II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 16 June 1999

relating to a proceeding pursuant to Article 81 of the EC Treaty

(Case IV/36.081/F3 — Bass)

(notified under document number C(1999) 1472)

(Only the English text is authentic)

(1999/473/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 11 June 1996 by Bass 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,

Whereas:

I. THE FACTS

A. INTRODUCTION

(1) In February 1995, the Office of Fair Trading (hereinafter 'OFT') started, at the request of the Commission, an enquiry into the UK brewers' wholesale pricing policy. This enquiry, which also covered Bass plc (Bass), resulted in the internal OFT report on their 'enquiry into brewers' wholesale pricing policy' (hereinafter: 'the OFT report') being adopted in May 1995; a press release on the report was issued by the OFT on 16 May 1995.

(2) On 11 June 1996 Bass Holdings Limited and the Bass Lease Company Limited, both wholly-owned subsidiaries of Bass, notified pursuant to Article 4 of Regulation No 17 a standard form of lease (the standard lease), the subject of which is a fully fitted-out, on licensed [3] public house in England and Wales with a tie for beer as described below. The parties have also notified certain related agreements. On 8 September 1997, the parties notified their standard lease agreements for Scotland. The parties requested negative clearance, or confirmation that the agreements could benefit from 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'), as last amended by Regulation (EC) No 1582/97 [5] or individual exemption pursuant to Article 81(3) of the EC Treaty to take effect as from the date on which the agreements were entered into. The Regulation contains, in Title II, special provisions for beer supply agreements.

[1] OJ 13, 21.2.1962, p. 204/62.
[2] OJ C 36, 3.2.1998, p. 5.
[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.
[5] OJ L 214, 6.8.1997, p. 27.

(3) The information in the notification has been completed or supplemented by way of a verification pursuant to Article 14(2) of Regulation No 17 at the premises of Bass, and several requests for information. In particular, the Commission has sought confirmation of the data to the Commission by Bass.

(4) Following the publication in the *Official Journal of the European Communities* of the notice 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 81(3), the Commission received 20 observations from interested third parties. 16 standard replies were submitted using a model (hereinafter: 'the model'), prepared by an action group for lessees. The Commission also received observations from three lessees. In addition, the Commission received observations from an accountant.

(5) The information in these observations will be dealt with in the remainder of this Decision. 16 of the interested third parties requested the Commission to register their submission also as a formal complaint against Bass. Some of the complainants withdrew their complaints, but the 11 remaining complainants were informed in November 1998, pursuant to Article 6 of Commission Regulation No 99/63 of 25 July 1963 on the hearings provided for in Article 19(1) and (2) of Regulation No 17 [6] of the Commission's intention to reject their complaint. Eight of them presented further comments on this letter. Those comments are also integrated into this Decision.

B. THE PARTIES

(6) Bass is a public company listed on the London Stock Exchange. The Bass Group is an international drinks and leisure group operating in the hotel, leisure, hospitality, brewing and drinks sector in Europe, the USA and elsewhere in the world.

(7) In June 1996 Bass owned approximately 4 182 pubs in the United Kingdom, of which 2 736 were managed (that is to say, the operator was an employee of the company) and 1 446 were leased to tenants.

(8) As of March 1997, the Bass leased estate totalled 1 430 pubs, of which 106 are located in Scotland. Of this total of 1 430 pubs, 1 186 were let on standard leases, 178 were subject to tenancies at will (hereinafter: 'TAWs'), 42 were subject to a short-term tenancy agreement known as the Foundation Agreement, and the remaining 24 were either subject to other agreements or unoccupied. In the year ended 30 September 1996, Bass supplied approximately 422 000 barrels of beer to its leased estate, which represents 1,6% of the 1996 on-trade beer consumption (by volume) in the UK.

(9) In December 1997, Bass agreed to sell the majority of its leased estate (1 190 leased pubs) and a number of its managed pubs to a management buy-in team led by Hugh Osmond and backed by BT Capital Partners Europe, the private equity arm of Bankers Trust. Completion took place on 9 April 1998 and legal title in the properties is now vested in Punch Taverns Limited. Bass also agreed the sale of a further 27 leased pubs to the same group, and completion of that transaction took place on 3 July.

(10) In January 1998, Bass disposed of a further tranche of outlets, including 153 leased pubs, to Beechley Limited, although management control will be vested in a subsidiary of Beechley, Avebury Limited. Completion in respect of all but seven of the leased properties has now taken place.

(11) Bass has retained just over 20 leased pubs and expects to convert these into managed outlets in due course.

(12) Bass' worldwide turnover in the year ending 30 September 1997 was GBP 5 254 million, of which GBP 1 390 million arose from its pub operations (both leased and managed outlets). Bass' market share in that year remained in the region of 23% in terms of beer volume production.

(13) Details of the actual number of barrels [7] sold by Bass to and the relevant market shares on the UK on-trade beer market of (a) all property tied pubs, including those on temporary tenancy agreements, (b) managed houses, (c) pubs with a loan tie to Bass, (d) total of Bass' sales to property tied pubs, managed houses and loan

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

[7] 1 barrel equals 1,63659 hl; 1 hl equals 0,611026 barrels.

ties, (e) Bass' total sales to the on-trade and (f) the total UK on-trade market are given in Table 1 below.

Table 1

Bass' position in the UK on-trade beer sector

	(a)	(b)	(c)	(d)	(e)	(f)
1991	1 151	1 761	2 433	5 345	7 108	29 553
1997	[…]	[…]	[…]	[…]	[…]	[…]
1990/91	3,9%	6,0%	8,2%	18,0%	24,1%	100%
1996/97	[…]	[…]	[…]	[…]	[…]	[…]

(14) The average length of a Bass loan agreement is eight years. The average duration of Bass' loan tie agreements has, since 1990, been less than half its contractual term since these arrangements are frequently renegotiated. Bass estimates that it retains the business with the outlet after the loan is terminated in a declining number of instances following renegotiation. Bass' outstanding-loan book has fallen from a figure of GBP 361 million in financial year 1991 to GBP 314,2 million in the financial year ending 1997.

(15) The Commission observes that the barrelage/percentage of beer sold by Bass to other operators on the wholesale level on the UK on-trade beer market is subject to some form of restriction such as a minimum purchasing obligation, a must-stock obligation or a (limited) non-compete clause. These other operators include other brewers, independent wholesalers or non-brewing pub companies, and Bass has agreements with such operators covering approximately 1,2% of the UK on-trade beer market. The information available tends to indicate that the volume accounted for by 'restrictive' agreements (minimum purchasing obligations with penalties) is virtually non-existent compared to the early 1990s, as more recent agreements have tended to promote discounts as an incentive, with 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 made as to the volume this might represent.

