COMMISSION DECISION

of 16 June 1999

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

(Case IV/35.992/F3 — Scottish and Newcastle)

(notified under document number C(1999) 1474)

(Only the English text is authentic)

(1999/474/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 25 April 1996 by Scottish and Newcastle 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 Scottish and Newcastle plc (hereinafter: 'S&N'), 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 25 April 1996 S&N notified eight standard forms of leases (hereinafter: 'the leases'), the subject of each of the leases being a fully fitted-out, on-licensed [3] public house in the United Kingdom with a tie for beer as described below. The eight standard forms can be put into three groups: the 'English leases' consisting of the S&N standard England and Wales November 1993 lease ('E&W November lease'), the S&N Standard England and Wales 1993 lease, as amended by a letter of variation, and the Matthew Brown lease; the 'Scottish leases' consisting of the S&N standard Scottish November 1993 lease, the Scottish E-type lease and the Scottish S-type lease, as amended by letter of variation; and finally, the 'short-term leases' which include a temporary lease and a tenancy-at-will agreement. S&N requested negative clearance or confirmation that the leases 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.

(3) The information in the notification has been supplemented by way of a verification pursuant to Article 14(2) of Regulation No 17 at the premises of S&N, and by several requests for information.

(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 observations from interested third parties. 21 observations by current and former tenants were provided on a model designed by the Scottish Licensed Trade Consultants ('the SLTC model'); two

[1] OJ 13, 21.2.1962, p. 204/62.
[2] OJ C 8, 13.1.1998, p. 4.
[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.

tenants enclosing the work of an accountant, who also submitted observations on his own account; the Bavarian Lager Company; three trade associations and an employee of the Finnish Petrol Retailers Organisation.

(5) The information in these observations will be dealt with in the remainder of the Decision. 26 of the interested third parties requested the Commission to register their submission also as a formal complaint against S&N. Some of the complainants withdrew their complaint, but the 15 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. 11 of them presented further comments on this letter. Those comments have been integrated to this Decision.

B. THE PARTIES

(6) The S&N group comprises three business divisions: brewing, pub retailing, and leisure. S&N's brewing business is based principally in the UK and Ireland, where it brews and distributes its own brands and brews and/or distributes a number of other brands under licence.

(7) In August 1995, S&N acquired the brewing and distribution business of Courage Limited. The combined UK brewing businesses trade under the name Scottish Courage, while in Ireland S&N trades principally through Beamish and Crawford plc, acquired by S&N as part of the Courage acquisition. These brewing activities represent around 28 or 29% of the UK beer market in volume production terms.

(8) Following undertakings given to the Secretary of State under the UK Fair Trading Act 1973 after the Courage acquisition, S&N was not allowed to tie or manage more than 2 624 on-licensed premises. On 16 November 1998 the UK competition authorities released S&N from its undertaking, allowing it to tie 2 739 public houses. This number represents approximately 1,9% of the total number of on-licensed premises in the UK and these outlets account for 4,4% of total beer throughput in the UK on-trade market. Currently, 432 pubs are leased to tenants under the notified agreements, and those pubs bought in 152 000 barrels of beer from S&N in the year ended 3 May 1998, accounting for 0,6% of the UK on-trade beer market.

(9) S&N's worldwide turnover for the year ended 30 April 1997 was GBP 3 349 million. In that year, S&N's retail division's turnover was GBP 779 million.

(10) In March 1998, S&N acquired 310 on-licensed premises from Inntrepreneur Pub Company Limited (IPCL). These outlets are included within S&N's 2 739 permitted tied or managed outlets. In order to allow headroom, within the permitted maximum, for the acquisition of these outlets, S&N released the tenants of 184 outlets from the purchasing obligations in their leases, and disposed of a further 126 outlets.

(11) Details of the actual number of barrels ([7]) sold by S&N to and the relevant market shares on the UK on-trade beer market of (a) all tied pubs, including those on temporary tenancy agreements, (b) managed houses, (c) pubs with a loan tie to S&N, (d) total of S&N's sales to property tied pubs, managed houses and loan ties, (e) S&N's total sales to the on-trade and (f) the total UK on-trade market are given in Table 1 below:

Table 1

S&N's position in the UK on-trade beer sector

(1 000 barrels)

	(a)	(b)	(c)	(d)	(e)	(f)
1990/91	421	471	1 070	1 962	2 677	31 863
1997/98	[…]	[…]	[…]	[…]	[…]	[…]

(%)

1990/91	1,32	1,48	3,36	6,16	8,40	100
1997/98	[…]	[…]	[…]	[…]	[…]	[…]

(12) The average length of S&N's loan tie agreements has, since 1990, been about 10 years. The average duration

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

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

of S&N's loan tie agreements before repayment of renegotiation is between 2,5 and 3,5 years. S&N have no records of the prior arrangements of accounts entering a new loan agreement with the company. S&N's outstanding-loan book has increased from a figure of some GBP 72,9 million in 1990 to GBP 217,6 million in 1998.

(13) The Commission has some limited information on the barrelage/percentage of beer sold by S&N to other operators on the 'wholesale' level of the UK on-trade beer market, 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. There are no contractual restrictions in agreements with independent wholesalers. However, there are restrictions in agreements with pub companies representing approximately 1,1 % of the UK on-trade beer market. In respect of other brewers, restrictions accounted for around 1,2 % of the UK on-trade beer market. The information in the Commission's possession tends to indicate that the volume accounted for by 'restrictive' agreements (minimum purchasing obligations with penalties) is decreasing compared to the early 1990s, as more recent agreements have tended to promote discounts as an incentive, foreseeing discounts linked to certain volume or distribution targets.

