclusive purchasing agreements. This is because, in the first place, the possibility of discriminating is facilitated by the exclusive purchasing agreement, which for the duration of the agreement gives the purchaser, unlike the other clients of the producer, no alternative legal source. A brewer might therefore decide to 'cash in' on his leverage *vis-à-vis* his tied customers.

(157) Secondly, with regard to the condition regarding the improvement in distribution, the Commission considers that someone who faces an appreciable 'net' price discrimination might face difficulties in competing on a level playing field. Consequently, any improvements in distribution resulting from such agreements may maintain theoretical, or be structurally inhibited in such a way that they cannot outweigh in the longer term the anti-competitive features of the agreement. This idea that price discrimination can be incompatible with Article 85(3) is also expressed in the Regulation, of which recital 21 points out that 'in particular cases in which agreements satisfying the conditions of this Regulation nevertheless have effects incompatible with Article 85(3) of the Treaty, the Commission may withdraw the benefit of the exemption'. These circumstances, laid down in Article 14 of the Regulation, include unjustified price discrimination ([44]).

(158) The relevance of the above considerations to the standard Leases, in the context of the UK on-trade beer market, is that the lessee who faces (unjustified) price differentials may not be in a position to compete on a level playing field.

([44]) See Article 14(c)(2) of the Regulation: 'the application of less favourable prices or conditions of sale [...] without any objectively justified reason'.

His business, all other conditions being similar, will be less profitable or might even become unprofitable. The impact of this adverse effect on profitability, either at the moment of entering as a newcomer into the market or during any considerable period in time during the operation of his business, means that the lessee may be unable to keep up with his competitors, who can make use of the beer price discounts either by passing them on in part to the final consumer by lowering temporarily or permanently the price at which they sell the same beer, or by investing in their total pub 'offer' (new kitchen, toilets, family facilities, and so forth). This will lead, all other conditions being equal, to an even further loss of competitiveness for the lessee, whose clients will receive a better offer for the same price in other pubs.

(159) Unjustified price discrimination will only have an appreciable negative impact on the competitiveness of the lessee, and will therefore only affect the appraisal of any lack of improvement in distribution, if and when it is significant and lasts over a considerable period of time. It is estimated that the level of discounts (before taking into account any possible justification) traditionally found on the UK on-trade market up to the mid-1980s (MMC report of 1985: individual free houses receiving a discount from 3 % to 5 %) were not of such a significant nature. However, since that date, and over the period of the standard Leases, the situation has altered and certain groups of purchasers receive discounts of a substantially higher level than those granted to the tied lessees. This was looked at in some detail in the OFT report.

(160) Such higher discounts are available to all other operators in the UK on-trade market who do not have an agreement with similar exclusive purchasing obligations and with whom Whitbread trades: wholesalers, pub management companies and other brewers, and the individual free traders. Furthermore, the discounts granted to wholesalers, the own managed houses, and pub management companies and other brewers are, on average, higher than those granted to the individual free traders.

(161) Most of the direct competitors of the tied lessees, namely brewers' managed pubs, managed houses of pub companies, loan-tied houses and free-trade operators, and clubs (being only to a limited extent direct competitors of the tied lessees in view of the restricted access) are thereby enabled to buy their beer cheaper than the tied lessees.

(162) As for the above competitors, only the free-trade operators (the non-loan-tied supplies to clubs have been included in the Whitbread data on the discounts for the free trade operators) directly purchase their beer on market terms from Whitbread; this group is considered to be the 'reference group'. They are indeed the only group where '*the supplier* […] applies favourable prices […] to resellers bound by an exclusive purchasing obligation as compared with other resellers *at the same level of distribution*' ([45]) (*italics added*).

(163) Table 3 (recital 93) indicates clearly that the price differential between the price paid by tied lessees (the WPP list price minus discounts on cask-ale purchases) and the average price paid by individual free-trade operators has increased every year in view of the increasing discounts granted to such individual free traders.

2.1.3. *Countervailing benefits*

(164) However, Whitbread has argued that the relationship with its lessees should not only be judged by reference to the price the lessees pay, and that the whole business relationship should be taken into account in order to judge whether the lessee is able to 'survive' in the market place, and, hence, whether the improvement in distribution can be argued.

(165) The Commission accepts this argument. However, this implies an inherently difficult comparison between on the one hand, clearly quantifiable price differentials and on the other hand more qualitative aspects of the business relationship.