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

C. THE MARKET

(17) Since 1991, the date of introduction of the leases, 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

(18) The 1989 MMC report on the supply of beer led to a number of recommendations being made which were aimed at relaxing the traditional tie (exclusive purchasing obligations 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 on the 'national brewers', which means brewers having an estate of more that 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) ([8]) from a source other than the brewer/landlord (hereinafter: 'the guest beer clause'),

— they were allowed to tie only 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. Bass are allowed to tie a maximum of 4 752 pubs.

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

Demand factors

(19) Beer can be sold through the on-trade, namely 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 4% between 1989 and 1997 and volume sales of beer in the on-trade fell by 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.

(20) 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;

(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.

(21) 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

(22) The main change since 1989 is the increasing concentration of the brewing market. The increased concentration has been caused by companies leaving the brewing market and selling their brewing operations to existing competitors. In 1996, the remaining four national brewers, Scottish & Newcastle, Bass, Carlsberg Tetley Brewing and Whitbread, controlled 78% of the UK beer market in terms of supply. The Herfindahl-Hirschmann index (hereinafter: 'HHI'), used to help describe market concentration, increased for the UK beer market, on the basis of the market shares of the national brewers, from 1 350 in 1991 to 1 678 ([9]) in 1996. With a HHI between 1 000 and 1 800, the market is described as 'moderately concentrated'. Some regional brewers ([10]) left the market between 1989 and 1996, reducing the number of regional brewers from 11 to eight. The model notes that Scottish & Newcastle has 38% of the market in Scotland and Bass 42%.

Wholesaling

(23) 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 independent wholesalers. However, in 1995/96 independent 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.

(24) 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 direct by the brewers. Similarly, regional brewers do not require the services of independent wholesalers. 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 independent wholesale sector.

Retailing

(25) In the UK, the retail sale of beer and other alcoholic drinks for consumption on the premises requires a

([9]) 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, from which a market is considered to be 'highly concentrated'.

([10]) 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 by taking as a benchmark the number of owned pubs and production volume for the smallest regional in the MMC Report.

justices' (local courts of law) licence. Three distinct classes of licences are currently in operation [11]:

— 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 are pubs. The remainder includes 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. This covers some 32 300 private hotels and restaurants,

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

(26) 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 independent pub companies, (d) the managed estate of independent 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 to 1989; the 1997 data are from the Brewers and Licensed Retailers Association (hereinafter: 'BLRA'), including estimates for non-members.

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

(27) 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 guest beer [12] purchases the tenants and lessees of the national brewers made with their landlord-brewer. The figure does not include the purchases of guest beer from another supplier.

(28) The 18,1% figure for 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-tie quantity. The 18,1% figure does not include the 'free' purchases of a loan-tie pub operator with other suppliers.

(29) Whilst Table 2 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-licenses (1995 data).

(30) The Orders also reduced the restrictive scope of loan ties, by allowing their termination at any 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. Judging by 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 for small/big loans, the number of

[11] The licensing system is slightly different in Scotland.

[12] This is 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 (recital 18).

non-exclusive 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 that the publican pays back with money loaned to him by another brewer (in exchange for the loan tie). Beer volumes sold through loan ties have reduced in the last couple of years and, for the years 1994 to 1996, the scale of loan repayments has exceeded the value of new loans.

Competition between brewers

(31) At the wholesale level, the major brewers have some guaranteed sales through their tied and managed estates. The brewers have to compete 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 competition parameters are mainly on 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

(32) 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 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 expenditure for the national lager brands has increased substantially over the last couple of years, even on a brand basis.

(33) 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 24). 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.

(34) 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 budgets. Bass has formed a joint venture in the UK with the Dutch brewer Grolsch for the brewing and distribution of Grolsch products.

Market entry at retail level

(35) 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.

(36) 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 they are, they 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 green-field sites in recent years.

Changes in arrangements between pub tenants and their landlords

(37) Historically, pubs were let by means of 'traditional' short-term pub tenancies. Brewers retained responsibility fot 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 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

(38) The tenancy agreements are contracts between Bass and the lessee, whereby Bass 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 Bass and agrees to purchase the beers detailed in the agreement from Bass or its nominee.

(39) The basic Standard Lease Agreement has been in existence in England and Wales since 1991, with slight modifications in the form used. The lease is generally of 10 years' duration (some are of 15 or 20 years), with a fixed rent that is subject to review every five years and in certain other limited circumstances. The lessee may assign his obligations under the lease after two years, with Bass' prior consent provided Bass is given first option to purchase the lessee's interest. Under the terms of the standard lease the lessee has full responsibility for repairs and cannot install any amusement machines without Bass' written consent, but may keep all the revenue from such machines. In 1992 a standard lease was introduced in Scotland. The main differences with the standard lease in operation in England and Wales are the following: first, the deed of leasing conditions, which contains the relevant trading conditions for the Scottish leases, entitles Bass to review the rent annually and increase it in accordance with the retail price index. However, Bass has never exercised this right. Second, Bass has the right to terminate the agreement five years after commencement. Third, Bass asks that in-going lessees pay a certain sum of money into a 'retention fund'. The maximum amount so required is GBP 10 000. Bass retains this sum as security for losses or damages sustained to the premises or to Bass, or any other amounts owed to Bass by the lessee. Bass normally pays interest on the fund at a rate of two % per annum over the deposit rate of Barclays Bank plc on termination of the lease. Lessees have complained that the leases contain a stated account and certificate clause, whereby, it is argued, if tenants owe Bass monies, a stated account is produced and signed by a Bass director. When this certificate is registered and an appropriate certificate served on the tenant it has the same effect as a decree notwithstanding any court action disputing the sums in the statement. The lessees argue that this effectively prevents tenants from seeking a remedy through national courts. If tenants do not or cannot pay the stated sum then their assets will be sequestrated. However, the Commission notes that this is a matter for national, not Community law. Finally, until recently, the deed of leasing conditions contained a covenant, which Bass has never enforced, restricting the lessee from competing within a radius of half a mile from the leased premises for one year from termination of the lease.

([13]) Except for a limited number of specified reasons, i.e. where 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 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.

(40) In addition to the Standard Lease Agreements, the parties have also notified certain related agreements. There are two further forms of tenancy agreement, the Foundation Agreement and Tenancy at Will ('TAW'), where the latter is a temporary agreement. The Foundation Agreement is a three-year agreement used in circumstances where a 10-year lease may be inappropriate such as unstable economic conditions or uncertain expense levels relative to trade. The agreement gives the occupier the opportunity to convert to a standard lease during the first two years. The tenant is not permitted to assign his interest, is not fully responsible for repairs, and shares amusement machine income with Bass. The exclusive purchasing obligations in both the Foundation Agreement and the TAW are not materially different from those contained in the Standard Lease Agreement. In March 1997 there were 42 pubs let under Foundation Agreements and 178 let under TAWs. These agreements are not used in Scotland.

