OFFICE OF FAIR TRADING

Anticipated acquisition by A.G. Barr plc of Britvic plc

**ME/5801/12**

The OFT's decision on reference under section 33 given on 13 February 2013. Full text of decision published 5 March 2013.

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

## PARTIES

1. A.G. BARR p.l.c (**AG Barr**) is a UK manufacturer and distributor of soft drinks, listed on the London Stock Exchange (**LSE**). AG Barr manufactures and sells a wide portfolio of branded soft drinks, including Tizer, D'N'B, KA, the Barr range, Barr's Originals, Strathmore Spring Water, St Clements juice drinks, Simply juice drinks, Sun Exotic and Rubicon exotic juice drinks. AG Barr's biggest selling brand is IRN-BRU. It has also entered into a bottling partnership in the UK with Orangina Schweppes whereby AG Barr manufactures and sells Orangina in the UK under licence. Further, AG Barr has a partnership with Rockstar Inc., under which it sells and distributes the Rockstar energy drink brand in the UK and Republic of Ireland. In the year ended 28 January 2012, AG Barr's turnover was £237 million, of which £231.3 million was generated in the UK.

2. Britvic p.l.c. (**Britvic**) is a manufacturer and distributor of soft drinks, listed on the LSE. It owns a number of brands, including Robinsons, J2O, R Whites, Fruit Shoot, Britvic, Purdey's, Pennine Spring, Tango, Juicy drench and drench in Great Britain (**GB**), MiWadi, Club, Cidona and Ballygowan in Ireland, and Teisseire, Moulin de Valdonne, Fruité and Pressade in France. Britvic also has an exclusive bottling agreement (**EBA**) with PepsiCo in GB for Pepsi, 7UP, Gatorade, Mountain Dew and So Be V Water, as well as an exclusive arrangement with Pepsi Lipton International Limited for Lipton Ice

Tea. In the year ended 2 October 2011, Britvic's turnover was £1,290 million, of which £913 million was generated in the UK.

## TRANSACTION

3. The proposed transaction involves the acquisition by AG Barr of the entire issued and to be issued ordinary share capital of Britvic (together with AG Barr, the **parties**) (the **Transaction**). At present, the Transaction values the current issued share capital of Britvic at approximately £855 million.

4. It is intended that the Transaction will be implemented by way of a Court-sanctioned scheme of arrangement pursuant to Part 26 of the Companies Act 2006 (the **Scheme**) pursuant to which AG Barr will acquire the entire issued and to be issued ordinary share capital of Britvic.

5. The Scheme involves an application by Britvic to the Court to sanction the Scheme and to confirm the cancellation of the entire issued share capital of Britvic, save for any shares already owned by AG Barr, in consideration for which Britvic shareholders will receive new shares in AG Barr in accordance with the terms of the Transaction, as set out in the Scheme document.

## JURISDICTION

6. As a result of the Transaction, AG Barr and Britvic will cease to be distinct.

7. The UK turnover of Britvic in the 2011 financial year was £913 million. Consequently, the turnover test contained in section 23(1)(b) of the Enterprise Act 2002 is met. The OFT is the only jurisdiction where the Transaction is being notified.

## TIMING

8. The OFT started the administrative clock on 14 November 2012. The current administrative deadline in this case is 13 February 2012.

## FRAME OF REFERENCE

### PRODUCT SCOPE

9. The parties overlap in the manufacture and supply of soft drinks, which, as previous UK and EU decisions have shown, are recognised as forming part of the wider non-alcoholic beverage (**NAB**) sector. Specifically, the parties overlap in the supply of carbonated soft drinks (**CSDs**) and non-CSDs (in particular, water and fruit drinks).

10. The OFT considers that product market definition provides a framework for assessing the competitive effects of the merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the OFT's assessment in any mechanistic way, and the OFT may take into account constraints from outside the relevant market, or the degree to which competitive constraints – inside and outside of the market—are more important than others.[1]

11. The OFT emphasises the particular relevance of this approach in this case, noting that most of the affected soft drink categories are characterised by high levels of differentiation and branding with significant advertising and/or promotional spending. Further, the main suppliers, including the merging parties, supply a range of brands and are active across a number of categories, as are some specific brands.

12. The OFT considers market definition to begin with the overlapping products of the parties in the narrowest plausible candidate product markets. Traditionally, decisions concerning the NAB/soft drinks sector have distinguished between CSDs[2] and non-CSDs. Within CSDs, further distinctions may be drawn between different types of CSD. Non-CSDs have been considered to include, but not limited to, water,[3] fruit juice, fruit

[1] This approach is in line with the CC's and OFT's joint *Mergers Assessment Guidelines*, September 2010, paragraph 5.2.2.

[2] See for example *Case No COMP/M.2504 - Cadbury Schweppes / Pernod Ricard,* 2001; *Case No. IV/M.833 - The Coca-Cola Company/Carlsberg A/S,* 1997; and *Case No. COMP/M.5632-Pepsico/Pepsi Americas,* 2009.

[3] *Case No COMP/ M.1065 - Nestle/San Pellegrino,* 1998. The Commission considered there to be a separate market for bottled water, but left open the question whether the market should be further subdivided according to whether the water was still or sparkling. In an earlier case, it suggested that sparkling and flavoured source water may indeed form part of the overall bottled source water market (*Case COMP. M.190 - Nestle/Perrier,* 1992).

drinks[4] and dilutes. Each of these different product categories are therefore considered below.

13. Sales are principally to large retailers who then sell to final consumers and cash and carry outlets who can sell to both the on-trade (where drinks are consumed on the premises, such as hotels, restaurants and other catering establishments) and the off-trade (where drinks are consumed off the premises, such as supermarkets and petrol service stations).

14. In both distribution channels, customers pointed to there being little distinction between patterns of substitution at the wholesale level (sales to the retailer or brewer) and patterns of substitution at the downstream retail level (sales by the retailer or brewer to the end-customer) as the two are driven by consumer preferences. Retailers, for example, pointed to their own behaviour being driven by that of the end consumer.[5] The OFT notes however, that there are factors which may mean that the preferences of retailers and consumers can differ.[6]

15. As with the different product categories, each of the distribution channels has been considered below.

**CSDs and non-CSDs**

16. The parties submitted that, consistent with past cases, CSDs are distinct from non-CSDs. The OFT received no evidence to suggest that this is not the case and, in line with previous decisions (outlined above), the OFT supports distinguishing between CSDs and non-CSDs. Accordingly, the OFT will consider CSDs and non-CSDs separately for the purposes of the competitive assessment.

[4] The parties' informal submission dated 14 November 2012, paragraph 53, footnote 28 which refers to Nielsen categorisations which state that a drink will be a 'fruit juice' only if it is non-carbonated and consists of 100 per cent pure juice or juice blend with no added water (other than that which has been added to juice made from concentrate). By contrast, a 'fruit drink' is a non-carbonated drink, which may or may not contain fruit juice (juice content must be 99 per cent or less), which has added water and which generally contains added preservatives, colourings, sugar, sweeteners, etc. Fruit drinks include products described as nectars, juice drinks, ready-to-drink squashes, fruit flavoured drinks etc.

[5] [ ].

[6] For example, as a result of differing switching capabilities between the two.

**CSDs**

17. Within CSDs, the Commission has previously concluded that there is a separate product market for cola-flavoured CSDs (which is the largest segment by overall CSD sales). In more recent cases it has considered its assessments in the context of an overall CSD market, sometimes leaving the precise market definition open,[7] and sometimes concluding that the market is for CSDs overall.[8]

18. The parties recognised a possible distinction between cola and non-cola CSDs, but considered that the precise market definition could be left open. In particular, the parties pointed to evidence purportedly demonstrating that Coca-Cola Enterprises Limited's (**CCE**) Coca-Cola (**Coke**) is the closest competitor to AG Barr's biggest selling soft drink, the non-cola CSD IRN BRU (representing [ ] per cent of its sales).

19. Whilst the OFT considers that it may be possible to identify differences within CSDs, between cola and non-cola CSDs, as well as between different non-cola CSDs, for example, in terms of taste and colour, the OFT has not considered such distinctions relevant in this case and considers the narrowest candidate market in which the parties' principal brands overlap to be CSDs.[9] As a result, the OFT assesses the loss of competition between brands within the candidate market of CSDs, rather than focusing on potentially plausible narrower distinctions in which the parties may not overlap.[10]

20. As a result, noting the wide variety of CSD brands supplied by both the parties and competitors, the OFT considers that, to the extent that they

[7] *Case No. COMP/M.5632 - Pepsico/Pepsi Americas,* 2009; *and Case No. COMP/M.5633 - Pepsico/The Pepsico Bottling Group,* 2009.

