

ANTICIPATED ACQUISITION BY GREENE KING PLC OF SPIRIT PUB COMPANY PLC

ME/6501/14

The CMA’s decision on reference under section 33(1) of the Enterprise Act 2002 given on 11 May 2015. Full text of the decision published on 29 May 2015.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

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SUMMARY

1. Greene King plc (**Greene King**) has agreed to acquire Spirit Pub Company plc (**Spirit**) (the **Merger**). **Greene King** and **Spirit** are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct as a result of the Merger, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

The operation of pubs

3. The Parties overlap in the operation of pubs in the UK. The CMA has not been presented with sufficient evidence to widen the frame of reference from the operation of pubs to include restaurants and/or other licensed outlets. However, the CMA acknowledges that there will be some constraint on the Parties from restaurants in some local area, the extent of which will vary depending on local conditions, and has taken this into account in its competitive assessment.
4. The CMA considers that the product scope of the relevant market consists of the operation of pubs. A possible differentiation within an overall product market of the operation of pubs, for example as between 'dry-led' pubs and 'wet-led' pubs is examined in the assessment of closeness of competition. In particular, the CMA finds that wet-led pubs exert a lesser constraint on the Parties' dry-led pubs than other dry-led pubs.
5. In terms of the geographic scope of the relevant market for the operation of pubs, the CMA considers that, on the demand side, competition between pubs is local as customers are generally only willing to travel short distances to visit pubs. On the supply side, however, the CMA considers that the competitive dynamics between pubs exhibit features (eg advertising, promotions and pub themes) that are wider in geographic scope. The CMA has therefore considered the impact of the Merger on both a local basis (on the basis of catchment areas defined by drive-time isochrones) and a national basis.
6. In conducting its assessment, the CMA applied a primary filter which prioritised 56 local areas where the Parties have 35% of the pub count and the Merger results in a 5% increment. The 35% combined share of pubs primary filter also takes account of evidence (including survey evidence) on closeness of competition between pub classifications as well certain constraints from outside the market for the operation of pubs. As a result, the

CMA considers that the impact of the Merger in these 56 local areas may give rise to raise *prima facie* competition concerns.

7. The CMA then conducted a second stage analysis of the 56 local areas which took account of:
 - (a) the extent of competitive constraint exerted on dry-led pubs by wet-led pubs through the re-calculation of the Parties share of pubs with the inclusion of wet-led pubs but applying a discount factor to reflect the reduced competitive constraint imposed by wet-led pubs on dry-led pubs;
 - (b) the geographic proximity of the Parties' pubs in a given area and the presence of third party competitor pubs that customers can switch to in the event of a price rise;
 - (c) the application of a drive time sensitivity to catchment areas of the Parties' pubs located in 'City Centre' (ie Central London) locations;
 - (d) survey evidence in specific areas in which a survey was undertaken that enabled the CMA to analyse diversion ratios; and
 - (e) the presence of additional effective competitors outside of the competitor set identified by the primary filter. Such competitors were identified by considering images of the sites, details of amenities and facilities and menu details and prices.
8. The CMA's analysis of these factors resulted in its finding that there remain significant competition concerns in relation to 16 local areas.¹ In particular, in these areas, the Merger gives rise to a pub count share of over 35%, even taking account of the appropriate degree of competitive constraint from wet-led pubs, the fact that the Parties' pubs are within close geographic proximity, there are no additional third party pubs that can be considered to be effective competitors on the basis of the competitive offering, and that the application of a drive time sensitivity does not alter the competitive assessment.
9. The CMA therefore considers that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in those 16 local areas.

¹ Listed at paragraph 152 below.

Provision of overnight accommodation and brewing activities

10. The CMA also assessed the Merger's impact on the market for the provision of overnight accommodation on a local and national basis and found that no competition concerns arose on any plausible basis, given the Parties' relatively small combined share of the market. Similarly, the CMA considers that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in the supply of beer supplied by Greene King given the Parties' limited position in the upstream or downstream markets.