(41) Bass have also notified supplemental agreements relating to the division of the financing of alterations and improvements between Bass and its lessees, into which approximately 109 lessees had entered by June 1996.

(42) In addition, Bass have notified an incentive package scheme available free of charge up to October 1996 to certain Standard Lease Agreement lessees, the premier alliance scheme. Under this scheme, which was first introduced in September 1994, lessees without any current debt are eligible for additional volume-based discounts and enhanced business support in terms of business planning, development and marketing. The only requirement is that the lessee attends regular business development meetings. A marketing fund is also available, which may be used *inter alia* towards promotions offered by Bass or promotions run at the initiative of the lessee. By December 1997 there were

865 Bass lessees participating in the premier alliance scheme. In Scotland, the premier alliance scheme was launched in September 1996 and as a result out of 865 total members, 90 are Scottish lessees. Prior to September 1996 Bass offered its lessees the opportunity to participate in its volume reward scheme. Under the scheme, lessees were given a cash sum for purchases over a certain threshold.

The beer tie

(43) The lessee agrees to buy all specified beers from Bass or its nominee with the exception of one brand of cask-conditioned draught beer and, by the end of March 1998, one brand of bottle-conditioned beer (guest beer clause). Specified beers are the beers of the types set out in a schedule of the lease. These types are light, pale or bitter ale (known in Scotland as 70-shilling ale, heavy ale or Scotch ale), export or premium ale (also known in Scotland as 80-shilling ale), mild ale (known in Scotland as 60-shilling or light 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, 'diet pils' (or premium low carbohydrate beer), low carbohydrate (or 'lite') beer. These types are represented by the brands or denominations of beer listed in Bass' current price list.

(44) 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.

(45) Submissions based on the model and individual submissions by other tenants commented on this issue, in particular, that a brand may build up a favorable following to a lessee's consumers on a very local basis, but marketing decisions are taken by a national brewer on a national basis. Thus, if sales are uneconomical overall, a brand is discontinued to the potential detriment of an individual's customer base.

(46) It was also indicated that the type definitions adopted are very wide and cover substantially all beer sold in the UK. Through the use of so broad a definition, Bass is able to exclude the right to buy beers of another type as is required by the regulation. The observations based on the model gave the example of Caffrey's and Tennants Velvet. It is also argued that the right of Bass to increase the scope of the tie by adding additional beer products to the current price list is incompatible with the requirement that the tied products be specified in the agreement and furthermore tenants are also unable to know the extent of the tie at the inception of the lease.

(47) The Commission notes that the definition of beer types is a matter for experts to decide ([14]). 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.

Rent

(48) Under the Standard Lease Agreements, rent is paid monthly in advance and the lessee will repay the premiums paid by the landlord for insuring the premises against loss or damage by fire, explosion and aircraft (including three year's open market rent of the premises and expert's fees) and against other risks, and the cost of holding the justices' licence.

(49) Observations based on the model have indicated that lessees do not have a copy of the insurance policy offered by Bass.

(50) The Bass insurance covers the entire risk portfolio of the group, namely buildings, motor, public liability and so forth. The risk portfolio is insured with Commercial Union, and as a result the policy and the total premium are commercially sensitive and are not disclosed to lessees.

(51) The fixed rent is reviewed every five years. The reviewed rent is the higher of the existing rent or the market rental value of the premises at the relevant increase date. The market rental value is defined as an open-

([14]) See also recital 51 of the Commission notice concerning Commission Regulations (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).

market rent but taking into account the terms, and in particular the exclusive purchasing obligations, contained in the lease. In the absence of an agreement as to the market rental level, any rent review is subject to determination by an independent surveyor or valuer.

(52) Numerous submissions have indicated what the parties consider to be the negative effects of not permitting downward rent reviews, in particular when turnover in the individual pub goes down owing to local circumstances or an overall recession in the country.

(53) In the case of the Bass lease it is possible for the rent to stay the same, and Bass has on occasion granted reductions in rent to lessees where justified. The more common practice for leases is upward only rent reviews (hereinafter: 'UORR').

(54) The OFT report has looked into the issue of upward-only rent reviews and discussed the general practice of upward only rent reviews with the Department of the Environment which at around this time conducted a major review of UK commercial property leases. It appeared that the UORR is a widespread practice for all sorts of commercial property and thus not special for 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 over income flow.

(55) Tenants and former tenants using the model state that the Landlord and Tenant Act 1954 does not apply in Scotland and therefore that Scottish tenants are not provided with security of tenure. This is alleged to affect their ability to negotiate a new rent.

(56) The standard leases in Scotland also contain a break clause (see recital 39), which allows Bass to terminate the lease after five years. Tenants and former tenants allege that the treat, or fear, of implementation of the break clause significantly contributes to the tenants' ability or inability to negotiate a new rent.

(57) Tenants in Scotland enjoy security of tenure according to the contractual terms of their leases. In the case of Bass lessees, this means that they have security of tenure until the end of the lease. At rent reviews, during the term of the lease, the tenant enjoys the same security of tenure as a tenant in England.

(58) At a rent negotiation when a lease renewal is being discussed, it is the case that the tenant does not have security of tenure: the renewal of the lease and hence the continued occupancy of the tenant of the pub depend on the outcome of a negotiation on rent. No evidence has been submitted by the tenants to suggest that rent levels in Scotland are, on average, affected by the alleged imbalance of negotiation power between the parties.

(59) The break clause was introduced in Scotland immediately after the publication of the MMC Report in 1989, at a time of uncertainty for the industry. The clause allowed Bass some flexibility during this period of uncertainty. Subsequently, the clause has only been used once in exceptional circumstances after the lessee persistently defaulted on rent payments. There is no documentary evidence to suggest that the clause has ever been used as a lever to review rent. In six cases, the break clause has been deleted in return for a payment, but this was done because the lessee wanted to develop the public house and the banks had refused to lend the money until the clause was deleted. In any event, this is a matter for national law.

Discounts and countervailing benefits

(60) 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 Bass between the price paid by individual free-house operators and Bass' tied lessees and (ii) the value of benefits which are granted by Bass to its lessees and which are not readily available to the individual free-house operators. The starting point for this assessment was the report of the Office of Fair Trading on their enquiry into brewers' wholesale pricing policy of May 1995 ('the OFT report'), which was supplemented by further investigations by the Commission.