[8] *COMP. 39/116/B-2 - Coca-Cola Undertakings,* 2005. Although the Undertakings did distinguish between types of *Coke*, for example *Coke Light*, *Cherry Coke*, *Vanilla Coke* etc.

[9] The OFT notes, in this context, that evidence provided by the parties – principally a survey of end consumers and internal business documents – was not framed in terms of a 'hypothetical monopolist'. Nevertheless, the OFT considers that it is appropriate in this case to considers the competitive constraints from brands across the CSD category, including, for example the constraint from colas on *IRN BRU*.

[10] The OFT notes that this is supported by evidence from the consumer survey undertaken by the parties (and discussed below), pointing to substitution between varied brands within CSDs.

may be relevant, further distinctions will be reflected in a direct assessment of the effects of the Transaction, which takes account of the closeness of competition between brands.

**Non-CSDs**

21. In Coca-Cola Company/Fresh Trading Limited,[11] the OFT did not reach a firm conclusion on possible categories within non-CSDs but, in relation to the drinks at issue, the OFT suggested segmenting the market as follows: (i) 100 per cent juice beverages, (ii) nectars (fruit content between 25 and 99 per cent), (iii) smoothies, and (iv) juice beverages from concentrate.

22. In the present case, the parties submitted that water could be considered as a separate market but the precise definition of any non-CSD market could be left open as no competition issues arose.

23. The OFT, on the basis of its market investigation, found limited evidence to support widening the narrow candidate markets of water, fruit juice, fruit drinks,[12] and dilutes, and so, on a cautious basis, considered these separately. In two of these categories – fruit juice and dilutes – the overlap between the notifying parties is limited, as either one or both have minimal activity. The parties submitted that in these narrow plausible candidate product markets no competition concerns can be expected to arise. Third parties confirmed that the parties have only limited overlaps or brands with limited interaction in these categories and raised no concerns. On this basis, the OFT did not consider these further.

24. The OFT therefore focused its investigation on the remaining product categories of water and fruit drinks. Possible further distinctions within these categories, where applicable, and which may point to a narrower candidate product market (for example, on price or product attributes), were not identified or raised by third parties and so, to the extent that they may be relevant, are reflected in a direct assessment of the effects of the Transaction, taking into account the closeness of competition between brands.

[11] *Anticipated acquisition by the Coca-Cola Company of a minority interest in Fresh Trading Limited,* OFT, May 2009.

[12] Please see footnote 4 which notes a possible categorisation of fruit juice and fruit drinks.

**Distribution channels**

25. The OFT may define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers, and require a separate analysis.[13]

26. Previous Commission and OFT decisions have found that the supply of soft drinks could be distinguished according to whether sales are made through the on-trade or off-trade distribution channel.[14]

27. In the present case, the parties submitted that there are likely to be separate markets for sales through both channels in light of factors such as distribution arrangements, pricing, product ranges (which differ across these segments), pack size/type, and drinking experience for final consumers (which shapes the requirements of the parties' customers).

28. The on-trade represents [ ] per cent and [ ] per cent of AG Barr and Britvic's total sales, respectively (excluding cash and carry sales). In the off-trade, AG Barr achieved soft drink off-trade sales of £[ ] million against Britvic's soft drink off-trade sales of £[ ] million.

29. The OFT notes that the distinction between the supply to the on-trade and off-trade can be blurred – since, for example, UK wholesale customers can supply both the on- and off-trade, as major customers are active in both – and generally the OFT's market investigation supported the parties' submission, indicating that competition conditions may differ between on-trade and off-trade customers. In particular, sales to each group are materially different due to the different scale, distribution requirements and pricing mechanisms in each channel.

30. Further, on-trade establishments commonly have a dispense fountain system. The parties indicated that this system may mean that establishments make a primary choice of cola product, which may then determine the other CSDs sourced and resold to final consumers by that

[13] See *Merger Assessment Guidelines*, paragraph 5.2.28.

[14] *Cott Beverages Limited/Macaw (Holdings) Limited*, merger enquiry, CC Report, 28 April 2006; *Case No COMP/M.2504 - Cadbury Schweppes / Pernod Ricard,* 2001.

customer. In relation to this, the parties emphasised that AG Barr does not offer an independent dispense fountain solution. Instead, AG Barr has a longstanding commercial arrangement with Britvic to provide IRN BRU to a Britvic dispense option.

31. Where a dispense system is not used, on-trade establishments source in a similar way to the off-trade, with, for example, limited refrigerator space being just as much of a consideration for on-trade establishments as it is for off-trade customers with limited shelf-space.

32. The OFT recognises that on-trade and off-trade supply may be distinct. The OFT also notes the absence of any material change as a result of the Transaction for those customers that use dispense fountains in the on-trade. The OFT has therefore focused its assessment of the Transaction on the effects on the off-trade channel. The OFT considers that should any concerns arise in the supply to those on-trade customers that do not operate a dispense fountain system these will be reflected in an assessment of the competitive effects of supply to the off-trade. The exception to this is the supply of those soft drinks not generally supplied through a dispense fountain system (for example, water), where the OFT takes a cautious approach and considers supply to the on-trade and off-trade separately where relevant and where evidence allows.

**The constraint on branded products from private label**

33. The Competition Commission (**CC**)[15] and OFT[16] have separately considered whether private label products should be considered part of a wider beverage market in previous decisions. The OFT considers that the extent to which private label provides an effective constraint to branded goods depends on the extent to which branded products can be substituted by the customer for private label products, including, the bargaining power of retailers and their ability to divert sales from branded to private label products.

[15] *Cott Beverage Limited/Macaw (Holdings) Competition Commission Merger Inquiry*, 2005, in which the Competition Commission concluded that there was a separate market for private label CSDs. However, it should be noted that this case related specifically to the private label segment and indeed the market at issue was identified as that for the supply of own-label PET-bottled CSDs.

[16] *ME/4091/09, Coca-Cola Company/Fresh Trading Limited*, 2009, in which the OFT considered whether own label non-CSDs were effective substitutes for branded non-CSDs but did not find it necessary to reach a firm conclusion on this point.

34. The parties submitted that, in this case, branded and unbranded beverages should generally be considered to be part of the same relevant market. According to the parties, private label products constrain branded goods to a material degree, and the parties pointed to large multiples, as well as cash and carry stores, developing and promoting their own private label 'brands', which for some non-CSDs appear to be good substitutes for at least some consumers. In particular, the parties relied on the fact that: the name and packaging of private label goods are often very similar to branded products; private label goods are strategically positioned on shop shelves so that they are close to branded products; and some private label goods are promoted as if they were branded goods.

35. However, the OFT considers that the degree of substitutability between private label and branded products depends on the beverage segment being considered.

36. The OFT recognises that in some product categories sales of private label products are high. However, the OFT does not have sufficient evidence – for example of retailers using private label products in negotiations for branded products – to warrant widening the product scope for branded CSDs and non-CSDs to include private label products. The OFT notes in particular that evidence submitted by the parties in relation to CSDs (and discussed below) does not point to significant switching by end-consumers from branded products to private label products. Further, the OFT notes that not all customers will be in a position to develop and market strong private label products – and use these in negotiations with branded suppliers and/or to substitute away from branded suppliers – in the same way large retail multiples may be able to.

**Conclusion on product market**

37. For the reasons outlined above, the OFT assesses the transaction on the basis of CSDs and, within non-CSDs, water and fruit drinks. Further segmentation within these has been left open, and any distinctions which could form the basis for narrower, plausible candidate markets, have been considered as part of the direct assessment of the competitive constraints on the parties' brands.

38. In relation to the distribution channels through which the parties supply their products, namely the on-trade and off-trade, the OFT notes that considering each channel as distinct frames of reference does not materially affect the competitive assessment for most of the products supplied by the parties and so, as outlined above, the OFT focuses its assessment on supply to the off-trade. Where this does not apply – in particular those drinks not supplied through a dispense fountain, such as water – the OFT takes a cautious approach and considers supply to the on-trade and off-trade separately where relevant.

39. Lastly, the OFT has insufficient evidence to warrant widening the product scope for the supply of branded drinks to include private label products.

**GEOGRAPHIC SCOPE**

40. The parties submitted that the appropriate geographic market is GB-wide since neither party makes significant sales in Northern Ireland. The parties pointed to the fact that [ ] per cent of AG Barr's business by value is represented by customers supplied nationally or on national terms, while [ ] per cent of Britvic's customers are supplied on national terms. The parties considered that uniform pricing across GB is sufficient to conclude that the market is GB-wide.