(14) The other party 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 premise.

C. THE MARKET

(15) Since 1985, 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

(16) 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 obligation and non-competition obligation) between brewers and pubs. Most of the MMC's recommendations were implemented, mainly by the Supply of Beer (Tied Estate) Order 1989 and the Supply of Beer (Loan Ties, Licensed Premises and Wholesale Prices) Order 1989 (hereinafter: 'the Orders'). The Tied Estate Order imposed the following changes on the 'national brewers', which means brewers having an estate of more than 2 000 on-licensed premises:

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

— their tenants/lessees would have the right to buy one cask-conditioned ale (a beer with fermentation in the cask) ([8]) from a source other than the brewer/landlord (hereinafter: 'the guest beer clause'),

— they were only allowed to tie a certain number of pubs. This forced them to sell or free of tie about 11 000 of the then estimated 60 000 UK pubs. S&N is allowed to tie a maximum of 2 739 pubs.

Demand factors

(17) 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 1996. Volume sales of all beer in the UK fell by 9,5 % between 1989 and 1995 (in 1996 total volume increased marginally compared to 1995) and volume sales of beer in the on-trade fell by 17,3 % 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 69 % in 1996) but, with the exception of Ireland, remains the highest proportion in the Community.

(18) 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;

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

(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.

(19) 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

(20) 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 an 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 8. The SLTC model notes that S&N has 38% of the market in Scotland and Bass 42%.

Wholesaling

(21) 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.

(22) 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

(23) In the UK, the retail sale of beer and other alcoholic drinks for consumption on the premises requires a 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 include hotels and wine bars,

— restricted on-licences: where it is a condition on buying a drink that the customer is either a resident or having a meal. 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.

(24) 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

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

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

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

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

(26) 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.

(27) While 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-licences (1995 data).

(28) The Orders also reduced the restrictive scope of loan ties, by allowing their termination at any moment in time by the tenant on three months' notice. The Orders also introduced the guest-beer right for publicans with trade loans from the national brewers. 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 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 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 which 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

(29) 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

(30) 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

([12]) This is also sometimes called a guest beer, although the legal definition of a guest beer refers to the purchase of a cask-conditioned beer from another supplier (see recital 16).

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.

(31) 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 22). 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.

(32) Most foreign producers of beer (mostly lager) have chosen to enter the UK market by entering in 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. S&N has concluded such licensing agreements with, *inter alia*, Foster's, Beck's, Kronenbourg and Holsten.

Market entry at retail level

(33) 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.

(34) 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 greenfield sites in recent years.

Changes in arrangements between pub tenants and their landlords

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

(36) The leases are contracts between S&N and the lessee, whereby S&N makes available a licensed public house together with the non-moveable 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 S&N and agrees to purchase the beers detailed in the lease from S&N or its nominee and no other source.

(37) There are eight types of lease which can be put into three groups:

— the 'English leases': the S&N standard England and Wales November 1993 lease ('E&W November lease') is for an initial fixed term usually of three

([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 a new agreement, the UK courts will renew the agreement on similar terms to the existing agreement with the exception of the rent and the duration which cannot exceed 14 years.

years automatically renewable for additional terms each of three years (a small number have an initial term of between four and nine years, renewable on three-year terms). Under the lease the tenant is not obliged to repair the main structural parts of the premises, certain parts integral to the structure such as electrical and heating systems, but must repair other areas and fixtures and fittings, and redecorate the premises internally. The S&N standard England and Wales April 1993 lease, as amended by a letter of variation, is a lease in which the term and repair obligations are the same as the November lease, but the tenant must decorate the entire premises. Finally, the Matthew Brown lease, as amended by a letter of variation, is a lease which was in use by Matthew Brown plc prior to its acquisition by S&N in 1985. This lease may be terminated by S&N giving 12 months' notice or by the tenant giving three months' notice. Under the lease the tenant is obliged to repair and decorate only the interior of the premises and the fixtures and fittings,

— the 'Scottish leases': the S&N standard Scottish November 1993 lease is for a fixed initial term, usually five years (a small number are for between six and nine years), and continues indefinitely until terminated by either S&N or the tenant giving six months' notice. Under the lease, the tenant is responsible for repairing everything apart from the main structural parts of the premises, and for redecorating the premises internally. The S&N Scottish E-type lease, as amended by a letter of variation, is, in contrast, for a period of 10 years and continues thereafter indefinitely unless terminated either by S&N or the tenant giving six months' notice. The tenant's repair and redecoration obligations are similar to those obligations in the Scottish lease, save that the tenant must redecorate externally. Finally, the S&N Scottish S-type lease, as amended by a letter of variation, is identical to the E-type lease and is usually for a period of 10 years but sometimes for 20 years. The principal difference between this lease and the other two Scottish leases is that the tenant is granted ownership of all goodwill relating to the premises. On rent reviews such goodwill is disregarded and on assignment may be sold to the assignee,

— the 'short term leases': the temporary lease is for use in England in circumstances where the UK Landlord and Tenant Act 1954 has been excluded by Court Order. The lease is for a period of one year and can be terminated by either party giving 28 days' notice. The tenant's repair and redecoration obligations are the same as in the E&W November lease. The tenancy-at-will agreement is also for use in England where negotiations for a longer-term lease are pending. It permits the tenant to occupy the premises but can be terminated at any time. Under this agreement, the tenant must keep the interior of the premises in good order and must repair the trade fixtures and fittings. The leases are contracts between S&N and the lessee, whereby S&N 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. Under the leases, the lessee pays a rent to S&N and agrees to purchase the beers specified in the lease from S&N or its nominee and from no other source.