Conclusion

11. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). The Parties have until 18 May 2015 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

12. **Greene King** is a public company established under the laws of England and Wales and listed on the London Stock Exchange (the **LSE**).
13. Greene King runs approximately 1,900 managed, tenanted, leased and franchised pubs, restaurants and a small number of hotels in the UK. Some of these are operated under brands: Eating Inn; Farmhouse Inns; Flame Grill; Hungry Horse; Meet & Eat; Old English Inns; Metropolitan Pub Company; and Loch Fyne Seafood and Grill.
14. Greene King is predominately active in three business sectors: (i) retail, which consists primarily of the sales of food, drink and accommodation through Greene King's managed pubs, restaurants and hotels; (ii) pub partners, through which Greene King offers third parties the opportunity to run pubs on a brewery-tied tenancy agreement, or a leased or franchised basis; and (iii) brewing and brands. Greene King brews ale in the UK with a brand portfolio that includes Greene King IPA, Old Speckled Hen, Abbot Ale and Belhaven Best. As well as its internal customers, Greene King also sells its ales to other pub operators and to free trade customers. In the year ended 4 May 2014, Greene King had turnover of £1,301.6 million, of which £[~~] was generated in the UK.~~

15. **Spirit** is a public company established under the laws of England and Wales and listed on the LSE.
16. Spirit runs approximately 1,200 pubs across the UK. Spirit's business is divided into two main divisions: managed and leased divisions. Most of Spirit's managed division is operated under the following brands: Chef & Brewer; Fayre & Square (also incorporating Wacky Warehouse); Flaming Grill; Golden Oak Inns; Good Night Inns; John Barras; and Taylor Walker. Its leased division is mostly unbranded. Within Spirit's estate are 28 Good Night Inns and 44 pubs that offer more than ten rooms.
17. Spirit's turnover for the year ended 23 August 2014 was £800.9 million, [X] was generated in the UK.

Transaction

18. The merger envisages that Greene King will acquire the entire issued share capital and to-be-issued share capital of Spirit (the **Merger**). It is proposed that the Merger will be effected by means of a Court-sanctioned scheme of arrangement under Part 26 of the Companies Act 2006 (as amended), pursuant to which Greene King will acquire the entire issued and to-be-issued ordinary share capital of Spirit (the **Scheme**).
19. Under the Scheme, completion of the Merger is subject to the receipt of Phase I merger clearance from the CMA on terms reasonably satisfactory to the Parties.

Jurisdiction

20. As a result of the Merger, Greene King and Spirit will cease to be distinct enterprises. The UK turnover of Spirit in the year ended 23 August 2014 was £[X]. Therefore, the turnover test contained in section 23(1)(b) of the Act is met.
21. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
22. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 12 March 2015 and the statutory 40 working day deadline for a decision is therefore 11 May 2015.

Counterfactual

23. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions as between the parties.²
24. In this case, there is no evidence supporting a different counterfactual, and the Parties and third parties have not put forward arguments in this respect. Therefore, the CMA considers the prevailing conditions of competition to be the relevant counterfactual.

Background

25. The Parties predominantly overlap in the operation of pubs in the UK. The Parties also overlap to a limited extent in the provision of overnight accommodation. Greene King also has brewing activities and supplies ale to internal customers and other pub operators, including Spirit.
26. Pubs form part of the on-trade sector, which is comprised of premises that have a licence to serve alcoholic drinks for consumption on the premises, including outlets such as hotels, restaurants, clubs and cinemas.³ There are approximately 55,564 licensed pubs⁴ in the UK. These are made up of independent pubs, operated by self-employed landlords and portfolios of pubs owned by national or regional pub operating companies such as Greene King and Spirit. Other pub operating companies include J D Wetherspoon, Mitchells & Butlers, Fullers, Whitbread and Stonegate Pub Company.
27. In general, pubs are highly differentiated with differing food and drink offerings as well as differing facilities. Some pubs may focus on food while some are more traditional, drinks-focused premises. The former are referred to in the industry as 'dry-led' pubs and the latter 'wet-led'. The most widely recognised data source in this area, the CGA Drinks Places Index (the **CGA Index**) classifies pubs as dry-led where 30% or more of their turnover is derived from

² [Merger Assessment Guidelines \(OFT1254/CC2\), September 2010](#), paragraph 4.3.5 et seq. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#), Annex D).