41. Further, the parties stated that the product quality is uniformly GB-wide, innovation occurs across GB; and that, if there was any differential pricing, arbitrage would eliminate this discrepancy due to the possibility of transporting products across the border. The parties also indicated that customers do not perceive any difference in the quality of the service offered by them across GB. Moreover, the parties' competitors' brands have a GB-wide focus, for example Lucozade, Red Bull and the majority of CCE's brands.

42. However, during the OFT's market investigation, some third parties argued that Scotland should be considered separately from the perspective of AG Barr's products because of the materially different competitive strength, and relative presence, of AG Barr in Scotland. The OFT notes that AG Barr's relative presence in terms of sales is substantially greater in Scotland than GB-wide.

43. The OFT also notes that internal documents provided by AG Barr revealed that there were some differences in the marketing of IRN BRU in England and Scotland, in particular:

- [ ];[17]
- [ ];[18] and
- [ ].[19]

44. In relation to marketing, the OFT notes that the marketing [ ] is [ ] focused in Scotland, mirroring [ ] sales activity there. The parties accepted that there are some differences in AG Barr's products in Scotland in terms of consumer preferences and marketing.

45. In relation to the parties submission on uniform national pricing across GB, the OFT notes that the notion of uniform pricing does not take account of the complex way in which prices are set and determined at the wholesale level in this sector. In particular, the OFT notes that sales of soft drinks are characterised by significant discounting, promotional spend and in-store support, as well as sales and logistical rebates and other non-linear pricing elements, commonly negotiated with each customer.

46. Further, the OFT considers it important to focus on the extent to which customers – both in Scotland and the rest of GB – can substitute to alternative suppliers. Evidence suggests that the ability of customers to substitute between suppliers is driven by end consumer switching preferences. As a result, the switching behaviour of a customer to or from IRN BRU, for example, will be determined, to a large extent, by the switching preferences of end consumers in Scotland, where the majority of sales of IRN BRU are made, irrespective of where prices are set. In this context, whether the price is set nationally or centrally by a supplier will reflect this dynamic.

47. As a result, the OFT considers it appropriate to assess the impact of the Transaction on a GB-wide basis as a starting point but noting, where

[17] Parties' informal submission dated 14 November 2012, Annex 18.

[18] Parties response of 27 November 2012 to an information request dated 21 November 2012, Annex 6.

[19] Parties response of 27 November 2012 to an information request dated 21 November 2012, Annex 7.

relevant, any material differences in the effects of the Transaction in Scotland.

## HORIZONTAL EFFECTS

48. The OFT has examined the possibility that the merged entity could unilaterally impose prices above the pre-merger level or deteriorate its competitive offering. When products are highly differentiated, unilateral effects concerns are more likely if the brands of the merging parties are close substitutes. Where this is the case, the parties will recapture a significant share of the sales lost in response to a price increase post-merger, making the price rise less costly.

49. In assessing the effects of the Transaction, the OFT has considered each of the parties' brands in turn and the competitive constraint that the merging parties' brands have on each other, as well as the competitive constraint exerted by other competing brands. Such an approach allows an assessment of the competition that will be lost as a result of the Transaction. This approach means that concerns may arise from the loss of competition on one of the merging parties' brands from the brand(s) of the other merging party but the reverse may not be the case such that there may be an asymmetric competitive constraint between certain brands or groups of brands.

50. The OFT has also considered the extent to which there may be any additional effects – over and above that reflected in competition between specific brands – arising from combining the merging parties' overall business and product ranges together.

51. The OFT considers CSDs and non-CSDs in turn.

### Carbonated Soft Drinks

### Shares of supply

52. The parties overlap in the supply of CSDs. While the OFT acknowledges that shares of supply may not accurately reflect the degree of competition between the parties' and competing suppliers' brands due to the degree of brand differentiation, the OFT considers shares of supply provide an instructive overview of the main competing suppliers and brands in the supply of CSDs .

53. The table below shows the shares of supply of the parties in CSDs, separating these by on-trade and off-trade and by GB and Scotland for illustrative purposes.

**Table 1: Share of supply of CDS in Great Britain and Scotland, 2012 (per cent)**

| | On-trade | | Off-trade | |
|---|---|---|---|---|
| | GB | Scotland | GB | Scotland |
| **AG Barr** | [0-5] | [5-10] | [0-5] | [15-25] |
| **Britvic** | [35-45] | [15-25] | [5-15] | [5-15] |
| **Combined** | [35-45] | [20-30] | [10-20] | [25-35] |
| **CCE** | [40-50] | [60-70] | [45-55] | [35-45] |
| **JN Nichols** | [0-5] | [0-5] | - | - |
| **Red Bull** | [5-10] | [5-10] | [5-10] | [0-5] |
| **GSK** | [0-5] | [0-5] | [5-10] | [5-10] |
| **Others** | [5-10] | [0-5] | [5-10] | [0-5] |
| **VALUE** | £[ ] billion | £[ ] million | £[ ] billion | £[ ] million |

Source: the parties/ CGA/ Nielsen.

54. The parties combined shares of supply on the categories outlined in the table range from [10-20] per cent to [35-45] per cent. These figures include private label. Without private label, the parties combined share of supply in the off-trade in GB rises to [10-20] per cent. The largest increments are in Scotland due to a greater presence of AG Barr, especially in the off-trade. In any categorisation, CCE would remain the largest supplier post-merger. CCE supplies a broad portfolio of brands such as Coke, Schweppes, Fanta, Dr. Pepper and Sprite. The other large suppliers are Red Bull with its energy drink and GSK (mainly in the off-trade) with its principal brands, Ribena and Lucozade. Red Bull and GSK both have significantly fewer brands in their ranges relative to CCE, Britvic and AG Barr.

**Survey evidence and estimated diversion ratios**

55. In assessing the closeness of substitution between different CSD brands, the parties submitted evidence based on a survey of end consumers. As the results and interpretation of the survey are applicable across most of the parties' CSD brands – and was one of the main pieces of evidence that the parties supplied and relied on – the OFT considers it useful to discuss this particular piece of evidence at the outset of the assessment of the

closeness of competition between the parties before then considering the results as they apply to each brand.

56. The survey was commissioned by the parties to assess the closeness of competition between the main CSD brands and, specifically, to establish how a consumer that had purchased a CSD brand would have responded had the brand in question not been available at the time, and which brand they would have purchased instead. The target brands of interest in the survey were IRN BRU, Pepsi, Barrs, 7UP, Tango and Orangina. The survey included both on-trade and off-trade responses.

57. On the basis of this survey, the parties estimated diversion ratios between the merging parties' CSD brands.[20] The parties submitted that the survey revealed that the parties' brands were not each other's closest competitors and showed only minimal diversion ratios between the individual brands of the merging parties.

58. The parties also submitted that diversion at the retail level is likely to overstate diversion at the wholesale level. The parties outlined a number of commonly cited concerns about why a diversion ratio identified from consumer responses might overstate or understate diversion ratios at the wholesale level[21] and, on balance, considered that the estimated diversion ratios are likely to be overstated, noting in particular that retailers can act strategically, whereas end consumers are passive and price takers (for example, consumers will typically choose from the range of drinks on offer in the retail outlet (or pub/restaurant), whereas the retailer will have a wider range of choices).[22]

59. The OFT acknowledges that it is possible that diversion at the wholesale level may be lower than that at the retail level. However, the OFT does not consider this is necessarily the case, and there is no evidence to suggest

[20] The diversion ratio estimates are based on questions four and five of the survey, which asked consumers what they would have done if the target brand(s) which they had selected had not been available at the time of their last purchase and which brand they would have been most likely to purchase instead.

[21] Many of these reflect the OFT's analysis in *Anticipated acquisition by Unilever of Alberto Culver*, OFT, 5 April 2011.

[22] However, the OFT notes that the parties submitted that there [ ]. [ ]. The parties indicated that customers are split evenly between the two.

that it would be the case in practice here. As a result, the OFT considers that the diversion ratios obtained from the survey provide a reasonable proxy for the closeness of competition at the wholesale level.[23]

60. At a general level, the OFT therefore considers such a consumer level survey approach to be an appropriate method of estimating the second preferences of consumers and obtaining an estimate of relative diversion from one brand to competing brands. The OFT regularly uses survey data like this in order to assess, amongst other things, the closeness of substitution between merging parties and their products. Further, the OFT considers that the results of the survey are probative.

61. However, the OFT notes a number of points with regard to the survey methodology of the parties and, in particular, the parties' approach to estimating diversion ratios.