The beer tie

(38) The lessee agrees to buy all specified beers from S&N or its nominee with the exception of beer containing less than 1,2% alcohol and one brand of cask-conditioned beer. Specified beers are the beers of the type set out in the schedules of the lease which contain the terms of trading. These include: light, pale ale (including Scotch Ale) or bitter (also known as 70 shilling, heavy or special ale); export or premium ale (also known as 80 shilling ale); mild ale (also known as 60 shilling ale or light ale); brown ale; strong ale (including barley wine); fruit beers; wheat beers; stouts; sweet stout; porter; lager; export or premium lager (also known as malt lager or malt liquor); strong lager; 'diat pils' (or premium low carbohydrate beer or lager); low carbohydrate (or 'lite') beer or lager; and low alcohol beer or lager. These types are represented by the brands or denominations of beer listed in S&N's current price list.

(39) 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.

(40) A few lessees have commented on this issue. It is remarked that the 'specified' type definitions cover substantially all beer types sold in the UK. This is not disputed. One complainant has argued that the 12 specified types are too generic and thus not 'clearly distinguishable by composition, appearance or taste', the relevant criteria indicated in the Regulation to define 'different types of beer' ([14]). The complainant referred to the difference between 'cask-conditioned beer' (a beer

([14]) Article 7(2).

with fermentation in the cask) and 'keg beer' (no fermentation in the cask) types and the absence of any reference to this difference in the specification of the 12 types. The Commission recognises that discerning drinkers can taste the difference between the cask conditioned and the kegged version of the same brand. However, the Commission does not consider that this necessarily implies that the specification of the types should take account of this difference. The definition of beer types is a matter for experts to decide ([15]). As the specification of the 12 types was originally agreed between the respective federations of brewers and licensed victuallers in the United Kingdom, experts with regard to beer, the Commission accepts this definition as an appropriate, workable way of defining beer types in the UK.

Rent

(41) For all leases except the tenancy-at-will lease, rent is paid monthly or quarterly in advance and the lessee repays the premiums paid by the landlord for insuring the premises against the loss or damage by, for example, fire and including two year's open market rent of the premises and expert's fees. (For the tenancy-at-will leases the payment of rent is weekly.) Each year the rent payable under the Scottish leases increases by the General Index of Retail Prices.

(42) Numerous lessees have indicated in their submissions that they consider that the insurance that they have to repay S&N is above the market rate for similar coverage and that they are not entitled to see the contract.

(43) S&N insures all its licensed premises, both managed and tenanted, in an entire risk portfolio of the group, namely buildings, motor, public liability and so forth. S&N uses its purchasing power to obtain the best possible price in which the premium is closely related to the claims history of the estate; in other words, the insurer's margin is minimised. This results in the policy and the total premium being commercially sensitive and not being disclosed to lessees.

([15]) See also paragraph 51 of the Commission notice concerning Commission Regulations (EEC) No 1983/83 and (EEC) No 1984/83 of 22 June 1983 on the application of Article 81(3) of the Treaty to categories of exclusive distribution and exclusive purchasing arrangements (hereinafter: 'the notice to the Regulation') (OJ C 101, 13.4.1984, p. 2).

(44) A system whereby tenants individually insure the landlord's interest would result in higher costs to the tenants. The lease contains a statement of the risks that the landlord is entitled to insure and recharge to the tenant. There is nothing to prevent the tenant from seeking a quotation for the insurance of the premises, or advice on the validity of the recharge, on that basis. There was no evidence submitted that suggested that the amount charged by S&N was overinflated.

(45) The normal rent review period is every three 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 either what the parties agree is the then fair market rent or the sum as determined by an arbitrator.

(46) Submissions, based on the SLTC model, claim that the costs of arbitration influenced the decision as to whether or not to dispute the rents set by S&N. However, there was no evidence submitted to show that S&N's rent proposals do not stand up at arbitration — as would be the case if rents generally were higher than the level the arbitrator would set.

(47) S&N have indicated to tenants, in a letter sent in early July 1998, that the Royal Institution of Chartered Surveyors will appoint experts on a fixed-fee basis for fast-track resolution of rent reviews.

(48) Numerous submissions, based on the SLTC model, have indicated what the parties consider to be the negative effects of such an 'upward only rent review', in particular when turnover in the individual pub goes down owing to local circumstances or an overall recession in the country.

(49) The OFT report (see recital 50) has looked into this issue and the OFT discussed this practice with the Department of the Environment which in 1995 conducted a major review of UK commercial property leases. It appeared that upward only rent review (hereinafter: '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 for income flow.

Discounts and countervailing benefits

(50) In the United Kingdom, individuals who are not tied for their beer purchases to another company (individual free-house operators) can obtain discounts for their beer purchases which are not available to the tied operators. The Commission has therefore assessed (i) the net price differential for beer purchases from S&N between the price paid by individual free-house operators and S&N's tied lessees; and (ii) the value of benefits which are granted by S&N to its lessees and which are either not readily available to the individual free-house operators or in excess to S&N's contractual obligations towards its lessees (hereinafter: 'countervailing benefits'). The starting point for this assessment was the report of the Office of Fair Trading (hereinafter: 'OFT') on their enquiry into brewers' wholesale pricing policy of May 1995 ('the OFT report'), which was supplemented by further investigations by the Commission.