(61) The price differential is the difference between the average discounts in GBP/barrel granted by Bass to its individual free-house operator-clients (not including loan ties) across a typical product mix and the discounts granted to the lessees which include the actual discounts on beer purchases and the value of the lower Bass list prices (for the leased estate) as compared to the standard Bass price lists. Discounts to Bass lessees also include the discounts offered to members of the Premier Alliance Scheme via volume-related discounts and the marketing fund. All discounts offered have been averaged across the Bass leased estate, excluding tenancies at will.

(62) Most interested third parties have indicated that they are aware of higher discounts being granted by Bass to individual free traders than those indicated in Table 3 at recital 108 and some of them have supplied copies of offers made by Bass to such clients. It is not disputed that in individual cases higher discounts are granted as Table 3 is based upon averages for all Bass' individual free-house operator-clients. It also follows from recital 61 that the relevant figure in Table 3 is the result of the average discount to the free trade minus the discounts granted to Bass lessees, excluding tenancies at will.

(63) 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 rent/turnover ratio for the tied estate with an estimated rent/turnover ratio for 'free-of-tie' outlets. This third method has been used by the OFT report as the OFT had the most data available to use this method. The Commision has followed this methodology because it allowed the Commission to build on the work of the OFT which leads to an obvious economy in procedure.

(64) In practice, the rent subsidy is calculated by subtracting the actual rental income from the tied estate from 15% of the estimated retail turnover of the estate (the assumed rent for a free-of-tie outlet being 15% of turnover). For this purpose, tenancies at will were excluded from the calculation. This is because tenancies at will are characterised by significantly lower rent levels than other lease agreements.

(65) The estimate of the total retail turnover for the estate (that is, the aggregate turnover of the pubs let under Standard Lease or Foundation Agreements in the estate) was calculated on the basis of the aggregate rent paid being equal to 11,36% of turnover. The figure of 11,36% stems from internal Bass documents compiled for the most part in preparation for rent or rent review negotations ([15]), for a random sample of 30 pubs chosen by the Commission. These documents included individual estimates of turnover for the pubs, from which the average rent to turnover ratio was calculated.

(66) To arrive at the rent subsidy per barrel, the overall rent subsidy was divided by the total number of barrels sold to the estate (excluding TAWs) in each year. To have included TAWs, in the case of Bass, would have distorted the rent subsidy as they typically are let on nominal rents — that is, the rent subsidy would have been larger. The Commission has taken a conservative approach in this case and excluded data on TAWs from the calculations used to provide figures for Table 3.

(67) The methodology for calculating the rent subsidy has been criticised. Numerous current and former tenants, using the model, have stated that it is widely known that the fair and arbitrary rent for an average public house is between 6 and 8% of turnover.

(68) In their observations, an accountant and a couple of tenants consider that, in practice, rents are determined by an expert valuer on the basis of 50% of the divisible balance, namely 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% of turnover is therefore also false ([16]). They consider that the rent imposed by Bass, namely the lease rent and the cost of discounts denied (wet rent), result in the lessees' being disadvantaged financially.

(69) The Commission does not dispute the fact that actual rent (review) negotations 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 (such as the number of bars).

(70) The contractual rent negotiated by the parties is not automatically determined on the basis of 50% 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.

(71) However, the purpose of the current assessment is not to describe how individual rents are negotiated but to

([15]) Some observations questioned whether Bass has factual information on the turnover of leased properties. It should be noted that Bass carries out a detailed assessment of the business of each public houses in conjunction with the lessee, and therefore significant factual figures are available and used by Bass. These may also be cross-checked with performance figures for comparable businesses in similar market segments drawn from the Bass managed house estate.

([16]) The accountant provided a guide showing how he would construct a pub lease rent. However, the accountant provided no evidence that his model reflects the actual workings of the open market.

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 'costs' structure of the pubs in working with rent/turnover.

(72) 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% and that the average divisible balance is 50%.

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

— Bass had been informed by Fleurets, Chartered Surveyors for Hotel and Licensed Property Valuers, by letter of 28 September 1998 that rents on new lettings of free houses had often been in the 15% to 18% range. This accords with estimates given by other experts to other national brewers,

— these findings support the facts presented to the OFT, namely 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% 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% and 15% of turnover.

(74) 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.

(75) In addition to the rent subsidy, Bass has supplied details of seven other quantifiable benefits to the Commission.

Value added services

(76) Since the date of introduction of the Standard Lease Agreements Bass has offered its lessees bulk buying and procurement services, the value of which has increased over time. These value-added services currently include discounts on glassware, gas supply, rating, banking, insurance and paint. Bass has calculated the annual benefit of these services by estimating the potential value per outlet of the discounts and offers available across the range of goods and services, on the assumption that, where lessees have not taken advantage of the services on offer, they have used the fact that discounts are available to Bass lessees to obtain equivalent or better prices on the open market. This potential value per outlet, which has been estimated at GBP 3 054,9 for the years 1994/1995 and 1995/1996, is then multiplied by the number of outlets, excluding TAWs, in the estate.

(77) Almost all respondents to the notice commented upon this. Many of those who used the model simply stated that the value of these services was zero. Other observations have indicated that better terms are almost always available elsewhere, and have thus placed a minimal value on it (under GBP 1 per barrel in recent years). Moreover, the accountant noted that contact names for the selection of butchers, frozen food, glassware, chips and nuts can be offered by most local Licence Victualler's Associations at no cost. A tenant alleged that they could get better discounts on all the items from a group called the Scottish Licensed Trade Consultants.

(78) The Commission recognises that it may be possible to negotiative individually better terms with the same supplier than those offered by Bass. However, even if this were to be the case for all items, the fact that an interested lessee has a preference point based on a negotiated rate for a large estate, to start price discussions is already an advantage in itself ([17]).

(79) The above methodology for calculating the benefit of the value added services compares the Bass 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 and 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 its pubs. On the other hand, many

([17]) With regard 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 will be household names 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 Bass managed estate.

tenants took up the glassware offer (500), banking (400), rating and insurance (1 267) and gas (200).

(80) The Commission considers that on the basis of all of the above considerations relating to 'value added services' a reduction should be made to the value of the benefit as calculated by Bass and represented in the notice, in order to take account of the fact that, as was stated in recital 79, 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 the paragraph above to the up-take, this reduction should be moderate. Therefore, in order to reduce the margin of possible error as much as possible, and taking all considerations into account in order to ensure a conservative figure, the Commission will base its assessment of the value of this 'countervailing benefit' on a reduction of 25% of the benefits as indicated by Bass and in the notice. The relevant GBP/barrel figures for value added services, in Table 3 below, are adapted accordingly.

Investment

(81) The benefit which is attributed to investment carried out in the tied estate in cooperation with lessees, excluding TAWs, is calculated by taking the total cost, including outside consultancy and project supervision funded by Bass, and subtracting attributable rent increases over five years.