62. First, the parties submitted diversion only between individual brand pair substitutes and pointed to none of the merging parties' brands being closest competitors. The OFT considers this to estimate only the extent to which a consumer would switch from one brand to another brand (for example, from IRN BRU to Pepsi). However, the OFT is principally concerned by an assessment of the competitive constraint that will be lost as a result of the merger and so considers it more probative to assess the extent to which a consumer would switch from one brand to any of the brands of the other merging party (in aggregate).[24]

63. The OFT also notes that the appropriate diversion ratio must reflect those customers that switch from one brand to another brand(s) of the other merging party relative to all customers that switch away from that original brand. In this context, the OFT considers that those customers that switch away from the original brand should exclude those consumers which switch to another brand of the same supplier. This is to ensure that the diversion ratio accurately reflects the effect of the merger and the change in incentives brought about by the merger (so, for example, those

[23] The parties also argued that the survey may not reflect the propensity of marginal consumers to switch. However, the parties did not submit any evidence on the identity or preferences of marginal consumers. The OFT considers that, in the absence of evidence to the contrary, overall consumer preference are a reasonable proxy for the preferences of the marginal consumer.

[24] This considers the appropriate numerator of the diversion ratio estimate.

consumers that switch from IRN BRU to Tizer, both AG Barr brands, are clearly not relevant for estimating the diversion ratio).[25]

64. Second, the parties submitted diversion estimates only at a GB-wide level and did not provide separate results for Scotland on the basis that they do not consider this to be an appropriate geographic scope (see above). As discussed above, the OFT considers that there may be differences in purchasing patterns and switching preferences between consumers in Scotland and the rest of GB, which has been confirmed by third parties (and, as outlined below, by the survey itself). Alongside this, the OFT notes that the survey focused only on those consumers who had recently bought the relevant brand. However, no account was taken in the survey of the extent to which the consumer had purchased that brand (that is, no volume or price weighting had been applied to consumer responses, for example, to weight the brands by each respondent's soft drinks consumption or the brands' respective prices).[26]

65. The OFT has therefore estimated diversion ratios (for those brands for which evidence suggests switching patterns may differ) for both Scotland and GB. The OFT believes that given that the survey results do not give appropriate weight to those consumers for which, based on the sales figures of certain brands, may be expected to drive demand for a given brand. In particular, for IRN BRU, given the relative concentration of sales of this brand in Scotland, the relevant and true diversion ratios are likely to lie in between the estimates for Scotland and GB (since proportionately they are under-represented in the survey sample).

66. Despite these caveats, the OFT considers the survey evidence submitted by the parties to be generally probative of the degree of substitution between the parties' brands and of the extent of competition that may be lost as a result of the merger. The OFT has analysed the survey results and

[25] This, in turn, considers the appropriate denominator of the diversion ratio estimate.

[26] The parties argued that no revenue weighting of respondents was undertaken as it was important to keep the survey clear and easy to respond to in line with the OFT's guidance, *Good practice in the design and presentation of consumer survey evidence in merger inquiries* (**Survey Guidance**). The OFT notes that the Survey Guidance states that if the aim of the consumer survey is to estimate the proportions of sales revenue that would divert to various options, it is important to ask about the extent of recent purchase of the consumer (paragraph 3.40). The OFT recognises that this may not be especially relevant in all circumstances but considers it to be a relevant issue in this case for the reasons outlined.

also estimated diversion ratios, in an attempt to take account of the caveats raised above.[27,28] These results are discussed below in relation to each brand, where applicable.

67. The parties also provided gross variable profit margins for each of their products, which they used in combination with the diversion ratio evidence above (and pricing information) to compute a gross index of upward pricing pressure (**GUPPI**). The parties submitted that high diversion ratios and high variable profit margins were not probative of unilateral effects alone and that, in order to assess the likelihood of unilateral effects, these must be combined to form a pricing pressure index, and that this is consistent with previous OFT practice.

68. However, the OFT considers that high diversion ratios and high variable profit margins (outlined below), when considered alongside other evidence, can be probative of unilateral effects[29] and the OFT has taken this approach in numerous past cases.[30, 31]

[27] The OFT also analysed variations based on two more technical points. First, the survey weighted data back to the adult population rather than CSD customers. This gives equal weight to different members of the public, for example, of different ages. The parties argued that given the penetration rate of soft drinks across different demographic groups, there would be no material difference between the two approaches and this was a reasonable approach. To assess the extent to which this may be the case, the OFT has analysed results removing the population weighting that has been applied.

Second, the survey asked about the switching preferences of more than one brand where this was possible to take account of the lower incidence of purchases of certain brands in the population as a whole. The parties note the potential for bias that may result from this approach. The OFT recognises this potential risk of bias but is also conscious of the additional power gained in this particular case from larger sample sizes (for example, by providing separate result for Scotland or for less frequently purchased brands) and so has also analysed the additional responses undertaken as part of the survey.

[28] The OFT also analysed the survey data for on-trade and off-trade responses separately, taking account of the different conditions of competition in each distribution channel, as outlined in the approach to the product scope (an approach to the product scope supported by the parties).

[29] This approach is outlined in the Merger Assessment Guidelines, paragraph 5.4.9. All else equal, the higher the parties' gross margins and the higher the diversion ratio between them, the greater the presumed incentive of the merged firm to worsen its offer to customers.

[30] The OFT has previously considered diversion ratios in a significant number of cases without necessarily combining them with variable profit margins. See, for example, *Completed acquisition by GXS of Inovis*, OFT, 25 June 2010; and *Proposed acquisition by Rontec Investments LLP of petrol forecourts, stores and other assets from Total Downstream UK plc, Total UK Limited and their affiliates*, OFT, 9 November 2011.

[31] [ ].

69. Nevertheless, the OFT recognises that combining the profit margin and diversion ratio into a pricing incentives framework may also be probative of the change in incentives brought about by the merger, subject to the limitations inherent in applying such a framework (for example, where prices may be negotiated bilaterally). Such an approach provides a more explicit measure of the risk to competition resulting from the merger in terms of incentives.[32]

70. The OFT has therefore considered the parties GUPPI estimates as they apply to each relevant brand below, and has considered adjusted estimates based on the OFT's more detailed assessment of diversion ratios. The OFT is also mindful, however, of the limitations of such an approach, particularly in cases where prices are negotiated bilaterally.[33]

## THE LOSS OF COMPETITIVE CONSTRAINT ON THE MERGING PARTIES' BRANDS

### IRN BRU

Survey evidence and diversion ratios

71. The parties submitted that Pepsi and the other Britvic brands were not close substitutes to IRN BRU, by comparison to Coke, Dr. Pepper and even Lucozade which they submitted were close substitutes. The parties relied on the survey evidence to show that there was higher diversion from IRN BRU to Coke and Dr. Pepper than to Pepsi.

72. The parties estimated that diversion from IRN BRU to all Britvic brands in the aggregate is [10-20] per cent. The OFT reviewed the survey evidence and estimated a [15-25] per cent diversion ratio from IRN BRU to Britvic at a GB level. The OFT notes that this diversion ratio is higher in Scotland at [25-35] per cent, reflecting the difference in preferences between Scotland and the rest of GB in relation to IRN BRU.

[32] Such a calculation allows for an explicit examination of the value of diverted sales that the merging parties lose to each other (in proportional terms) following a price rise that is then captured or internalised as a result of the merger.

[33] To the extent that substitution patterns at the wholesale level may differ from those at the retail level.

73. The OFT also notes that the highest diversion was to CCE. As outlined in detail above, the OFT considers that its estimate of diversion to be a more accurate reflection of the actual diversion ratio taking account of the factors outlined above. Further, the OFT considers that due to the weighting issues and the significantly higher diversion ratio estimate in Scotland, the true diversion for IRN BRU to other brands – given [ ] per cent of IRN BRU's sales are in Scotland – is likely to be weighted more towards the Scotland diversion ratio estimate.[34]

Variable profit margins

74. The OFT generally considers that if the variable profit margins of the products of the merging parties are high, unilateral effects are more likely to arise as a result of the merger.

75. The OFT notes that the soft drinks industry appears to be characterised by high margins. An independent market research report comments that the vast majority of soft drinks are made from a combination of water (still or carbonated), sugar juice, and flavourings and since the cost of raw materials is relatively low, soft drinks usually produce large profit margins. The report also comments that this is particularly the case for large companies, because they can benefit from economies of scale.[35]

76. The parties provided the OFT with profit margin data across their different brands, which indicated that the variable profit margin of IRN BRU is [ ] per cent and the variable profit margin of Britvic's CSD brands together is [ ] per cent, ranging from [ ] per cent for [a Britvic CSD brand] to [ ] per cent for [another Britvic CSD brand].[36]

77. The OFT notes that if the variable profit margins on the Britvic brands, which in the aggregate constrain IRN BRU, are high, unilateral effects are

[34] The sample is already weighted towards Scotland/*IRN BRU* consumers but not to the extent reflected in sales of the brand.

[35] Keynote (2012), page 15.