(51) For the purposes of the calculation of the price differential, the average discounts granted by S&N to individual free-house operators were calculated on the basis of actual invoices in each year for either the best selling lager or ale for a sample of 400 individual free trade accounts. The average discount figure resulting from this exercise was then increased by a factor based on historical volume for the sample outlets.

(52) The average price paid by the tied tenants takes account of a discount scheme, introduced in November 1993 and called 'the Deed of Variation', which 80% of S&N lessees have joined. Under the Deed, the rent payable by the lessee is increased (compared to those lessees not under the scheme) by a fixed amount, in return for which the lessee is entitled to a basic discount per barrel on purchases of specified beers. The amount of the increase in rent is calculated at the outset as 90% of the discount payable on an agreed barrelage, based on previous trading levels.

(53) In a submission by a trade association, it is contended that the Deed operates as a minimum purchasing penalty agreement. Given the lessee's rent increases by 90% of the discount, in this case at least GBP 25 per barrel, i.e. GBP 22,50, the actual discount is GBP 2,50. Should the leaseholder purchase a guest beer, the lessee would forfeit GBP 22,50 of the recoverable extra rent paid in advance. This is the penalty for purchasing other products.

(54) It should be noted that S&N lessees had a choice, they were fully entitled to retain their existing terms and 20% did. Second, in calculating the additional rent it is only on tied products. Guest beers are excluded from the calculation of the rent increase. Where the tenant is not currently purchasing a guest ale from another supplier, the S&N supplied cask ale with the largest volume is excluded from the calculation.

(55) The Deed of Variation varies the terms of the lease and, therefore, has no independent existence. It does not, in itself, impose any purchasing obligation on the tenant. The lease and the Deed of Variation therefore form a single new agreement and, as such, the agreement must be considered as a whole in relation to both any exclusive purchasing obligations or countervailing benefits.

(56) The Deed of Variation creates a contractual obligation to pay discount in return for a higher fixed fee. The market rent for a lease where discount is payable must be higher than that where no discount is payable. Inevitably, the higher the rent, and the higher the discount, the more the tenant (rather than the landlord) is exposed to the risk/reward of over/underperformance.

(57) Most interested third parties have indicated that they are aware of higher discounts being granted by S&N to individual free traders than those indicated in Table 3 at recital 77 and some of them have supplied copies of offers made by S&N to such clients. It is not disputed that in individual cases higher discounts are granted as Table 3 is based on averages for all S&N's individual free-house operator-clients. It also follows from recital 51 that the relevant figure in Table 3 is the result of the average discount to the free trade (excluding loan-tie customers) minus the discounts granted to S&N lessees.

(58) 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.

(59) There are a number of methodologies for calculating the rent subsidy. The OFT report has identified three main methods of comparison. The first is to take an 'average pub', estimating the value of the property and the divisible balance and comparing the resulting mortgage payments with the rent a brewer would take. The second is to look at the brewers' returns on capital employed from their pub estate and compare these to some estimate of a normal return. The third is by calculating the difference between the ratio rent/turnover for the tied estate with an estimated ratio rent/turnover for 'free of tie outlets'. This third method has been used in the OFT report as the OFT had the most data available to use this method. The Commission has

followed this methodology because it allowed the Commission to build on the work of the OFT which leads to an obvious economy in procedure.

(60) In practice, the rent subsidy is calculated by subtracting the actual rental income from the tied estate from 15% of the turnover of the estate (the assumed rent for a free of tie-outlet being 15% of turnover). To arrive at the rent subsidy in GBP/barrel, the overall rent subsidy is divided by the total number of barrels (tied and untied) supplied by S&N to the estate.

(61) The total rental income is defined as the sum of the lease rent, the Deed of Variation rent and S&N's share of machine income.

(62) The total retail turnover of the estate is an estimate for which the starting point was an estimate of the total annual turnover of each individual house in February 1995 made by the responsible first line manager ([16]). The turnover of each individual house resulting from the sale of alcoholic and non-alcoholic drinks was estimated by examining actual and past volume purchases from S&N. The figures for the past relate to the year ended October 1993, as up to then almost all tenants were required to make all purchases of beer, cider and minerals from S&N ([17]). Wines and spirit volumes were also estimated by checking actual purchases from some tenants pre-October 1993 and current conversion rates (that is, the number of cases per 100 beer-barrels sold) from a comparable sample of S&N's managed houses, i.e. S&N Retail (North) Ltd. The estimate volume purchases per outlet were then used to calculate turnover, based on more recent prices. Machine turnover was calculated by reference to the actual number and types of machines in each house, together with knowledge of the typical revenue generated by such machines (backed-up by estimates of specialised consultants and actual revenues for a large number of houses which had been subject to machine sharing terms prior to October 1993). Tobacco and sundry sales were estimated at 6% of wet turnover. Turnover for food and rooms was set at only 3% of total turnover. For 1994/95 onwards, the proportion of turnover relating to food sales has grown considerably. Having looked at data supplied by S&N, the Commission has taken a conservative view in considering that this percentage has increased from 3% in 1994/95 to 6% in 1997/98. The Commission chose at random 20 pubs in the estate to check the reliability of the estimate of total retail turnover against S&N's internal files for each of them.

(63) The turnover for the year 1997/98 so arrived at was converted to a turnover per beer barrel (from all suppliers). This figure for 1997/98 was then used to calculate the estimated turnover per barrel for the previous years by indexing the figure to the rise in average S&N list price per barrel. This figure was reduced by 2% per annum in proceeding years, to reflect the growth in non-drinks turnover, principally food.