(82) Lessees and former lessees, on the basis of the model, generally claim that as the responsibility for repairing is with the lessee they carry out all investment. Observations, based on the model, have therefore concluded that there is no investment by Bass.

(83) Tenants, on the basis of the work of the accountant, allege that the expenditure carried out by Bass will generally relate to property extensions and improvements, as the tenant is responsible under the lease for the fabric of the building. They allege that Bass are claiming that there is investment in a number of pubs that are not covered by the capitalised increase in rental income Bass will acquire over the following five years (which they will continue to receive in future thereafter).

(84) The accountant and tenants based on this work allege that Bass has included in the figures for investment the foregone rental from pubs that are empty. Moreover, they allege that any improvement in rent is retained for all future years under the upwards only rent review element of the lease.

(85) 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 unless Bass ([18]) wants to use the premises for its own purpose.

(86) Bass has not included monies used to refurbish empty public houses. The figures provided to the Commission were specifically for the growth of the lessee's business. Bass has both a total investment scheme and a joint investment scheme as noted in the notice.

Repairs

(87) This is the value to existing lessees, excluding TAWs, of non-rentalised repairs funded by Bass. These repairs are either to support investment or to fund statutory requirements, licensing demands and other such unavoidable expenses.

(88) Lessees, using the work of an accountant, and the accountant concerned allege that most of the leases contain a full repairing obligation. Bass would generally only pay for repairs in respect of the short-term lets and the Tenancy at Will Agreements where Bass retains the responsibility for the fabric of the building. Before letting, it is Bass' responsibility to put the property into condition or to reduce the rent so that the individual tenant may carry out the work. Other lessees and former lessees, using the model, claim that they have not received any such repairs.

(89) In response, it should be noted that there is a benefit to the extent that the works falls outside the terms of the lease and that Bass does not receive monies in terms of increased rents.

Support franchise

(90) Since 1994 Bass has provided certain business planning, performance review and development initiative services free of charge for lessees wishing to utilise up to

([18]) See recital 9: as of 9 April 1998 it is Punch Taverns Limited.

October 1996, an additional scheme known as the support franchise. By the end of the 1995/96 financial year the lessees of an average of 669 pubs in the estate had joined the support franchise and for those pubs, there was an average increase of 0,93% in barrelage turnover, compared to a decline of 2,33% for non-participating pubs. Bass have estimated that the average increase in net profit to a typical lessee receiving the support franchise was GBP 2 585 in 1995/96. The total estimated increase in net profit generated by the support franchise is therefore GBP 1,7 million, which produces a figure of GBP 4,50 per barrel if divided by the total barrelage to the leased estate.

(91) A few observations dispute the methodology used for calculating the benefit of the support franchise. In particular, they allege that the Commission has failed to assess whether any increase in barrelage is attributable to the support franchise, for example, it may be attributable to investment, which the lessee pays for in increased rent. The tenants and the accountant further dispute the figures provided by Bass for the average increase in net profit to a typical lessee, stating that it is more likely to be GBP 775 per annum rather than the GBP 2 585 quoted. Moreover, account should have taken of the fall in barrelage by 2,93% that occurred in non-participating pubs. This would translate into a fall in turnover and GBP 2 639 fall in profit. The tenants and the accountant therefore claim that there would be an overall fall of 2 283 barrels and that consequently there cannot be a benefit to Bass lessees.

(92) The Commission examined a number of methods for calculating the benefit of the support franchise and determined that the volume and profit uplift was the simplest and the most statistically accurate for the purpose of calculating average values. Any element of double counting is not statistically significant. There are similar percentages of lessees participating in support franchise and lessees who have chosen not to join the support franchise who have benefited from investment. There are no significant differences between the investment profile of the two types of outlet. Other methods to calculate this benefit would provide comparable results.

(93) The data used by the Commision is based on actual returns and therefore the Commission considers that the calculations for the average increase in net profit to a typical lessee are acurate. The data for the support franchise show the benefits that can accrue to a lessee from participation should he/she elect to do so. It is incorrect to net off the estimated reduction in barrelage for those lessees who have not chosen to take advantage of the scheme.

Direct operational support

(94) Bass has estimated the value and benefit of direct operational support per lessee for each of the relevant years by taking 75% of the total remuneration costs (salaries plus benefits and expenses) of the Bass Lease Company employees who are directly involved in supporting and developing the business of the lessee. These employees include business directors and business managers, business development managers, property managers and surveyors and employees dealing with catering, training of lessees, assisting with assignments, promotions and public relations.

(95) Observations, based on the model, have in general contended that there is no benefit to the direct operational support offered by Bass.

(96) Other observations of tenants note that the Bass employees referred to in the notice are there to protect Bass' interests. They police the tie and the lease. Moreover, Bass' operating costs in operating tied houses cannot be attributable to the tied lessees as a benefit.

(97) The accountant, and a few tenants, further assert that lessees would be better advised to obtain independent professional advice and pay less and have the benefit of professional indemnity cover that Bass cannot supply due to their position being in conflict as landlord. The surveyor employed by Bass will seek to secure his own future employment by pressing for work to be carried out, at the tenant's cost, which may be treated or handled in a far more economic manner.

(98) The Commission calculated the direct operational support benefit on the basis of all the Bass Lease Company personnel who have an input into a lessee's business. The business manager is the primary point of communication between the lessee and the Bass Lease Company. In reaction to these observations the Commission asked Bass for a sample job description which defines the responsibilities of the business manager, and the working hours and percentage of time allocated to each function. Given this, the Commission has taken a conservative view that at least 68% of the working time of the business manager is spend working for the benefit of lessees. The figures in terms of GBP/barrel in Table 3 have been re-calculated accordingly.

Set-up and development costs

(99) Bass provides support to new lessees in the form of literature and assessment schedules, including

development, administration and printing costs associated with new initiatives as well as training costs, and to existing lessees in the form of annual recognition awards.

(100) Observations, based on the model, generally state that there is no benefit. No evidence was supplied to back up the statement.

(101) A few parties, together with the accountant, assert that the lessor would generally incur most of the costs when entering into a lease with a lessee. It is a one-off outlay and should not be allocated as a cost benefit per barrel. Moreover, it is Bass' cost of attempting to make uniform the operation of the leased estate.

(102) It is alleged that Bass claim that they produce assessment schedules, bear printing costs in relation to new initiatives plus annual recognition costs. These are costs that Bass should absorb as landlord and brewer.

(103) In response, it is noted than the observations did not support their allegations with any factual evidence. It should be clear that these costs are not incurred in an attempt to make the operation of the Bass leased estate uniform. Further, these are costs which a lessee would normally incur, and not a lessor as the accountant alleges. Moreover, asserting that these costs are one-off neglects the contribution of ongoing development and training.