(166) The description of the so-called 'quantifiable countervailing benefits' in recitals 57 to 93 reflects the difficulties involved in such quantification. However, in view of the arguments described there in support of the

([45]) Article 14(c)(2) of the Regulation.

methodology for each of the benefits and the factual information which backs up the results for these different items, the Commission considers that the result, described as 'Conclusion' in Table 3, provides a reasonable instrument for the Commission to decide, within its discretionary margin in applying Article 85(3), whether the 'practical' operation of the standard Leases brings about an improvement in distribution.

(167) In its assessment of the conditions of Article 85(3), and in particular where a retroactive exemption is requested, the Commission cannot make an overall assessment for the whole 'retroactive' period, but should evaluate whether at all times the conditions of Article 85(3) are fulfilled. The Commission considers, in view of the 'standard' nature of the notified agreements which cover several hundreds of individual agreements, and given the intrinsic complexity of the data and the limited availability of data on bases other than annual, that it is reasonable to limit its assessment of whether the conditions of Article 85(3) are fulfilled to a year-by-year assessment.

(168) It is apparent from Table 3 that for the years 1994/1995 onwards the price differential is more than offset by quantifiable countervailing benefits. The 'average' lessee is therefore, on an overall assessment of the business relationship with Whitbread, in a position to compete on a 'level playing field' with his free-trade counterpart. Over the years 1990/1991 to 1993/1994, the price differential was not totally offset by the countervailing benefits, the shortfall being between GBP 3 and GBP 6 per barrel. However, the Commission considers that these figures in itself are not sufficient to warrant the conclusion that the average tied lessee faced, during each of these years, significant handicaps in his capacity to compete. This view is based on (a) the fact that such figures represent between 1 % and 3 % of the beer price and (b) the existence of 'unquantifiable' countervailing benefits, mainly the different risks faced by a tied lessee as compared to a free trader (recital 94).

(169) The Commission therefore concludes that for the whole duration of the standard Leases there are no arguments to support the conclusion that the improvements in distribution described in general terms above have not been obtained. This conclusion is supported by the fact that during the period from 1991 to 1997, which incorporates the longest recession in the UK economy, the percentage of bad debt among Whitbread lessees has been, on average, three times less than for Whitbread's individual free trade-clients.

(170) The standard Leases, including the tying restrictions, have thus contributed to an improvement of distribution on the UK on-trade beer market.

2.2. **Benefits to the consumer**

(171) With regard to the general benefits created by tied leases, recital 16 of the Regulation indicates that 'consumers benefit from the improvements described, in particular because they are ensured supplies of goods of satisfactory quality at fair prices and conditions while being able to choose between the products of different manufacturers' ([46]).

(172) In addition to these general references, it can be noted that property ties create an incentive for brewers to invest, or maintain investment, in outlets that may be too small to be economically run by the brewers' own managers. The system is therefore a means of maintaining pubs that might otherwise close, or fail to attract the investment made by WPP and/or the lessee. The continued availability of those outlets and/or the improved facilities following from an investment are a clear benefit to the consumer. It is self-evident that the property ties of a particular brewer can only be considered to contribute to this benefit if the long-term operation of the houses is not endangered. In other words, when in market circumstances where there are price differences, such differences are broadly offset by other specific benefits. As indicated above, this is the case with Whitbread.

(173) With regard to the specification of tie by type, the Commission also notes that in the period 1994 to 1998 Whitbread has on average

([46]) This refers to the possibility under Article 6, read in conjunction with Article 7(1)(a) of the Regulation, whereby lessees can buy beer brands of a type different from those supplied under the agreement and can offer these to the consumers. This possibility is equally maintained by the standard Leases, i.e. the procedure for the non-specified types.

introduced three draught beer brands into its leased public houses each year. These brands include ales such as Fullers London Pride, Greene King IPA and Adnams. Whitbread also has made available around 30 non-Whitbread bottled beers, including Budweiser, Hoegaarden Grand Cru and Leffe Blonde.

(174) The Commission therefore concludes that consumers benefit from the operation of the Leases.

2.3. Indispensability of the restrictions

(175) The exclusive purchasing obligation, together with a non-compete clause is indispensable to the advantages produced by beer supply agreements, as noted in recital 150. As described in recital 17 of the Regulation these advantages cannot otherwise be secured to the same extent and with the same degree of certainty.

(176) It can also be noted that the specification of the beer tie by type is indispensable for the ease of introduction of brands to the tied networks of the brewers on the UK on-trade beer market (recitals 153 and 173).