(64) The methodology for the calculation of the rent subsidy has been criticised. Numerous lessees, based on the SLTC 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 in contrast to the 15% of turnover for free-of-tie public houses used in the notice.

(65) First, the Commission notes that the letter on which the claim made by the lessees is based does not mention whether the 6 to 8% refers to a free or a tied public house. Second, if the letter referred to 6 to 8% as the free-of-tie rent, it is not clear why a newcomer to the industry would choose an S&N tenancy if, as the sample of S&N tied houses selected by the Commission suggests, the rent/turnover ratio is 11,36%.

(66) Two tenants, on the basis of the work of an accountant who also submitted his work independently, consider that, in practice, rents are determined on the basis of 50% of the divisible balance — namely the net profit ([18]). 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. They consider that the total rent imposed by S&N, namely the

([16]) The accountant commented that S&N has no factual knowledge of its tenants. S&N informed the Commission that is has considerable factual knowledge of the turnover of its tenants (based on S&N's sales to tenants and tenants' price lists which are publicly displayed in accordance with UK legislation).

([17]) In October 1993, S&N became a 'national brewer' so that its tenants were entitled, pursuant to the Beer Orders, to the special rights described in recital 28.

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

lease rent and the cost of discounts denied (wet rent) result in the lessees' being disadvantaged financially. The tenants and the accountant have gone further in asserting that the rent subsidy cannot exceed the price differential (but without stating why). They offer no evidence that it does not do so in the open market, where prospective tenants make their own judgments of risk and reward.

(67) The Commission does not dispute the fact that actual rent (review) negotiations take place between the company and the (prospective) lessee on the basis of a shadow profit and loss account taking into account the performance achievable by a competent lessee; the market sector in which the site trades; the product sales mix; the tied product procurement terms; the size and condition of the property, and the complexity of the operation (such as the number of bars).

(68) 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 and 60% of the divisible balance.

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

(70) 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%.

(71) 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:

— S&N has informed the Commission in a letter of 22 April 1998 that they released free-of-tie in 1998 some 184 pubs within six weeks in order to comply with the Beer Orders. The average rent increase achieved through these negotiations was, compared to the previous tied rent, some 18% greater, i.e. the rent/turnover ratio is approximately 14,6%. Had the sale period been longer S&N believe that they would have been able to achieve a higher rent,

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

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

(72) 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.

(73) Numerous tenants, based on the SLTC model, noted that the Landlord and Tenant Act 1954 does not apply in Scotland. It is argued that the tenant therefore does not have security of tenure and hence there is an imbalance between the parties when rent negotiations take place.

(74) Tenants in Scotland enjoy security of tenure according to the contractual terms of their leases. In the case of S&N 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.

(75) 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, on average, in Scotland are affected by the alleged imbalance of negotiating power between the parties.

(76) A submission by the Licensed and Gaming Association contended that S&N could use a decision to exempt the leases to tie in relation to the provision of auxiliary equipment and coin-operated equipment. Under the leases (except for the E- and S-type leases where no consent is required), S&N require prior written consent if the tenant wishes to bring onto the premises or operate from the premises any amusement machine. For so long as S&N remains the landlord, under the Scottish lease, the E&W November lease and the temporary lease, S&N cannot make it a condition of such consent that it share in the profits for any such amusement machine. Under the other leases, S&N can make it a condition of such consent that it shares in the profits or can alternatively require a rent review. Under those leases where S&N can make it a condition that it share in the profits, S&N will usually do so.

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

Table 3

Price differential and countervailing benefits

(GBP/barrel)

Year end 30 April	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Price differential	1	8	13	21	13	18	25	27
Rent subsidy	31	35	37	31	18	24	25	27
Conclusion (*circa*)	30	27	24	10	5	6	0	0

(78) 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 rent subsidy more than compensated the price differential.

(79) S&N spends significant sums on capital maintenance and repairs of fixtures and fittings. To the extent that this expenditure falls outside the contractual lease obligations of S&N, it can be counted as a countervailable benefit. Tenants and former tenants have stated that in their individual cases they have not benefited from such expenditure.

(80) In addition, S&N also provides some unquantified benefits. First, S&N provides loans to tied tenants. Though not subsidised, they are a benefit to lessees to the extent that they cannot gain access to finance from other sources. Secondly, training is provided. Observations based on the SLTC model have noted that there are other providers of training. Thirdly, S&N provides certain technical and marketing assistance benefits only to S&N tenants. Such assistance includes advice on the storage and dispensing of products as well as assistance in connection with licensing applications and appeals and the provision of promotional materials and periodic promotional discounts.

(81) Tenants also benefit from the S&N group's purchasing power in relation to the insurance of the premises. Finally, S&N have also, in certain circumstances, agreed to a surrender of the lease.

II. **LEGAL ASSESSMENT**

A. ARTICLE 81(1)

1. ***The relevant market***

The relevant product market

(82) 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

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

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'

(83) 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 23) 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 price of beer 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 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.

(84) 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 competitors to make their brands known and to use their reputation in order to gain access to the market constituted by premises for the sale and consumption of drinks.

The relevant geographic market

(85) The objective competitive conditions of supply and demand for the supply of beer to the on-trade vary considerably in the different parts of the Community. As the Court of Justice has noted in the Delimitis judgment at paragraph 18, most beer-supply agreements are still entered into at a national level. This is especially so for the United Kingdom, given the lack of land borders. 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.