Promotions

(104) Since the date at which the Standard Lease Agreement came into operation Bass has made certain promotions and marketing offers exclusively available to its lessees on a national, regional or local basis. These promotions are intended to increase the turnover of the individual lessee.

(105) Observations based on the model have generally valued these promotions at zero benefit to the tenants.

(106) A few parties have contended that it is common practice for all manufacturers to offer promotions to resellers in an attempt to popularise their wares. The inclusion of this in the Commission's assessment is therefore alleged to be incorrect.

(107) In response, the Commission points out that, as was stated in the notice, the promotions and marketing included in the analysis are exclusive to Bass lessees. Information received by the Commission from Bass suggests that in fact some of the lessees that have made a formal complaint have accepted promotional material, including free stock and some product promotions have also been made available via weekly telesales calls.

(108) 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)

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
Price differential	19	22	26	35	41	45	48
Rent subsidy	16	15	19	23	22	22	24
Value-added services	2	2	2	3	7	7	11
Investment	0	0	0	0	1	3	1
Repairs	2	4	1	1	1	2	0
Support franchise	0	0	0	0	4	5	4
Direct operational support	2	2	3	3	5	4	5
Set-up costs	0	0	0	1	1	1	0
Promotions	0	1	2	2	3	4	5
Conclusion	3	1	1	−2	3	3	2

(109) There are other possible countervailing benefits that are not included in Table 3. It was not necessary to include the countervailing benefits described below as the countervailing benefits considered above compensate broadly for the price differential.

(110) Bass offers additional support and benefits to tenants in the form of fixtures and fittings funding for tenants in difficulty, one-off PR promotions, a charitable support fund and, until late 1994, a legal advice scheme for tenants and prospective tenants. A few observations commented that there was no need for a legal advice scheme as a competent tenant could follow the legal obligations in the lease. It was also pointed out that Bass should not be advising its own tenants on legal matters that may give rise to a conflict of interest. However, it should be noted that the Bass business and the legal advice providers were separate entities.

(111) Finally, Bass lessees also have reduced beer-derived profit volatility as the result of a reduced profit margin on beer relative to free-house operators which, combined with lower fixed costs (rent), reduces the risk of an investment in a Bass tenancy.

II. LEGAL ASSESSMENT

A. ARTICLE 81(1)

1. *The relevant market*

1.1. The relevant product market

(112) 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 ([19]). As the Court of Justice has stated in the Delimitis judgment ([20]), '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 ([21]) 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 for this sector which require special installations; and that the prices charged in the sector are generally higher than retail prices'.

(113) 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 25) form the relevant product market of 'public houses and restaurants'. In this respect, reference is made to paragraph 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-licences, have the common feature that the drinks are purchased for consumption on the premises and that there is an important service element provided for. 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 ([22]). However, this reflects to a large extent the fact that these clubs operate on a non-profit basis. It remains that 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.

(114) 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 stated in the Delimitis judgment ([23]), that finding is not affected by the fact that there is a certain overlap between the on- and off-trade, namely inasmuch as retail sales allow new competitions 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

(115) 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

([19]) Case 27/76, United Brands, [1978] ECR 207, paragraph 12.

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

([21]) 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.

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

([23]) See footnote 20; at paragraph 17.

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.

(116) The UK market is also distinct from beer markets in other Member States in view of the Orders (recital 18), the high consumption of draught beer (recital 21), the presence of pub-management companies (recital 24), the pub-licensing regulations (recital 25) and the variety in types of ale offered (recital 43).

2. ***Agreement between undertakings***

(117) Bass and the lessees are undertakings within the meaning of Article 81(1).

(118) The individual leases, in a form similar to the standard leases described above, between Bass and each of its lessees are agreements in the sense of Article 81(1).

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

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

(119) 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 ([24]). These clauses are formulated in the lease as follows (recitals 43 and 44):

— the tenant shall purchase from Bass 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),

— 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 Bass or its nominees; or (b) any other beer unless either (i) 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).

(120) It can 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'.

(121) 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).

(122) The explicit and implicit non-competition obligation for specified types of beer, that is to say, the prohibition on the lessees' purchase of 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**

(123) Having identified the nature of the restriction of competition brought about by the network of the brewer's leases, the restrictive effects on retailers and suppliers in the relevant market need to be demonstrated ([25]).

(124) In the case of Brasserie De Haecht v. Wilkin ([26]), 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

([24]) See footnote 20; at paragraph 10.

([25]) 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'.

([26]) Case 23/67, [1967] ECR 407.

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 among others in ascertaining whether competition is prevented, restricted or distorted ([27]).

3.2.1. *Cumulative effect of several similar networks*

(125) 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 ([28]) defined independently by the brewer in question.

(126) Furthermore, as Bass 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 1991, the year of introduction of the leases.

(127) 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 houses. Secondly, the network includes also 'vertical agreements' on either of two levels: either directly, with retail outlets via loan ties, or on the wholesale level, via '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.

(128) From Table 2 (recital 26) 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 1990 data are considered as 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 occured in tied outlets.

(129) 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 legal binding commitment of the retailer to buy the volume of the tying brewer (see recital 28) ([29]), but it is most likely that the binding commitment will at least cover 10% of on-trade volume throughput. Therefore, 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.

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

(131) 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 ([30]). 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.

(132) 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

([27]) See footnote 20; at paragraph 14.

([28]) 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.

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

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

brewer that wants 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 to also offer loan ties. In addition it needs to be remarked that such an independent entry in 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).

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

(134) 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 ([31]) 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.

(135) It can thus be concluded that a maximum of around 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*

(136) 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, among 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

(137) 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'.

(138) 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 36). Moreover, although there is an active trade in UK pubs and substantial numbers of pubs have been sold off in single deals, it has to be noted 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 ([32]) and would, in fact, involve a change in focus from being a brewer to also being a UK retailer. This would,

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

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

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.

(139) Direct takeovers of UK brewers (and their tied estate) by foreign brewers has 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 Ruddles, and the Australian brewer Foster's in Courage).

(140) In addition, the relatively small role played by 'traditional' wholesalers in the distribution of beer in the UK (recital 23), make it difficult for a foreign brewer, or for a new brewer, to enter the market independently.

(141) Therefore, in most cases, foreign breweries license a major UK brewer to brew and distribute their products within the UK, thereby having 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.

(142) 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 access 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 only had one brand, and thereby gaining access to all the pubs in that network as compared to concluding agreements with individual outlets. However, as stated at recital 135, 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 24 and 33).