[36] The OFT notes that the variable profit margin, based on accounting data, may be subject to interpretation and limitations. In particular, the OFT considers a narrower interpretation of variable costs, and a shorter time period for estimating variable costs, may be appropriate, and so the variable profit margins submitted by the parties may be an underestimate. Nevertheless, the OFT has used the variable profit margins provided by the parties as a starting point for the purposes of its assessment.

more likely to arise because the value of sales recaptured by the parties post-merger will be greater, making any price rise less costly. The OFT considers that [ ]. Where the profit margin of a brand is high, each lost customer pre-merger is a significant loss (the entire margin per customer), amounting to a constraint on the supplier not to improve margins further (for example, by raising price) because the lost revenue of losing marginal customers may make it unprofitable. However, if diversion ratios show that a significant proportion of that lost margin may be recouped once the firm owns the competing brand to which those customers divert, then the incentive to improve margins – by, for example, raising prices – may be significant.

78. The OFT considers the combination of the diversion ratio evidence and the profit margins in relation to IRN BRU [ ] and the competing Britvic brands indicate that the change to incentives brought about as a result of the merger may be significant and the potential risk of unilateral effects appears relatively high.

Pricing incentives

79. On the basis of the parties' estimates of diversion ratios and the variable profit margins above (as well as price ratios calculated by the parties), the parties estimate a GUPPI for IRN BRU of around [0-5] per cent for GB and lower than this if diversion to 'outside goods' be considered.[37,38] The parties submitted that this does not point to a likelihood of unilateral effects.

80. The OFT estimated GUPPIs based on the parties' framework but on the different diversion ratio estimates, the different basis for which is outlined in detail above. The OFT estimated a GUPPI of [5-10] per cent for GB and in Scotland a GUPPI of [5-10] per cent. The OFT considers that the indicative change in incentives suggested by this calculation supports the initial concerns raised by the high diversion ratios and high variable profit

[37] The parties estimated that GUPPI would be [5-10] per cent for Scotland.

[38] The parties submitted that the pass-through rate, which would translate incentives to increase prices, as suggested by GUPPI, into actual predicted price increases, is below 100 per cent. They used an example of a failed attempt by Britvic to increase wholesale prices following costs' inflation.

margins and the potential for unilateral effects to arise as a result of the merger.

Internal documents

81. The parties also pointed to the lack of reference to Pepsi or other Britvic brands in AG Barr's internal documents that had been submitted to the OFT which discussed IRN BRU. The parties point to a number of documents, as well as the survey, which highlight Coke as the closest competitor to IRN BRU.[39]

82. The OFT acknowledges that CCE and specific brands supplied by CCE may be a closer competitor to IRN BRU. However, the fact that CCE, and specific CCE brands, may be closer competitors to IRN BRU than Britvic (and specific Britvic brands) is not in itself probative of a lack of potential unilateral effects. The issue for the OFT is whether AG Barr and Britvic are sufficiently close competitors, not whether there is one equally close or closer competitor to AG Barr than Britvic.

The [ ] de-listing event

83. The parties also provided an analysis of a recent temporary delisting of all of Britvic's products stocked in 2012 in [ ].[40] The parties pointed to this study as evidence that Britvic did not provide a competitive constraint on AG Barr, and more specifically on IRN BRU. By comparing the evolution of the shares of supply of Britvic's competitors in [ ] to a control group of other [ ] before and after the delisting, the parties asserted that the study showed that [a competitor] was the main beneficiary of the delisting and, to a lesser extent, [a second competitor] and [a third competitor], whereas AG Barr and IRN BRU in particular did not gain from it. The parties submitted this demonstrates an absence of competitive constraint from Britvic brands on IRN BRU.

[39] [ ].

[40] In [ ] 2012, [ ] delisted a large number of Britvic's products across all its shops throughout GB. The delisting included all Britvic's CSD brands that were stocked by [ ] including *Pepsi*, *7UP*, *Tango* and *Mountain Dew*, as well as the fruit juice drink brand *Juicy Drench*. Britvic's dilute products and water plus products were not delisted but saw a significant decline in value share. The parties have constructed volume and value shares and compare this across two periods in time, the [ ] weeks before and after and, separately, the [ ] weeks before and after.

84. The OFT considers that this event study is best considered in attempting to demonstrating the lack of competitive constraint from IRN BRU (and AG Barr generally) on Britvic. However, it is only imperfect evidence of the constraint from Britvic on IRN BRU. The study seeks to examine the second preferences of consumers should Britvic not be available and how consumers respond by changing their purchasing behaviour and so considers the extent to which consumers substitute to other brands from Britvic. The study therefore is more effective at highlighting the degree of substitution from Britvic brands to IRN BRU rather than the reverse.

85. Further, the OFT notes that, even if the study were to be given greater weight in considering the constraint from Britvic on IRN BRU, the parties did not submit evidence to the OFT on what happened to the prices of IRN BRU (either at the wholesale or retail level) during this period (or the number of outlets the de-listing affected where IRN BRU was stocked). This makes it difficult for the OFT to determine the extent to which there were any other factors affecting the results, for example, any changes in price in response to the removal of the constraint from Britvic. The parties' argument is based on the premise that the removal of the Britvic brands had no effect on sales of IRN BRU but there is no evidence to demonstrate that the price of IRN BRU did not rise as a result of the removal of this constraint. The OFT attempted to determine this through a comparison of the volume and value shares of supply that the parties used to estimate the effects. However, the OFT notes that different time periods were used for each, which did not allow for such a comparison: [ ] weeks before and after the de-listing for value shares and [ ] weeks before and after the delisting for volume shares.[41]

86. Moreover, the OFT notes that evidence provided by the parties points to the possibility that there may have been an increase in the share of AG Barr's sales in [ ] when assessed over a longer period of time than the [ ] and [ ] weeks used in the parties' analysis. For example, the share appears to rise from around [5-10] per cent to around [5-15] per cent (based on the parties' measure of share) in the latter half of 2012.

[41] The OFT notes that even if there was an initial period where demand adjusted first followed by a price response (although this would not necessarily be the case, given the customer is aware that it has removed Britvic from its outlets), this would not be reflected in the parties analysis as they have used only a single data point, reflecting [ ] weeks and [ ] weeks following delisting, rather than a continuous time period.

Nielsen data

87. The parties also used Nielsen Homescan data[42] to demonstrate that Coke is a stronger competitor to IRN BRU than Pepsi. These data allow comparison of the purchasing behaviour of a panel of households between two consecutive annual periods. The extent to which a household has decreased spending on one brand can be compared to the extent to which it has increased spending on other brands in the same segment. The parties submit that, if the results are taken at face value, while there is significant switching between brands, there is no evidence of significant switching between IRN BRU and Pepsi. In particular, the parties note that IRN BRU's losses were primarily to Coke and Dr. Pepper.

88. The parties note, however, that this evidence should be interpreted with caution as it does not disentangle the various reasons that may have motivated any switching activity and, as a result, it is not possible to associate the degree of switching with any measure of the relative substitutability of different brands.[43] The parties further point to the significant degree of switching between [ ] and [ ] and [ ] as indicative of how unreliable the data is as an indicator of the closeness of substitution between brands.

89. In previous cases, the OFT has found this type of data can be helpful in assessing the degree of interaction between brands in certain consumer goods categories.[44] However, the OFT acknowledges that the data appears to be less reliable in this category and, taking account of the parties arguments, considers the data with caution.

Conclusion on the loss of competitive constraint on IRN BRU

90. The OFT concludes that the combination of high diversion ratios and high margins are sufficient to raise concerns over the change to the incentives

[42] The Nielsen Homescan data is based on a comparison panel of consumers

[43] The OFT notes, for example, that recorded switching activity could be motivated by changes in relative prices but could instead reflect different household composition and a number of other factors. The OFT also notes that the figures provided by the parties appear to relate to net switching activity (that is, the total gains less the total losses), rather than gross switching, although this is unclear.

[44] See, for example, *Anticipated acquisition by Unilever of Alberto Culver*, OFT, 5 April 2011.

of the parties to increase price as a result of the merger. The additional evidence provided by the parties is not sufficiently compelling to mitigate these concerns. As a result, the OFT considers the test for reference is met on the basis of the potential loss of competitive constraint on IRN BRU.