2.4. Possibility of eliminating competition in respect of a substantial part of the market in question [47]

(177) It is evident that Whitbread cannot eliminate competition from a substantial part of the market, as they account for only 13 % of the UK on-trade beer market in 1997. Moreover, even taking into account the fact that in 1997 at most 58 % of the UK on-trade market for beer was foreclosed through the parallel networks of brewers' agreements, Whitbread's notified agreements do not lead to the elimination of competition in respect of a substantial part of the UK on-trade beer market.

2.5. Conclusion

(178) The standard Whitbread Leases, and the beer tie (exclusive purchasing and non-competition obligations) which they contain, fulfil the conditions of Article 85(3).

[47] A concept different from 'significant contribution to the foreclosure of the market'.

C. RELATION WITH ARTICLE 30

(179) The Bavarian Lager Company and the 23 lessees that signed the standard reply (recital 4 and footnote 7) consider that the Commission cannot grant a retroactive exemption given the Commission's established position by way of the Article 169 EC Treaty procedure against the 'guest-beer clause'. On the basis of the Metro I [48] judgment, it is argued that it would be an improper exercise of the Commission's powers under Article 85(3) to permit a retroactive exemption which would bless, under the competition rules, what is considered to be a clear breach of Article 30.

(180) The compatibility of the guest-beer law with Article 30 is irrelevant for Article 85 purposes. First of all, a decision pursuant to Article 85(3) in respect of an agreement that incorporates up to April 1998 only the 'old' guest-beer clause, namely the cask-conditioned beer, is without prejudice to a final judgment on the Article 30 matter. Furthermore, the Regulation exempts agreements for use in all Member States whereby the brewer/landlord does not have to grant a right similar to the guest-beer clause. This is because the brewer/landlord can impose a non-compete obligation for all brands of beer of the same type as the brands he tied for in the agreement. The inclusion of the 'old' guest beer was thus already a liberalisation of what was allowed under the Regulation and cannot, therefore, give rise to a concern under Community competition law.

(181) As the Article 30 issue is irrelevant, for the reasons stated above, it was not necessary for the Commission to refer to this issue in the Notice. The Notice was, therefore, complete so that the Commission did not need to publish an addendum and extend the deadline for submissions as requested by the Bavarian Lager Company. Moreover, interested third parties are entitled to submit observations not only on explicit points mentioned in a notice pursuant to Article 19(3), but on all other points they consider relevant.

[48] Case 26/76, Metro v. Commission, [1977] ECR 1875.

D. RETROACTIVE NATURE AND DURATION OF THE EXEMPTION

(182) The standard Leases are agreements in the sense of Article 4(2)(1) of Regulation No 17 where 'the only parties thereto are undertakings from one Member State and the agreements […] do not relate either to imports or to exports beween Member States'. It follows from Article 6 of Regulation No 17 that for such agreements the date from which a decision pursuant to Article 85(3) takes effect may be earlier than the date of notification.

(183) The Court has held in its judgment in Fonderies Roubaix [49] that 'the fact that the products involved in [the] agreements to be assessed] have previously been imported from another Member State does not by itself mean that these agreements must be regarded as relating to imports within the meaning of Article 4(2) of Regulation no 17'. Therefore the application of that Article should not be excluded in view of the brands on WPP's price list that are imported from outside the United Kingdom.

(184) Since it has been found above that the standard Leases have fulfilled the conditions under Article 85(3) since the date of first introduction of one of the notified agreements on the market on 1 January 1990, this Decision should apply from 1 January 1990.

(185) Pursuant to Article 8(1) of Regulation No 17, an exemption should be issued for a limited period. As Whitbread still has a large tenanted estate and continues to enter into standard Leases with a duration of 20 years, the Commission considers that a relatively long-term exemption period, namely until 31 December 2008, is appropriate to enable Whitbread to take its decisions to invest in its estate subject to a reasonable level of legal certainty under Community competition rules,

HAS ADOPTED THIS DECISION:

Article 1

1. The provisions of Article 85(1) of the Treaty are, pursuant to Article 85(3), declared inapplicable to the individual lease agreements in the standard form of (a) the 20-year lease, (b) the pre-retirement lease and (c) the five-year lease, and to the exclusive purchasing and non-competition obligation ('beer tie') which they contain.

2. This Decision shall apply from 1 January 1990 until 31 December 2008.

Article 2

This Decision is addressed to:

Whitbread PLC
Chiswell Street
United Kingdom London EC1Y 4SD

Done at Brussels, 24 February 1999.

For the Commission
Karel VAN MIERT
Member of the Commission

[49] Case 63/75, Fonderies Roubaix v. Société Nouvelle des Fonderies [1976] ECR 111, paragraph 8.