3.2.2.2. Competitive forces on the market ([33])

(143) The UK brewing industry has been going through a process of concentration (recital 22). 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 19). 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 on 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 (paragraph 19).

3.3. **Conclusion on first Delimitis test**

(144) It can thus be concluded that an examiniation of all tying agreements, included 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**

(145) It is now necessary to assess, as the Court clarified 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 that 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 81(1)'. Therefore, in assessing the extent of the contribution made by the brewery in question, in this case Bass, 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' ([34]).

([33]) See also paragraph 22 of the Delimitis judgment; see footnote 20.

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

(146) In so doing, consideration will be given to the effect of the network of Bass as a whole; the finding of a restrictive effect for the network would then apply equally to each of its constituents ([35]).

3.4.1. *The beer deminimis notice* ([36])

(147) Bass is clearly not a 'small brewer' as defined by the notice as it produces more than 200 000 hl, and its market share is more than 1% of the UK on-trade market.

3.4.2. *Individual assessment*

(148) The Court has ruled in the Delimitis judgment ([37]) 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 clarified that 'that position 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 held 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'.

(149) 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' ([38]). The CFI has thus based itself primarily on the broader concept of the overall market share.

(150) An assessment of the contribution by the brewer therefore needs to take into account his 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.

(151) 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 81(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 is given to the foreclosure resulting from the managed estate of a national brewer as 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 moment 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.

(152) The other segments of the 'tied network' of Bass are Bass' loan ties and the amounts of beer for which its 'wholesale partners' are under an obligation to buy (exclusivity, minimum purchasing, must-stock, non-compete and so forth). Furthermore, in assessing any brewer's role on the market, consideration 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.

(153) The 5 555 pubs (of which 2 402 were leased) owned by Bass in 1991 and the 4 182 (1 446 leased) owned in 1996/97 account for 3,8% and 2,88% respectively of the total number of on-licensed premises. Moreover, they account, as was indicated in Table 1 (recital 13), for 24,1% and 25,6% respectively of the on-trade volume in 1990/91 and 1996/97 respectively (the property tied part accounting for 3,9% and 1,8% respectively). The Bass tied sales for which the Commission has the data, namely the above and including the loan tie sales, account for 18% and 13,7% respectively of the UK on-trade market volume. The 'tied' part (property, loan and managed) thus accounts for over half of Bass' total sales on the on-trade market share of 25,6%. To these already significant 'tied' market shares should be added the 'wholesale partners ties' as described at recital 152.

([35]) The Court of First Instance pointed out in Cases T-7 & 9/93, Langnese-Iglo and Schöller, [1995] ECR II 1539 and 1611, at paragraphs 129 and 95 (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'.

([36]) Paragraph 40 of the notice to the Regulation (OJ C 121, 13.5.1992, p. 2) see footnote 14.

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

([38]) Op.cit. paragraph 87 for Schöller and paragraph 112 for Langnese-Iglo. See footnote 35.

(154) With regard to the duration of the segments of Bass' tied network, it has to be understood that all the houses that Bass 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. Bass' loan ties last on average eight years.

(155) It is therefore concluded that Bass' 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 restrictive effect on competition.

4. ***Restrictive effect on competition of other restrictions***

4.1. **Description**

(156) 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 standard lease,

— 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 the termination of the lease to Bass or to the new lessee,

— not to place amusement machines without the consent of Bass,

— not to compete within a radius of half a mile from the former leased premises for one year post-termination of the lease,

— 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**

(157) 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 ([39]).

(158) The covenant in the Deed of Leasing Conditions which restricts the former lessee from competing with half a mile of his former premises can be considered to protect the goodwill of the new lessee and the ability of Bass to sell its beer, and the restriction is therefore ancillary to the lease agreement. In any event, the Commission understands that the covenant has never been used and thus cannot be regarded as an appreciable restriction of competition.

(159) Whether or not the advertising clause falls foul of Article 81(1) is only relevant for 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.

(160) With regard to the supply of beer, the advertising clause has the object of limiting the advertising of beer supplied by other undertakings. The only beer that the Bass 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

([39]) See also paragraph 53 of the notice to the Regulation: see footnote 14.

Commission possesses no information that the advertising clause has been this strictly applied. On the contrary, Bass has confirmed in a letter of 6 October 1998 that 'Bass does not enforce this clause, 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 'proportional support' from their guest beer supplier. None of them has indicated that Bass 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***

(161) 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 Bass. 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 at recital 34, most foreign producers have chosen to enter the UK market by entering licensing agreements with existing brewers, including Bass, to gain access to their on-trade network ([40]). Accordingly, the leases affect trade between Member States.

6. ***Appreciability***

(162) The exclusive purchasing and non-competition obligations only infringe Article 81(1), however, if they affect competition and trade between Member States to an appreciable extent.

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

(163) The quantification of the restrictive effect to 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 Bass' network to that effect, as laid out in recitals 126 to 161, demonstrate their appreciable nature in restricting competition and trade between Member States with respect to the UK on-trade beer market.

7. ***Conclusion***

(164) The exclusive purchasing and non-competition obligations of the leases fall foul of Article 81(1) since the introduction of the leases in 1991.

B. ARTICLE 81(3)

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

(165) The Court has confirmed in the Delimitis judgment (recital 36) that Article 6(1) of the Regulation requires that the exclusive 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 form 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 (recital 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.

(166) The standard leases provide for a specification of the beer tie by type which allows Bass 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 Bass unilaterally to extend the scope of the exclusive purchasing obligation and therefore do not fulfil the conditions of Article 6 of the

Regulation, which requires a specification by brand or denomination ([41]).

(167) 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*

(168) 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 Bass 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 the 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 are sometimes described as a 'half-way house' between being a manager (in a managed pub owned by the brewer/pub company) and owning one's own pub (which may be loan tied or totally free).

(169) The incentive for 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 of the distribution of the 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.

(170) 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) of the Regulation which states that 'exclusive purchasing obligations and bans on dealing in competing products specified in this 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 does not constitute an obstacle to exempting the exclusive obligation and non-compete clause.

(171) 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 ([42]). This is particularly the case in view of the large number of beers supplied by Bass to the lessees and of the frequency with which Bass 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 around 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 has further to be noted, that in any case, the tenant is not in a position to introduce new brands as the brewer would anyway be able to prohibit sales by the lessee of the other brands of the same type in his outlet, using the non-compete clause which 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.

(172) It is correct that a lessee might be forced to buy unfamiliar products when Bass sells his tied house to another company. Where this change takes place 'overnight', it may have a considerable impact on turnover in the respective 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

([41]) Paragraph 41 of the notice to the Regulation: see footnote 14.

([42]) In so far as the underlying agreements are in conformity with Article 81.

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 the customers would not be interested in.