Orangina

Brand characteristics and marketing positions

91. The parties submitted that Tango and the other Britvic brands are not close substitutes to Orangina. They explained that Orangina's brand positioning is significantly different from Tango, and that this reflects the desire of AG Barr to differentiate it from other orange flavoured CSDs. In particular, AG Barr's internal documents [ ] whereas [ ].[45]

92. The parties also highlighted that the two products are fundamentally different, noting that Orangina contains more fruit and pulp (14 per cent) than Tango (5 per cent) and contains no artificial sweeteners, and is also less carbonated than Tango. Orangina is sold only as an orange flavour whereas Tango is sold in a range of other flavour as well, according to the parties. Further, the packaging of the two brands is different since Orangina is also sold principally in glass bottles (although is also sold in other packaging formats similar to those of Tango as well, including cans and standard plastic bottles). The parties also emphasised the higher price of Orangina (the typical average price of Orangina is [ ] per litre whereas Tango is typically sold at [ ] per litre, according to the parties) and its lower unit rate of sales for two litres bottles, which the parties submit suggests that it is less popular.[46]

The limited presence of Orangina

93. The parties also submitted that Orangina was a smaller brand than other CSDs with only a [0-5] per cent share of supply even within a very narrowly defined orange flavoured CSDs market. The OFT notes that revenues from Orangina sales are above £7 million a year (to both the on on-trade and off-trade). Fanta is cited by the parties as the largest supplier

[45] Parties' informal submission dated 14 November 2012, paragraph 176, first bullet point.

[46] The OFT notes that the unit rate of sales applies only to two litre bottles.

in this category and the parties also point to Lucozade as another close competitor along with San Pellegrino.

Survey evidence

94. Orangina was one of the brands included in the parties' survey from which diversion to Britvic brands was estimated. On the basis of the responses provided by consumers, the parties estimated a diversion ratio of [30-40] per cent. In contrast to IRN BRU, the majority of diversion is to a single Britvic brand, Tango. The parties submitted themselves that the closest competitive constraint to Orangina, based on the survey evidence, is Tango.[47]

95. The OFT's estimated diversion ratio from Orangina to Britvic's brands, taking account of the differences in approach outlined above, is very similar, at [30-40] per cent to the CSD brands in the Britvic portfolio in GB. The OFT has no evidence to suggest the diversion ratio for GB in relation to Orangina is not a reasonable indicator of the true diversion. The OFT notes that the diversion to Fanta is similar to the diversion to Tango, although the total diversion to CCE is higher than the total diversion to Britvic.

Variable profit margins

96. The parties have estimated variable profit margins for Orangina ([ ] per cent) and Britvic CSD brands (together [ ] per cent) and for Tango ([ ] per cent).

97. Following the framework set out in relation to diversion ratios and profit margins for the analysis in relation to IRN BRU above, the OFT considers that the diversion ratio and variable profit margins in relation to Orangina are particularly high and, in the absence of other compelling evidence suggesting otherwise, point to the potential for a significant change in incentives resulting from the merger and a likelihood of unilateral effects.

Pricing incentives

98. On the basis of the diversion ratios and profit margins outlined above (as well as details of pricing of the parties' brands), the parties have estimated

[47] RBB Economics submission on TNS survey evidence on closeness of competition, 2 November 2012, submitted as Annex 9 to the Informal Submission.

a composite GUPPI of over [5-10] per cent.[48] The OFT's GUPPI estimate is similar.

99. The OFT considers that the indicative change in incentives suggested by this calculation does not remove initial concerns raised by the high diversion ratios and high variable profit margins and the potential for unilateral effects to arise as a result of the merger. Instead, this calculation confirms the OFT's assessment that the merger, absent other mitigating evidence, may give rise to a significant change in the incentives of the parties and result in increases in price.

The de-listing of Tango

100. The parties analysed the affect on sales of Orangina of a partial delisting of Tango in [ ] in 2010[49] to purportedly show that, unlike Fanta, Orangina did not achieve a material uplift in sales afterwards. The parties used the weekly Nielsen scanner data to estimate share of sales by brand of a set of fruit CSDs sold at [ ] for a period before and after the delisting.[50] The volume share of Tango's sales amongst this set of fruit CSDs decreased from [ ] per cent to [ ] per cent, while the volume share of Fanta and Sprite both increase (from [ ] to [ ] per cent and from [ ] to [ ] per cent, respectively) and Orangina made no noticeable gains from the delisting.

101. The parties argued that following the delisting one would expect to observe sales of Orangina at [ ] to increase and suggested [ ] may have increased distribution of Orangina after it had chosen to restrict Tango sales. The parties concluded that the absence of any boost to Orangina sales in the period before and after the delisting is probative of both the lack of

[48] The parties again provide an estimate assuming that there is diversion to 'outside goods' of 20 per cent. No evidence has been provided to support such diversion to outside goods. However, in relation to *Orangina*, the OFT notes that there may be a stronger *a priori* case for possible diversion from *Orangina*, given its characteristics, to brands outside of the set of around 25 that were shown to consumers as part of the survey. However, the OFT considers that, even if it were to take account of the parties assumption on diversion to outside goods without any supporting evidence, this would not affect the conclusions of the competitive assessment in relation to *Orangina*.

[49] [ ].

[50] The parties examined the [ ] weeks prior to the de-listing compared to the [ ] weeks following the de-listing. This compares with the [ ] delisting discussed above where the parties examined [ ] weeks and [ ] weeks before and after the delisting.

competitive constraint from Tango on Orangina (and from Orangina on Tango).

102. The OFT considers that the parties' analysis of this event may be useful in suggesting the absence of a competitive constraint from Orangina on Tango. However, it is only imperfect evidence of the constraint from Tango on Orangina, as it seeks to examine the second preferences of consumers should Tango not be available or be less appealing, and so considers the extent to which consumers substitute to other brands from Tango.

103. The parties also noted that during this period the weighted average prices of Fanta and Sprite were not materially different in the period before and after the delisiting. However, the OFT notes that, even if it were to put greater weight on the event study in assessing the constraint from Britvic on Orangina, evidence submitted by the parties suggests that the price of Orangina increased (by a weighted average of over [ ] per cent) between the two periods following the delisting which, in the absence of other evidence on why prices may have increased, may suggest that Tango may have been exerting some pricing constraint on Orangina, serving to confirm, and potentially exacerbate, the OFT's unilateral effects concerns in relation to the loss of constraint on Orangina.

**Third party views**

104. The OFT received mixed views from third parties on the extent to which Tango represented a competitive constraint to Orangina. However, the OFT notes that some third parties explained that Tango is a close competitor to Orangina since there are some similarities between the two products, such as their flavour.

**Conclusion on the loss of competitive constraint to Orangina**

105. The OFT considers that the diversion ratio and variable profit margins are sufficiently high to point to a strong incentive on the parties to raise price, confirmed by the GUPPI calculations undertaken by the parties. Evidence points to the parties' brands being closest competitors. While some of the additional evidence submitted by the parties suggesting this is not the case is informative, it does not compelling point towards the parties' brands not competing. Indeed some of this – such as the Tango [ ] delisting event

study – may confirm that the parties' brands are close competitors and only serves to exacerbate the strength of the OFT's concerns.

106. As a result, the OFT considers, based on the evidence available to it, that the test for reference is met in relation to the potential loss of the competitive constraint exerted by Britvic on Orangina.

**Barr range**

107. The Barr range includes a number of different types of soft drink (for example, Barr Lemonade, Barr Cola, Barr Limeade). The parties explained that sales of the Barr range are very low relative to other CSDs, with most sales being made through the off-trade channel.

108. The parties also consider that the Barr range and its competitors mainly compete on prices and that, in this context, private label is a significant constraint.

109. The parties' survey also asked consumers about the Barr range. The OFT considers that the results from the survey in relation to the Barr range are far less clear than for other brands and notes a number of concerns, including, first, the survey did not make any distinction between the products included in the Barr range. Indeed, it is not even clear the extent to which is was made clear as to what the Barr range referred to and there may have been a risk that the Barr range may have been confused with AG Barr, the company (and all its brands), although this is unclear. Second, the OFT notes that, as with IRN BRU, switching patterns in Scotland appear to be different to the rest of GB when considering an AG Barr-owned brand. The OFT also notes that at this level of stratification, and as a result of being a brand with more limited sales, however, the sample sizes become very small and the confidence intervals around those sample sizes larger. As a result, the OFT is less certain about putting significant weight on the survey results.[51]

110. In the parties' assessment, they indicate that Barr Lemonade is not a close substitute to R Whites, which is mainly sold on-trade or with 7UP because of the differences in flavour. While some third parties suggested that Barr

[51] The OFT does not, however, that the survey results, subject to these limitations and significant uncertainty, do point to potentially material diversion ratios from the Barr range to Britvic.

Lemonade was a possible substitute to R Whites, these were a minority and none raised concerns.

111. The OFT considers that the evidence available to the OFT is not sufficient to determine the extent to which the test for reference may be met in relation. As the OFT consider the test for reference is met in relation to the loss of competitive constraint on other brands, it has not found it necessary to conclude on the extent of competition lost in relation to the Barr range.