³ CAMRA super-complaint – OFT Final Decision, October 2010.

⁴ According to the CGA Drinks Places Index, excluding other full-ons.

food. The closeness of competition between differentiated pub offerings is considered further in the competitive assessment below.

Frame of reference

28. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.⁵

Product scope

The operation of pubs

29. The Parties overlap in the operation of pubs. Pubs form part of the on-trade sector, which is comprised of premises that have a licence to serve alcoholic drinks for consumption on the premises.⁶ The CGA Index is the most widely-recognised source of data for on-trade premises and includes in its definition of pubs:
- (a) Branded Food-Led;
 - (b) Café Bar/Wine Bar/Brasserie/Bar and Restaurant;
 - (c) Circuit Bar – Traditional Town;
 - (d) Circuit Bar – Young Persons
 - (e) Community/Wet-Led/Local;
 - (f) Dry-Led; and
 - (g) Rural Character.

⁵ [Merger Assessment Guidelines](#), paragraph 5.2.2.

⁶ CAMRA super-complaint – OFT Final Decision, October 2010.

30. The CMA has taken the operation of pubs as its starting point in assessing the impact of the Merger on competition.⁷
31. The Parties submitted that the relevant frame of reference may be broader than the operation of pubs and may include not only pubs but other licensed outlets. The Parties submitted that pubs face significant competition from licensed venues such as hotel bars and clubs (not included in the CGA Index's pub segment), and that many more pubs now have late licences and provide discos and other forms of entertainment.
32. The Parties also submitted that there has also been an increase in competition between pubs and restaurants in their view as a result of a shift in the market towards pubs offering a more sophisticated 'food-led' experience, and that there is direct competition between pubs and branded restaurant chains. To evidence this, the Parties provided internal documents to the CMA that assessed competition to the Parties from, to differing extents, some branded restaurant chains including [REDACTED].⁸
33. The Parties conducted a customer survey for the purposes of the CMA's investigation (the methodology for which is described in more detail at paragraph 77 below) (the **Survey**). The Survey included a 'diversion question', asking respondents what they would do if the pub they had previously visited was closed. The options given included going to another pub, but also a variety of other options, including other forms of entertainment, staying at home, or going to a restaurant.
34. Around 20% of respondents indicated that they would go to a restaurant if their 'home pub' was closed. However, when asked which restaurant they would go to, a number of these respondents named establishments that were in fact pubs according to the CGA classification. Respondents did name a number of other restaurant chains, but there was a lack of consistency across areas in the brands and chains named.
35. The CMA recognises that there is some evidence in internal documents and the Survey that restaurants and other licensed premises compete with pubs. However, the magnitude of this constraint is unclear and the evidence does not allow the CMA to identify particular chains or types of premises that compete closely with pubs. For these reasons, the CMA has on a cautious basis limited its frame of reference to pubs, but has taken account of the

⁷ Yates Wine Lodges/the SFI Group, ME/1926-05, 11 October 2005; Punch Taverns plc/Spirit Group Holdings, ME/2191/06, 19 May 2006; Greene King plc/Hardys and Hansons plc, ME/2497/06, 18 July 2006; Greene King plc/Belhaven Group plc, ME/1936/05, 22 September 2005.

⁸ Internal documents entitled [REDACTED].

competitive constraint from such 'out-of-market' options in its competitive assessment.

36. In regards to possible differentiation within an overall product market of pubs, the CMA has undertaken an assessment of the key competitive constraints facing the Parties in a local area based on the methodology set out in the competitive assessment section below.