(86) The UK market is also distinct from beer markets in other Member States in view of the Orders (recital 16), the high consumption of draught beer (recital 19), the presence of pub-management companies (recital 22), the pub-licensing regulations (recitals 23 and 34) and the variety in types of ale offered (recital 38).

2. ***Agreement between undertakings***

(87) S&N and the lessees are undertakings within the meaning of Article 81(1).

(88) The individual leases, in similar form to the standard leases described above, between S&N and each of its lessees are agreements within the meaning of Article 81(1).

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

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

(89) 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 38 to 39):

— the tenant shall purchase from S&N 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,

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

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

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 S&N 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).

(90) 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'.

(91) 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 inter-brand competition).

(92) 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**

(93) 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]).

([25]) See also paragraph 13 of the Delimitis judgement: 'If such (exclusive beer supply) agreements do not have the object of restricting competition within the meaning of Article 81(1), it is nevertheless necessary to ascertain whether they have the effect of preventing, restricting or distorting competition'.

(94) 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 combine with others to have a cumulative effect on competition. 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*

(95) 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.

(96) Furthermore, as S&N notified the leases in order to obtain an exemption to take effect as from the date on which the agreements were entered into, this assessment must go back to 1985, the year of introduction of the leases.

(97) 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.

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

([27]) See footnote 19; 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.

(98) From Table 2 (recital 24) 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 occurred in tied outlets.

(99) 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 (recital 26) ([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 offers no direct opportunities for independent access by other brewers direct to the retail level.

(100) 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.

(101) 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 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.

(102) The Commission also recognises that the Orders make it easier to terminate a loan tie. However, the average duration of four years indicates that the contractual relationship is not a temporary one. Furthermore, the brewer 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).

(103) 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 another brewer's beer in his outlets when this is in the tying brewer's interest.

(104) 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 non-brewing pub companies' property tied and managed houses. It is estimated that around 13% is accounted for by 'tying' beer-supply agreements between pub companies and brewers. This percentage includes the volume throughput of the Inntrepreneur Pub Company Limited, Spring Estates Limited and Allied Domecq Retailing all of which had to buy in 1996 ([31]) all their beer requirements 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.

(105) 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 1985, had

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

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

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

considerable effect on the opportunities for gaining independent access to the UK on-trade beer market.

3.2.2. *Other factors*

(106) The Court of Justice also held that, as was last confirmed in the above mentioned 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

(107) 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'.

(108) 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 34). 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 remarked that the investment that would need to be borne by a new competitor to acquire a network of sales outlets, or to open new public houses is a considerable one ([32]) and would, in fact, involve a change in focus from being a brewer to also being a UK retailer. This would, furthermore, require additional horizontal links with other UK brewers to provide all the different types of beer that a retail outlet would need to offer as new competitors (and especially foreign competitors) will tend to offer individual brands rather than the whole range of types of beer common in the UK.

(109) 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).

(110) In addition, the relatively small role played by 'traditional' wholesalers in the distribution of beer in the UK (recital 21), makes it difficult for a foreign brewer, or for a new brewer, to enter the market independently.

(111) 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 has a strong influence on the positioning and the marketing (advertising) of the foreign brewer's brand.

(112) 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 have an access to the UK on-trade beer consumer. It is indeed a lot easier for a newcomer on the market to conclude an agreement with a pub company, even if the newcomer only has one brand, and thereby gaining access to all the pubs in that network as compared to concluding agreements with individual outlets. However, for the reasons stated above in recital 99, the concrete opening of that 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 23 and 32).

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

(113) The UK brewing industry has been going through a process of concentration (recital 20). Second, the overall demand for beer as well as the on-trade market are

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

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

likely to continue to decline or remain, at best, static (recital 17). Furthermore, the increasing advertising expenditure needed 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 independent 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 30 % of total beer sales (recital 17).

3.3. **Conclusion on first Delimitis test**

(114) It can thus be concluded that an examination of all tying agreements including, but not limited to, beer-supply agreements entered into, and the other factors relevant to the economic and legal context of the UK on-trade market, shows that the brewers' tying agreements had in 1985, and still have today, on the basis of the most recent available information, the cumulative effect of considerably hindering access to that market, for new national and foreign competitors.

3.4. **Significant contribution**

(115) 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 85(1)'. Therefore, in assessing the extent of the contribution made by the brewery in question, in this case S&N, 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]).

(116) In so doing, consideration will be given to the effect of the network of S&N 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 de-minimis notice ([36])*

(117) S&N is clearly not a 'small brewer' as defined by the notice as it produces more than 200 000 hl, its market share is more than 1 % of the UK on-trade market and one of the standard leases is in some cases longer than the maximum of 15 years indicated in the notice.

3.4.2. *Individual assessment*

(118) 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'.

(119) 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.

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

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

([36]) Paragraph 40 of the notice to the Regulation (OJ C 121, 13.5.1992, p. 2). See footnote 15.

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

([38]) See footnote 33; at paragraph 87 for Schöller and paragraph 112 for Langnese-Iglo.

(120) 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.

(121) 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.

(122) The other segments of the 'tied network' of S&N are S&N's 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). As indicated at recital 13, the Commission has some limited data for this 'channel'. 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.