**The loss of competitive constraint on other CSD brands**

112. In relation to each of the other CSD brands, as the OFT has found competition concerns in relation to the competitive constraint lost on IRN BRU and Orangina as a result of the merger, and considers the test for reference to be met, the OFT has not found it necessary to conclude on the extent to which the loss of competitive constraint on the other CSD brands – including Pepsi, 7UP, Tango, Tizer – is sufficient to give rise to unilateral effects.

**Closeness of competition in non-CSDs**

Fruit drinks

113. Both AG Barr and Britvic supply fruit drinks with their main brands in this segment being Simply Fruity (AG Barr) and Fruit Shoot (Britvic), although the parties argued that AG Barr has a small presence. The parties submitted that CCE would remain the largest supplier of fruit drinks in the UK and private label represents, in aggregate, a substantial proportion of supply. The OFT nevertheless notes that, similar to CSDs, fruit drinks are highly differentiated products, and therefore are best examined by assessing how closely the parties' products compete.

114. The parties submitted that Simply Fruity does not exercise a competitive constraint on Fruit Shoot because Simply Fruity achieves significantly lower sales than Fruit Shoot (£[ ] million per year, as opposed to £[ ] million for Fruit Shoot). The parties added that Simply Fruity is not distributed in the large retail multiples and is cheaper than Fruit Shoot.[52] Capri Sun and

[52] In the on-trade, a 330ml pack of *Simply Fruity* is sold at 62p, whereas a 300ml pack of *Fruit Shoot* is sold £[ ].

Ribena, as well as private label, were cited by the parties as being the closest competitors to Fruit Shoot. The parties noted that Simply Fruity is sold in a different packaging size (330ml, as opposed to 200ml, 275ml and 300ml for Fruit Shoot).

115. The parties' argued that their views are confirmed by Nielsen switching data (discussed above) following a product recall of Fruit Shoot by Britvic during a period of eight weeks in 2012. The parties argued that due to the temporary discontinuation of Fruit Shoot, this absolute change in product available makes the Nielsen data more probative than in other contexts. The data shows that [ ], [ ], [ ] and [ ] were the main beneficiaries of the recall, whereas [ ] is not listed. In addition, AG Barr said that it neither had the [ ]. AG Barr also explained that [ ].

116. Some third parties confirmed that although they had tried to switch from Fruit Shoot to Simply Fruity at the time of the recall this had not been possible given the inability of AG Barr to supply them. AG Barr stated that [ ]. Other third parties explained that they had never heard of Simply Fruity, or that they would not view it as a close substitute.

117. The OFT considers that although some customers view Simply Fruity as a close substitute to Fruit Shoot, it is generally perceived by third parties as a very small brand compared to Fruit Shoot. This has been confirmed by the inability of Simply Fruity to benefit from the Fruit Shoot recall. On balance, the OFT considers that there is no realistic prospect of a substantial lessening of competition in relation to Fruit Shoot.

Water

118. The parties supply both flavoured and non-flavoured water. AG Barr mainly sells non flavoured water through its Strathmore Spring Water brand while Britvic sells the Pennine Spring non-flavoured water brand, as well as flavoured waters (for instance Robinsons H2O).

119. The parties presence – both in terms of sales and shares of supply – in the off-trade is minimal and the OFT does not consider this overlap further. The parties estimated that in the on-trade, the combined share of supply of the parties would be above [20-30] per cent. The parties would be the largest supplier in GB.

120. However, the OFT's market investigation indicated that the on-trade market appears to be very fragmented with a number competitors. The parties pointed to other suppliers, including San Pellegrino ([5-15] per cent share of supply), Highland Spring ([5-10] per cent) and Abbeywell ([5-10] per cent), all of which have higher shares of supply than Pennine Spring, and are significant competitors to the parties. The parties also emphasises that in the on-trade segment, [ ].

121. The parties also submitted that Strathmore Spring Water and Pennine Spring are not close competitors since the water market is characterised by [ ]. They asserted that there is intense price competition between suppliers, and that supply contracts are awarded following competitive tenders.

122. Some customers did identify Pennine Spring as Strathmore Spring's closest competitor. However, the OFT notes that the same customers also pointed to a range of other competing suppliers and brands available and raised no concerns. As a result, on the balance of evidence available and given the wide variety of suppliers pointed to by third parties, the OFT concludes that the Transaction does not lead to a realistic prospect of a substantial lessening of competition.

**The loss of competition between product ranges**

123. The OFT has considered the extent to which any additional unilateral effects may arise from the combination of the merging parties' product ranges, over and above any unilateral effects concerns that can be identified between specific brands. The OFT notes that third parties raised general concerns about the combination of the merging parties' brand portfolios that would result from the Transaction, highlighting some negotiations with customers taking place through a single buyer and across the range of products and brands sold, and promotional support covers the whole range. Some third parties pointed to increased negotiating strength of the parties and that CCE was the only other competitor with a broad range of brands.

124. The OFT recognises that it may be possible for there to be additional unilateral effects associated with the concentration of suppliers that compete for the supply of ranges. However, the OFT considers that there is insufficient evidence available to conclude on the extent to which this may give rise to unilateral effects.

125. As a result, and given the OFT considers the test for reference is met in relation to the lost competitive constraint on specific brands, the OFT has not found it necessary to conclude on this point.

**Conclusion on horizontal effects**

126. Based on the evidence and reasons outlined above, the OFT concludes that there there is a likelihood of unilaterall effects in relation to the loss of the competitive constraint from Britvic's brand, in the aggregate, on both IRN BRU and Orangina and thus the test for reference is met. The OFT does not believe there to be any competition concern in the supply of water or the supply of fruit drinks.

**PORTFOLIO EFFECTS**

127. The OFT has considered the extent to which the Transaction may raise additional exclusionary concerns associated with the combination of the range of products and brands supplied by the parties. The OFT considers this may arise because the brands are complementary (so that a fall in the price of one good increases the customer's demand for another) or because there are economies of scale or scope in purchasing them (so that customers tend to purchase the products or brands together).[53]

128. In this case, for example, the merging parties may increase the selling price of one of its products if it is sold on a stand-alone basis, but might not do so if customers buy both the parties' brands, giving customers an incentive to buy the second brand from the parties as well, putting rivals at a disadvantage. Similarly, the parties may be able to use their stronger brands as leverage in obtaining listings or greater shelf-facings for their tertiary or newly developed brands, at the expense of rivals.[54]

129. The OFT's approach in examining the possibility of such a scenario involves analysing the:

a) Ability of the merging parties to undertake such strategies (would the merged firm have the ability to harm rivals?);

[53] See *Mergers Assessment Guidelines*, paragraph 5.6.2.

[54] These theories would be termed mixed bundling and tying, respectively.

b) Incentive of the parties to do so (would the merged firm find it profitable to do so?); and
c) The effect of this strategy (would the effect be sufficient to reduce competition, for example, by foreclosing access to shelf-space of significant competitors.

130. In assessing these, the OFT takes into account the following factors:[55]

a) whether customers have a demand for more than one of the products, and whether the products are complements;
b) customer preferences for variety and one-stop shopping; and
c) the costs to rivals of providing variety and one-stop shopping at a scale to enable them to compete effectively with the merged firm.

131. The parties submitted that the Transaction would not allow them to use their combined brands' portfolios to increase market power by leveraging their strong brands to foreclose competitors through tying or bundling. They explained that there would still be suppliers competing with them in each product category, and that this was relevant since negotiations with customers are done on a category-by-category basis.

132. The parties asserted that [ ], and gave the example of [ ].

133. Some third parties highlighted the ability of the parties to execute Joint Business Plans that would allow them to protect their weaker brands and the corresponding shelf space. One competitor believed that the merger would make it difficult and more expensive for smaller suppliers to defend their own commercial position since the parties would have a range of products to include in all their promotions. No third party pointed to the parties ever having attempted to tie the sale or stocking choice of one brand to another, although some third parties did point to the parties offering discount on main brands in order for the customer to stock (more of) a tertiary brands. Further a number of third parties pointed to the essential nature of some of the parties' brands.

134. The OFT considers that the market may be described as involving suppliers competing for shelf space by negotiating on a broad range of products.

[55] See *Merger Assessment Guidelines*, paragraph 5.6.13.

However, the OFT is of the opinion that there is insufficient evidence to conclude whether portfolio effects may arise.

## BARRIERS TO ENTRY AND EXPANSION

135. In assessing whether entry or expansion might prevent a substantial lessening of competition, the OFT will consider whether such entry or expansion would be: (a) timely; (b) likely; and (c) sufficient.[56]

136. The parties submitted that there are relatively low barriers to entry in the supply of soft drinks, as is evidenced by the large number of small brands sold by various companies in the UK.