Brewing activities

37. The Office of Fair Trading (**OFT**) has found in previous decisions that the market for the supply of lager is separate from that of other types of beers.⁹ The OFT has also found that this market can be further segmented as follows: whether the supply is to pubs, bars and restaurants on the one hand (on-trade) and supermarkets and off-licences on the other (off-trade).¹⁰
38. Greene King brews its own beer, ale, lager and stout and sells it to both on-trade customers (including its own pubs and other pub operators, such as Mitchells & Butlers) and off-trade retailers (including to supermarkets such as Sainsbury's). Spirit does not have any brewing activities of its own.
39. Greene King currently supplies Spirit with [X] barrels of beer annually, under a supply agreement with duration of [X] years thereby creating a vertical overlap between the Parties' activities.
40. The CMA does not consider it necessary to conclude on the precise product frame of reference given that, as set out below, no competition concerns arise in regards to brewing activities on any plausible basis. However, following the approach of the previous decisions of the OFT, the CMA has assessed the Merger on the basis of a product frame of reference for the supply of beer to on-trade customers. The supply of beer to off-trade customers is not affected by the Merger.

Overnight accommodation

41. The Parties each operate a small number of hotels as well as a number of pubs and restaurants that offer overnight accommodation. The Parties submit that there is competition between B&Bs, guesthouses, hostels and hotels, and customers will switch between these types of accommodation according to price and availability. The OFT has previously found that branded budget

⁹ Anticipated acquisition by Scottish Courage limited of the business and certain assets of Northern Clubs' Federation Brewery Ltd.

¹⁰ Anticipated acquisition by Scottish Courage limited of the business and certain assets of Northern Clubs' Federation Brewery Ltd.

hotels competed with a range of other accommodation in the UK, including budget hotels (2-star), mid-range hotels (3-star), upscale hotels (4-star), B&Bs and guesthouses.¹¹

42. In the present case it is not necessary for the CMA to conclude on the precise frame of reference for the provision of overnight accommodation since, on the basis of the limited overlap between the Parties, no competition concerns arise on any plausible basis.

Geographic scope

The operation of pubs

43. As in the OFT's decision in Greene King/Hardys and Hansons, the CMA considers that on the demand side, competition between pubs is local as customers are generally only willing to travel short distances to visit pubs.¹² This is borne out by survey evidence supplied by the Parties and considered in more detail in the catchment area assessment below. On the supply side, however, the CMA considers that the competitive dynamics between pubs exhibit features that are wider in geographic scope. For instance, the Parties compete over a number of parameters on a national basis, including beer supply agreements (often negotiated on a Great Britain-wide basis), advertising, promotions and pub themes. The CMA has therefore considered the impact of the Merger on both a local and national basis.

Catchment area for local assessment

44. As stated above, the CMA considers that from a demand-side perspective, competition between pubs takes place at the local level. There is also evidence in the Parties' internal documents that the Parties make decisions on relevant parameters of competition (such as pricing, range of drinks, amenities, etc) at least partly based on local conditions of competition through local area managers. In previous investigations, the OFT has assessed competition on the basis of both local licensing authority areas (**LAAs**) and isochronal analysis.¹³ The Parties suggested using an isochronal approach based on drive time,ⁱ the details of which are discussed in the competitive assessment below. The CMA's approach to geographic scope has been to undertake a catchment area analysis based on drive time isochrones

¹¹ ME/1438/03 Spirit Amber Holdings plc/Scottish & Newcastle retail pub estate, 15 December 2003.

¹² ME/2497/06 Greene King plc/Hardys and Hansons plc, July 2006.

¹³ An isochronal analysis was used in CAMRA super-complaint – OFT final decision, October 2010.

evidenced by the Parties' internal data and customer survey data. The basis for this approach is set out in the competitive assessment below.