(123) The 892 pubs (of which 421 were operated by way of tenancies/leases) owned by S&N in 1990/91 and the 2 600 (432 leased) owned in 1997/98 account for 0,57 and 1,9% respectively of the total number of on-licensed premises. Moreover, they account, as indicated in Table 1 (recital 9), for around 2,8 and 4,12% of the on-trade volume in 1990/91 and 1997/98 respectively (the property tied part accounting for 1,32 and 0,89% respectively). The S&N tied sales for which the Commission has the data, namely the above and including the loan tie sales, account for 6,16 ([39]) and 9,44% respectively. The 'tied' part (property, loan and managed) thus accounts for around a quarter of S&N's total sales on the on-trade market share of around 28%. To this should be added the 'wholesale partner ties' as described in recital 122.

(124) With regard to the duration of the segments of S&N's tied network, it has to be understood that all the houses that S&N 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. The longest of the leases extends in some cases for 20 years. S&N's loan ties last on average 2,5 to 3,5 years.

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

4. *Restrictive effect on competition of other restrictions*

4.1. **Description**

(126) The leases contain the following clauses by 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 interior of the public house and fixtures and fittings in good repair,

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

— restrictions on assignments,

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

— not to place amusement machines without the consent of S&N,

([39]) The Commission has no detailed information on S&N's tied network previous to 1990, i.e. for the period 1985 to 1990. It is, therefore, possible that in that period, S&N's tied network might not have been a significant contributor to the foreclosure. However, it will be assumed, possibly to the disadvantage of the company, that the leases fall within the scope of Article 81(1) for the whole period.

— clauses relating to advertising in some of the leases (hereinafter: collectively referred to as 'the advertising clause'): the obligation to display advertisements supplied by S&N (in the England and Wales 1993 leases, and in the Scottish lease); and permission to only advertise goods supplied by third parties in proportion to the share of those goods in the total turnover of the premises (in all the English leases).

4.2. **Evaluation**

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

(128) 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, for example 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.

(129) With regard to the supply of beer, the obligation to display advertisements supplied by S&N does not restrict in any way the advertising of beer supplied by other undertakings and is thus no restriction of competition. The clause in the English leases has the object of limiting the advertising of beer supplied by other undertakings to a certain extent. The only beer that the S&N lessee is entitled, pursuant to the lease, to buy from other undertakings is the guest beer and beer of non-specified types. In particular the brands of beer of on-specified types may not be well known to the UK consumer and therefore would require specific on-the-spot advertising. The letter of the clause would make advertising for these new products impossible, as the clause requires the advertising to be proportionate to the turnover of these goods, which, by definition, is virtually zero as the goods are new. However, the Commission possesses no information that the advertising clause has been strictly applied. On the contrary, S&N has confirmed in a letter of 2 October 1998 that it has not in the past, does not at present, and will not in the future use the leases to exclude or unduly impede advertising for the products of other undertakings. In practice, tenants occupying premises under the Scottish lease very frequently display advertising material provided by other suppliers. S&N has not attempted to prevent tenants from displaying such material, or refused permission to display such material. In these circumstances the advertising clause is not considered to be an appreciable restriction of competition.

5. ***Effect on trade between Member States***

(130) 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 S&N. 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 'restrictive' agreements, including the exclusive beer-supply agreements, are likely to protect a substantial part of the UK market from direct competition from competing goods originating in other Member States. Indeed, as was noted in recital 32, most foreign producers have chosen to enter the UK market by entering licensing agreements with existing brewers, including S&N, to gain access to their on-trade network ([41]). Accordingly, the leases affect trade between Member States.

6. ***Appreciability***

(131) The exclusive purchasing and non-competition obligations only fall within the scope of Article 81(1), however, if they affect competition and trade between Member States to an appreciable extent.

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

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

(132) The quantification of the restrictive effect of the cumulative networks and the other factors contributing to the foreclosure of the UK on-trade beer market, and of the significant contribution made by S&N's network to that effect, as laid out in recitals 95 to 130 demonstrate their appreciable nature in restricting competition and trade between Member States with respect to the UK on-trade beer market.

7. ***Conclusion***

(133) The exclusive purchasing and non-competition obligations of the leases fall foul of Article 81(1) since the introduction of the leases in 1985.

B. ARTICLE 81(3)

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

(134) The Court has confirmed in the Delimitis judgment (paragraph 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 from unilaterally extending the scope of the exclusive purchasing obligation. A beer-supply agreement which refers, for the products covered by the exclusive purchasing agreement, to a list of products which may be unilaterally altered by the suppliers does not satisfy that requirement and thus does not enjoy the protection of Article 6(1). The Court thus concluded (paragraph 37) that the conditions for the application of Article 6(1) of the Regulation are not satisfied if the drinks covered by the exclusive purchasing terms are not listed in the text of the agreement itself but are stated to be those set out in the price list of the brewery or its subsidiaries, as amended from time to time.

(135) The standard leases provide for a specification of the beer tie by type which allows S&N 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 S&N unilaterally to extend the scope of the exclusive purchasing obligation and therefore does not fulfil the conditions of Article 6 of the Regulation, which requires a specification by brand or denomination ([42]).

(136) 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*

(137) 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 S&N standard leases, particularly in view of the restrictive UK licensing system, is a method of providing the means of a lessee to operate such premises and, as such, allows a low-cost entry of a newcomer on the on-trade market for the distribution of beer. The system whereby brewers in the UK allow an independent business person to operate a licensed property owned by the brewer thereby increases the options for entry into the market. In a way, property tied houses 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).

(138) The incentive on the reseller, following from the exclusive purchasing and the non-competition obligation, to devote all the resources at his disposal to the sale of the contract goods will thereby generally lead to an improvement 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

([42]) Paragraph 41 of the notice to the Regulation. See footnote 15.