137. The parties consider that a second-hand bottling line can be purchased for around £[ ] million. Further, whilst packaging can be outsourced, this is more expensive than undertaking packaging in-house.

138. Still, the biggest entry barrier, according to the parties, would be for entrants to achieve listings in the major multiples and wholesalers. As noted in the section below, multiple retailers may ask for upfront payments of £[ ] million to list certain products on their shelves. However, the parties submitted that a new manufacturer is likely to look at alternative channels of distribution for its new products since this will allow it to build its brand appeal and distribution alternatives. The parties gave three examples where new entry has occurred:

(a) Red Bull entered the UK market in the 1990s and has successfully built its market shares as a low sugar, high caffeine drink;
(b) Innocent was launched in 1999 as a 100 per cent fruit bottled smoothie brand and was partially acquired by The Coca-Cola Company (**TCCC**) in 2009; and
(c) Glacéau vitamin water, being electrolyte enhanced water, which was first sold in the UK 2008. It was launched in 2000 in the USA and built its market share there before being acquired by TCCC in 2007.

[56] See *Merger Assessment Guidelines*, paragraph 5.8.3.

139. Third parties emphasised the ability of a new entrant to develop a strong brand as being a particularly relevant barrier to entry. Specifically, third parties explained that the NAB sector was a mature and saturated segment, with highly established suppliers and brands with high customer loyalty. Third parties highlighted themselves that some segments were particularly difficult to break into. The area in which some growth was identified was that of energy drinks; but equally, third parties recognised that this sector already contained strong suppliers, with well established brands, such as Red Bull and Lucozade.

140. Based on the evidence available, the OFT does not consider the prospect of entry would be timely, likely and sufficient to allay the competition concerns identified above. The OFT considers that a new entrant faces significant costs in marketing and brand development that can take many years to build, as well as slotting allowances which require a significant upfront payment. The examples of successful entry provided by the parties only apply to highly differentiated products, for which entry might be facilitated by the fact that there are less close substitutes than for a new brand of CSD that would compete closely with the parties. In addition, it should be noted that the parties only provided limited examples of entry, none of which were in the last three years.

## BUYER POWER

141. The parties submitted that a number of their customers have significant buyer power, particularly the grocery multiples as well as some of the cash and carry operators, pointing to the CC's Groceries Investigation report in support of this point.[57]

142. The parties provided some credible evidence to suggest that buyer power does, to some extent, exist. This included the following:

(a) The parties' prices can only be increased [ ].
(b) [ ] having their products delisted.[58]

[57] *The supply of groceries in the UK market investigation* dated 30 April 2008: www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2008/fulltext/538.pdf, paragraph 9.21.

[58] An example of this was [ ].

(c) The use of grey imports to [ ].[59]
(d) Customers [ ].[60]
(e) Customers demanding [ ].[61]
(f) The threat and development of private label products. As already mentioned above, the parties stressed that many of the grocery multiples sell private label products alongside the products of their suppliers. The parties provided evidence that the name and packaging of private label products are often very similar to the branded products and that, for some products, the grocery multiple will effectively brand and promote its own private label products as if they were branded products.[62] Further, the parties provided an example of the constraint that such private label products place on their own, and this involved [ ].

143. The OFT's market investigation did not fully support the parties' submission, and it provided very mixed views on buyer power with a number of customers indicating that customers generally – even the larger retailers – did not consider themselves to have significant negotiating strength to counteract the reduction in competition arising from this merger. Further, some customers pointed to a number of brands of the parties that were essential for them to stock, limiting a customer's ability to negotiate with the supplier and fully switch away.[63]

144. In relation to private label specifically, the OFT recognises that in some categories private label represents a significant proportion of sales. However, the OFT notes that the presence of private label products is highly variable across categories with some of the affected brands likely to be subject to little or no constraint from private label at all where private label sales are limited or negligible. Further, even where there are a significant proportion of sales attributable to private label, this is not indicative of the extent to which retailers can substitute away from branded products to their own label. The OFT also does not accept that private label brands can be aggregated and considered as a single

[59] Examples included [ ].

[60] Examples included [ ].

[61] Examples included [ ].

[62] Some products include no indication that they are private label products. For example, [ ].

[63] Although the OFT notes the parties examples of complete and partial delisting.

competitive constraint on the merging parties' brands. In differentiated product segments, the OFT considers it appropriate to assess the constraint from private label products on a brand-by-brand, or at the least a store-by-store, basis.

**Conclusion on buyer power**

145. The OFT recognises that the parties did provide some probative evidence of buyer power; however, this was only in relation to certain customers, specifically, the retail multiples. Moreover, no evidence was provided that the buyer power which does exist would be sufficient to ensure that no price rises would be observed, as a result of the merger. Accordingly, there is insufficient evidence in order for the OFT to conclude whether there is sufficient buyer power to provide a competitive constraint on the parties post-merger.

## THIRD PARTY VIEWS

146. The OFT has received some complaints about the Transaction from third parties contacted by the OFT, including customers and competitors.

147. In addition to those concerns identified and addressed above where relevant, one third party also raised the potential for the merger to give rise to coordination. However, on the basis of further evidence provided by the parties on this point, as well as additional market testing, the OFT does not believe that there is a realistic prospect of the parties being in a position to coordinate prices post-merger. All other third party comments have been taken into account where appropriate in the competitive assessment above.

## ASSESSMENT

148. The Transaction will result in AG Barr and Britvic ceasing to be distinct, and it qualifies for assessment on the basis that Britvic satisfies the turnover test contained in section 23(1)(b) of the Enterprise Act 2002.

149. The parties overlap in the manufacture and supply of soft drinks, which form part of the NAB sector. Specifically, the parties overlap in CSDs and non-CSDs (in particular, water and fruit drinks) supplied to the on-trade and off-trade.

150. In relation to geographic scope, the OFT considers it appropriate, to assess the impact of the Transaction on a GB-wide basis. The OFT also considers, where relevant, the competitive constraints within Scotland when considering the closeness of competition between brands, noting that any separate effects in Scotland may apply only to a limited number of brands.

151. Within horizontal effects, the OFT notes that given the wide variety of brands supplied by both the parties and competitors, and the scope for a number of brands to represent relatively weak competitive constraints individually but represent significantly stronger competitive constraints in when considered in the aggregate, the OFT has considered the extent to which the loss of the aggregate constraint of one of the merging parties' brands on one of the other parties' brands may give rise to unilateral effects.

152. In particular, the OFT considers that the evidence – in particular high diversion ratios and high variable profit margins, indicating a material change in the pricing incentives of the parties and the absence of mitigating evidence – suggests that Britvic's brands provide a sufficiently strong competitive constraint to both IRN BRU and Orangina that the loss of this constraint as a result of the merger may give rise to unilateral effects.

153. The OFT considers that the evidence provided by the parties was not sufficiently convincing to suggest the Transaction would result in a loss of competitive constraint by Britvic on the Barr range so this question is left open.

154. The OFT did not consider the evidence pointed to the parties competing especially strongly in either the supply of water or fruit drinks and saw no realistic prospect of unilateral effects arising in relation to either.

155. In relation to unilateral effects in relation to the combination of the merging parties' product ranges, the OFT believes that it may be the case that the Transaction will lead to an increased negotiating strength for the parties vis-à-vis customers, and hence higher prices given the resulting combination of brands. The competitors cited by the parties are mainly known for having a few brands, and only CCE supplies a similar range of products to the parties. Also, several customers expressed concerns on this aspect of the Transaction. However, the OFT considers that there is

insufficient evidence to reach a conclusion on the existence of unilateral effects in this regard, and leaves this question open.

156. In relation to portfolio effects more generally, the OFT considered third party concerns that the parties would leverage the market power which they have on some brands in order to protect weaker brands through tying or bundling products together. However, the OFT is of the opinion that there is insufficient evidence to conclude whether the conditions listed above to make foreclosure profitable (through tying or bundling) are met. Therefore, the OFT leaves open the question of the portfolio effects of the transaction.

157. On the issue of buyer power, the OFT recognises that the parties did provide some probative evidence of buyer power; however, this was only in relation to certain customers, specifically, the multiples. Moreover, no evidence was provided that the buyer power which does exist would be sufficient to ensure that no price rises would be observed, as a result of the merger reducing the number of soft drinks suppliers with a wide portfolio of products from three to two. Accordingly, there is insufficient evidence in order for the OFT to conclude whether there is sufficient buyer power to provide a competitive constraint on the parties post-merger.

158. Consequently, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## DECISION

159. The OFT has therefore decided to refer the anticipated acquisition by AG Barr of Britvic to the Competition Commission pursuant to section 33 of the Act.

**13 February 2013**