2.1.2. *Price differentials*

(173) 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.

(174) 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.

(175) Secondly, with regard to the condition related to the improvement in distribution, the Commission considers that someone who faces appreciable 'net' price discrimination might face difficulties in competing on a level playing field. Consequently, any improvements in distribution resulting from such agreements may remain theoretical, or be structurally inhibited in such a way that they cannot outweigh in the longer term the anticompetitive features of the agreement. This idea that price discrimination can be incompatible with Article 81(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 ([43]).

(176) 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. 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.

(177) Unjustified price discrimination will only have an appreciable negative impact on the competitiveness of the lessee, and will therefore only affect the appreciation 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.

(178) 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 Bass 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.

(179) 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.

(180) As for the above competitors, only the free trade-operators (the non-loan-tied supplies to clubs have been included in the Bass data on the discounts for the free trade operators) directly purchase their beer on market terms from Bass; this group is considered to be the 'reference group'. They are indeed the only group where 'the supplier […] applies less favorable prices […] to resellers bound by an exclusive purchasing obligation as

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

compared with other resellers *at the same level of distribution*' ([44]) (italics added).

(181) Table 3 (recital 108) indicates clearly that the price differential between the price paid by tied lessees (the Bass 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*

(182) However, Bass 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.

(183) The Commission accepts this argument. However, this implies an inherently difficult comparison between on the one side clearly quantifiable price differentials and on the other side more 'quality'-related aspects of the business relationship.

(184) The description of the so-called 'quantifiable countervailing benefits' in recitals 60 to 108 reflects the difficulties involved in such quantification. However, in view of the arguments described there in support of the 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 81(3), whether the 'practical' operation of the standard leases brings about an improvement in distribution.

(185) In its assessment of the conditions of Article 81(3), and in particular where a retroactive exemption is requested, the Commision cannot make an overall assessment for the whole 'retroactive' period, but should evaluate whether at all times the conditions of Article 81(3) are fulfilled. The Commission considers in view of the 'standard' nature of the notified agreements which cover several hundred individual agreements, 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 81(3) are fulfilled to a year-by-year assessment.

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

(186) It is apparent from Table 3 that for the years up to 1992/93 and from 1994/95 onwards the price differential is more than compensated by quantifiable countervailing benefits. The 'average' lessee is therefore, on an overall assessment of the business relationship with Bass, in a position to compete on a 'level playing field' with his free trade counterpart. For the year 1993/94, the price differential was not totally offset by the countervailing benefits, the shortfall being around GBP 2 per barrel. However, the Commission considers that this figure in itself is not sufficient to warrant the conclusion that the average tied lessee faced a significant handicap 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 risk faced by a tied lessee as compared to a free trader (recital 111).

(187) 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.

(188) 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**

(189) 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 ([45])'.

(190) 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 not attract the investment made by Bass and/or the lessee. The continued availability of those outlets and/or the

([45]) 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 different type 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.

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, 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 Bass.

(191) With regard to the specification of tie by type, the Commission also notes that in 1997 alone Bass introduced 36 brands into its leased public houses, including such specialised beers as the ales Orkney Raven and Caledonian Christmas which were only introduced in Scotland. Other brands include well-known brands such as Guinness and Caffrey's Irish Ale and less well known brands such as Staropramen.

(192) The Commission therefore concludes that consumers benefit from the operation of the leases.

2.3. **Indispensability of the restrictions**

(193) The exclusive purchasing obligation, together with a non-compete clause, is indispensable to the advantages produced by beer supply agreements, as noted in recital 168. 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.

(194) 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 171 and 191).

2.4. **Possibility of eliminating competition in respect of a substantial part of the market in question** ([46])

(195) It is evident that Bass cannot eliminate competition from a substantial part of the market as they account for only 24% 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 beer market was foreclosed through the parallel networks of brewers' agreements, Bass' agreements do not lead to the elimination of competition in respect of a substantial part of the UK on-trade beer market.

([46]) A different concept from 'significant contribution to the foreclosure of the market'.

2.5. **Conclusion**

(196) The standard Bass leases, and the beer tie (exclusive purchasing and non-competition obligations) which they contain, fulfil the conditions of Article 81(3).

C. RELATION WITH ARTICLE 28

(197) The current and former lessees who used the model consider that the Commisison cannot grant a retroactive exemption given the Commission's established position by way of the procedure under Article 226 of the Treaty against the 'guest beer clause'. On the basis of the Metro ([47]) judgment, it is argued that it would be an improper exercise of the Commission's powers under Article 81(3) to permit a retroactive exemption which would bless, under the competition rules, what is considered to be a clear breach of Article 28.

(198) The compatibility of the guest beer law with Article 28 is irrelevant for Article 81 purposes. First of all, a decision pursuant to Article 81(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 28 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 than 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.

(199) As the Article 28 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. 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.

([47]) Case 26/76, Metro v. Commission [1977] ECR 1875.

D. RETROACTIVE NATURE AND DURATION OF THE EXEMPTION

(200) 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 to imports or to exports between Member States'. It follows from Article 6 of Regulation No 17 that for such agreements the date from which a decision pursuant to Article 81(3) takes effect may be earlier than the date of notification.

(201) The Court has held in its judgment in Fonderies Roubaix ([48]) 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 Bass' price list that are imported from outside the United Kingdom.

(202) Since it has been found above that the standard leases fulfil the conditions under Article 81(3) since the date of first introduction of one of the notified agreements on the market on 1 March 1991, this Decision should apply from 1 March 1991.

(203) Pursuant to Article 8(1) of Regulation No 17, an exemption should be issued for a limited period. The Commission considers that the period, until 31 December 2002 is appropriate, as the Bass leased estate has been sold off with only just over 20 leased properties remaining which are expected to be converted into managed houses. The exemption period therefore allows Bass to make its commercial decisions on the remaining tenanted houses with a reasonable level of legal certainty,

HAS ADOPTED THIS DECISION:

Article 1

1. The provisions of Article 81(1) of the Treaty are, pursuant to Article 81(3), declared inapplicable to the individual lease agreements in the standard form of (a) the 10-year lease, (b) the three-year foundation agreement and (c) the tenancy-at-will lease, and to the exclusive purchasing and non-competition obligation ('beer tie') which they contain.

2. This Decision shall apply from 1 March 1991 until 31 December 2002.

Article 2

This Decision is addressed to:

Bass plc
20 North Audley Street
London WIY IWE
United Kingdom.

Done at Brussels, 16 June 1999.

For the Commission
Karel VAN MIERT
Member of the Commission

([48]) Case 63/75, Fonderies Roubaix v. Société Nouvelle des Fonderies [1976] ECR 111, at paragraph 8.