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.

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

(140) Furthermore, the specification of the tie by type is considered to enable a more practical operation of exclusive beer-supply arrangements in the UK than the specification provided for in the Regulation. The specification of the tie by type makes it easier to introduce the brands of foreign or new brewers to their price lists because it does not require the consent of all the tenants ([43]). This is particularly the case in view of the large number of beers supplied by S&N to the lessees and of the frequency with which S&N 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 is further noted that, in any case, the tenant would not be in a position to add brands as the brewer would anyway have been allowed to prohibit sales by the lessee of the other brands of the same type in his outlet through the non-compete clause 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.

(141) It is correct that a lessee might be forced to buy unfamiliar products when S&N 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 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.

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

2.1.2. *Price differentials*

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

(143) 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 to discriminate is enabled by the exclusive purchasing agreement, which for the duration of the agreement gives the purchaser, unlike the other clients of the producer, no legal sourcing alternative. A brewer might therefore decide to 'cash in' on his leverage *vis-à-vis* his tied customers.

(144) Secondly, with regard to the condition related to the improvement in distribution, the Commission considers that someone who faces an appreciable 'net' price discrimination might have difficulties to compete on a level playing field. Therefore, 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 where recital 21 points out that 'in particular cases in which agreements satisfying the conditions of this Regulation nevertheless have effects incompatible with Article 85(3) of the Treaty, the Commission may withdraw the benefit of the exemption'. These circumstances, laid down in Article 14 of the Regulation, include unjustified price discrimination ([44]).

(145) 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

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

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.

(146) 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.

(147) 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 S&N 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.

(148) Most of the direct competitors of the tied lessees, namely brewers' managed pubs, managed and tied 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.

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

(150) Table 3 (recital 77) indicates clearly that the price differential between the price paid by tied lessees (the S&N 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*

(151) However, S&N 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.

(152) 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 'quantity'-related aspects of the business relationship.

(153) The description of the so-called 'quantifiable countervailing benefits' in recitals 50 to 76 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.

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

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

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.

(155) It is apparent from Table 3 that for all the years the price differential is more than compensated by the rent subsidy. It is therefore not necessary to examine the other quantifiable countervailing benefits identified in recitals 79 to 81. The 'average' lessee is therefore, on an overall assessment of the business relationship with S&N, in a position to compete on a 'level playing field' with his free-trade counterpart.

(156) 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 a general terms above have not been obtained.

(157) 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**

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

(159) 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 S&N and/or the lessee. The continued availability of those outlets and/or the improved facilities due to investment(s) made is a clear benefit to the consumer. It is self-evident that the property ties of a particular brewer can only be considered to contribute to this benefit if the long-term operation of the houses is not endangered. In other words, when, in market circumstances there are price differences, such differences are broadly offset by other specific benefits. As indicated above, this is the case with S&N.

(160) With regard to the specification of the tie by type, the Commission also notes that in the period 1990 to 1997 S&N introduced on average around five brands each year into its leased public houses. These brands include well known foreign brands such as Budweiser and Miller Pilsner and less well known brands such as Webster's Green Label ale.

(161) The Commission therefore concludes that a fair share of the benefits of the standard leases accrues to the consumers.

2.3. **Indispensability of the restrictions**

(162) The exclusive purchasing obligation, together with a non-compete clause, is indispensable to the advantages produced by beer-supply agreements, as noted in recital 137. 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.

(163) 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 140 and 160).

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

(164) It is evident that S&N cannot eliminate competition from a substantial part of the market as they accounted

([46]) This refers to the possibility under Article 6, read in conjunction with Article 7(1)(a) of the Regulation, whereby lessees can buy beer brands of a 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.

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

for only around 28 to 29 % 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 for beer was foreclosed through the parallel networks of brewers' agreements, S&N's agreements do not lead to the elimination of competition in respect of a substantial part of the UK on-trade beer market.

2.5. **Conclusion**

(165) The standard S&N 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

(166) The SLTC model and an individual tenant states that the Commission 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 I([48]) 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.

(167) 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 as the brands he tied for in the agreement. The inclusion of the 'old' guest beer was thus already a liberalisation of what was allowed under the Regulation and cannot, therefore, give rise to a concern under Community competition law.

(168) 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. 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.

D. RETROACTIVE NATURE AND DURATION OF THE EXEMPTION

(169) 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.

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

(171) Since it has been found above that the standard leases have fulfilled the conditions under Article 81(3) since the date of the first introduction of one of the notified agreements on the market on 1 January 1985, this Decision should apply from 1 January 1985.

(172) Pursuant to Article 8(1) of Regulation No 17, an exemption should be issued for a limited period. The period until 31 December 2002 is appropriate, as the remaining S&N leased estate is small and expected to decline as public houses are sold off or converted into managed houses. The exemption period therefore allows S&N to make its commercial decisions on the remaining tenanted houses with a reasonable level of legal certainty,

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

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

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 'English leases', (b) the 'Scottish leases' and (c) the 'short-term leases', and to the exclusive purchasing and non-competition obligations ('beer tie') which they contain.

2. This Decision shall apply from 1 January 1985 until 31 December 2002.

Article 2

This Decision is addressed to:

Scottish and Newcastle plc
50 East Fettes Avenue
Edinburgh EH4 1RR
United Kingdom.

Done at Brussels, 16 June 1999.

For the Commission
Karel VAN MIERT
Member of the Commission