Brewing activities

45. The OFT and European Commission have considered the geographic scope to be national¹⁴ and Greene King submitted that its supply agreements for beer are concluded at a national level. Consistent with its decisional practice, the CMA has assessed the impact of the Merger on brewing activities on the basis of a national frame of reference.

Overnight accommodation

46. The OFT has consistently found that the geographic frame of reference for the provision of hotel accommodation has national and local dimensions.¹⁵ At a local level, the OFT has previously undertaken its assessment on a city-wide basis, with further segmentation within London and for accommodation located close to airports.¹⁶ The CMA has not found it necessary to conclude on the appropriate geographic scope given that no competition concerns arise on any basis but has, on a cautious basis, assessed the Merger on the basis of both a national and local frame of reference.

Conclusion on frame of reference

47. For the reasons set out above, the CMA has assessed the Merger on the basis of a product frame of reference for the operation of pubs, excluding restaurants and other licensed outlets. The CMA has considered product differentiation (eg different pub segments based on the CGA Index and the distinction between dry-led and wet-led) in its assessment of closeness of competition.
48. The CMA has also assessed the competitive effects of the Merger on the provision of overnight accommodation and, separately, for the supply of beer to on-trade customers. The CMA did not find it necessary to conclude on the product frame of reference for the supply of these goods and services since the Merger does not give rise to a realistic prospect of a substantial lessening of competition on any plausible basis for the reasons set out in the competitive assessment below.

¹⁴ Case M.6587 *Molson Coors/Starbev* of 6 June 2012; Case M.582 *Orkla/Volvo* of 20 September 1995; Case M.2044 *Interbrew/Bass* of 22 August 2000; Case M.4999 *Heineken/Scottish & Newcastle Assets* of 3 April 2008.

¹⁵ ME/1649/04 *Whitbread/Spirit Group Holdings*, 11 May 2004; ME/1608/05 *Whitbread/Marriott*, 28 April 2005.

¹⁶ ME/1608/05 *Whitbread/Marriott*, 28 April 2005.

49. For these reasons, the CMA has considered the impact of the Merger in the following geographic frames of reference:
- (a) The operation of pubs on a national and on a local basis using catchment areas based on drive-time isochrones.
 - (b) Brewing activities on a national basis.
 - (c) The provision of overnight accommodation on a national and local basis.

Competitive assessment

Horizontal unilateral effects

The operation of pubs

50. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.¹⁷ Horizontal unilateral effects are more likely when the merger parties are close competitors. The CMA assessed whether it is or may be the case that the Merger may be expected to result, in an SLC in relation to unilateral horizontal effects in the operation of pubs first on a national basis and then on a local, catchment area analysis.

National assessment

51. The Parties are both national pub operators and, at a national level, compete over a limited number of parameters of competition such as openings in local areas and their brand positioning¹⁸ as well as negotiating beer tie agreements on a national basis.ⁱⁱ
52. The CMA notes that the market shares of firms in the market, both in absolute terms and relative to each other, can give an indication of the potential extent of a firm's market power. The combined market shares of the merger firms, when compared with their respective pre-merger market shares, can provide an indication of the change in market power resulting from a merger, although

¹⁷ [Merger Assessment Guidelines](#), from paragraph 5.4.1.

¹⁸ Third party responses indicated that some aspects of competition were set nationally, but most also noted that key aspect of competition were set at a local level. This includes aspects of the brand such as menu and food mix, although these may also be flexed at a local level.

the importance that can be attached to market shares for differentiated products, such as in the present case, may be limited.¹⁹

53. The Parties have submitted estimates of their national market share based on data from the CGA Index.²⁰ The estimated combined share of the Parties on a national basis is [X]% based on pub count, which the CMA considers is not significant enough to raise *prima facie* competition concerns (even taking account of the differentiation referred to above). In addition, the CMA notes that there are at least seven remaining national pub operators that will continue to provide a constraint on the Parties post-Merger. The CMA therefore considers that there is no realistic prospect of an SLC as a result of the Merger in the market for the operation of pubs at a national level.

Local assessment

54. A merger between two parties with sites (in the present case pubs) in a local area can affect the process of rivalry and lead to a worsening of some of the parameters of competition because it brings the sites under common ownership. Generally unilateral effects in local areas involve an increase in price, or a decrease in quality, at a site because a proportion of the customers would switch to a site belonging to the other merging party. As a result, instead of losing all of the profits associated with switching customers, the merged entity now recaptures a percentage of this diversion, making a previously unprofitable price rise profitable. Therefore, for unilateral effects to arise, the parties must have both the ability and the incentive to increase price or deteriorate quality at some of their pubs.
55. In the present case, the ability and incentive of the Parties may differ depending on whether the pub in question is managed or tenanted. As regards to the managed estates, the Parties clearly exercise direct control over the parameters of competition, including price and quality (the CMA understands from the Parties and third parties that pubs compete for customers on a range of parameters including the choice of drinks, existence and scope of a food menu, facilities such as car parks, décor and service levels), and bear the full effect of any change in profitability. On the other hand, leased and tenanted pubs are operated by an independent third party on a day-to-day basis and the effects of any change in profitability might be partly shared between the owner and the tenant through the operation of the tenancy agreement and the beer tie. As such, it is less clear whether the Parties would have the ability and/or incentive to unilaterally deteriorate the

¹⁹ *Merger Assessment Guidelines*, paragraphs 5.3.2 and 5.3.4.

²⁰ Parties' figures are based on internal estate lists and competitor figures based on CGA Index.

competitive offering in leased and tenanted pubs. The CMA considers this below to determine whether any reduced ability or incentive exists which may exclude the realistic prospect of an SLC arising in regards to leased and tenanted pubs.

- *Leased and tenanted pubs*

56. In instances where sites are owned by one of the Parties, but are not operated by them because they are leased to, or tenanted by, a third party, the Parties may have a reduced ability and/or incentive to increase prices or deteriorate quality and/or ability to recapture margin, which would reduce the possibility of a SLC in that area.

- *The nature of the Parties' lease and tenancy agreements*

57. The Parties submit that the two main types of agreements between themselves and their 'tenanted estate' are tenancies and leases. Leases typically have a longer duration and are assignable to a new incoming pub lessee,²¹ whereas tenancies have a shorter duration and are not assignable to a new tenant (they must be given up in the event that the existing tenant moves on and would revert to the pub company in these circumstances).

58. Both Greene King and Spirit operate a beer tie in their tenancy and lease agreements which is an obligation for the tenant/lessee to buy beer and, depending on the agreement, other drinks (eg soft drinks and spirits) from the pub company.

- *The ability to influence the competitive offering at the leased/tenanted site*

59. The Parties submit that they do not have any control over the day to day operation of leased/tenanted pubs, including in relation to choice of food and menus, pricing, opening hours and choice of beer and other drinks purchased under the tie. Pub landlords in tenanted/leased pubs are self-employed and determine their own strategy. While the beer tie requires tenants to purchase beer (and in some cases other drinks) from the landlord, tenants are otherwise free to select from a choice of beers and other drinks, and also to set their own prices.

²¹ For example, [X].

60. The CMA considers three possible ways in which the Parties may influence the competitive offering of the leased/tenanted pubs giving them an ability to alter the competitiveness of that pub. These are:
- (a) increasing wholesale prices through unilateral price rises or alterations to the mix of drinks supplied under the beer tie;
 - (b) preventing improvement to the premises; and
 - (c) reverting the pub back to the managed estate.
61. In regards to wholesale prices, the Parties control the wholesale prices for those drinks that the tenant is obliged to purchase under the terms of the beer tie contained in the tenancy or lease. The sample agreements provided to the CMA by the Parties [REDACTED].²²
62. The CMA also considers that the Parties have an opportunity to alter the mix of drinks that fall under a particular beer tie agreement, which may allow them to alter the aggregate wholesale price paid by tenants for drinks. The Parties submitted that this was not possible. However, the sample Spirit agreement provided to the CMA includes the provision that: '[REDACTED]'.²³ The sample Greene King agreement provides that: '[REDACTED]'.²⁴ The CMA therefore cannot rule out that such changes are possible.
63. The Parties submitted that tenants are protected from wholesale price rises by the UK Pub Industry Framework Code of Practice (IFC) which is incorporated into the agreements through the Parties' codes of practice (copies of which were provided to the CMA) and will in the future be incorporated into a statutory code. However, in light of the provisions of the agreements highlighted above, it is not clear to the CMA that these codes of practice sufficiently hinder the Parties from making changes to the price lists or drinks provided.
64. The CMA notes that a proportion of the leased sites in the areas raising *prima facie* competition concerns (listed in Annex 1) are dry-led.²⁵ The CMA understands that the Parties are not able to influence either directly or indirectly the price of food. In dry-led pubs, the wholesale prices of tied drinks may not induce switching by end customers, even if such increases were passed on by the pub operator. This is particularly true where there is a large difference between the percentage of revenue derived from food and the

²² [REDACTED] of the sample Greene King tenancy agreement.

²³ [REDACTED] of the sample Spirit tenancy agreement.

²⁴ [REDACTED] of the sample Greene King tenancy agreement.

²⁵ The CGA Index classifies pubs as dry-led where 30% or more of their turnover is derived from food.

percentage derived from drink and where the customer's primary reason for visiting was to purchase a meal.

65. However, price is not the only element of the competitive offering that the Parties may be able to influence in order to induce switching. The CMA considers that the Parties may be able influence longer term competitive parameters such as the state of internal or external repair. The Parties submitted that their consent is required for structural alterations to the premises. Therefore, a tenant or lessee would not be able to unilaterally change the elements of the fabric of the pub, other than decorations, such as expanding kitchen facilities, the floor area of the pub or parking facilities in order to respond to competition. The Parties submitted that their decisions on consent would depend on the overall impact of the alterations on the value of the premises and any increased rent. However, given the CMA's considerations on incentives set out below, the CMA considers that withholding consent for structural alterations, which may impact the competitive offering of the pub, is an option open to the Parties.
66. Lastly, the CMA considers that the Parties may also be able to convert a pub from being a tenanted/leased pub to being part of the managed estate so they would have full control over the competitive parameters at the pub, and as such, would be able to exploit any internalisation of diversion as a result of the Merger. The Parties submit that, in practice, doing so is difficult due to the application of legislation which gives tenants a right of renewal. However, the CMA understands that the Parties are able to give notice to tenants and reclaim the premises or negotiate a settlement with the tenant. Therefore, the CMA cannot exclude the possibility that the Parties would have the ability to revert tenanted/leased pubs to the managed estate should they be incentivised to do so.
- *The Parties' incentives to influence the competitive offering*
67. In a local area where one of the Parties' managed pubs is a close competitor to a leased pub belonging to the other Party, post-Merger the Parties may have the incentive to try to deteriorate the competitive offering in the leased site in order to attract customers to the managed pub where the Parties' margins are greater. Specifically, the Parties earn a full retail margin at one site, but only the wholesale margin for the proportion of tied drinks sales at the other site. As retail prices are typically higher than wholesale prices, the Parties would earn a greater profit from any single captured retail customer than they would lose from the associated reduction in wholesale profits from a single customer switching. As a result of this asymmetry, the CMA considers that the Parties have a higher incentive to try to degrade the offering at a

leased site with lower levels of diverted sales to their managed sites than would typically be the case in retail mergers involving stores owned and operated by merger parties.

- *Conclusion on tenanted and leased pubs*

68. For the reasons set out above the CMA considers that the Parties will have some ability to influence the competitive offering of their leased and tenanted pubs post-Merger, by increasing wholesale prices, by preventing structural alterations to the pub and by reverting the pub to the managed estate. The Parties are also incentivised to do so, given the opportunity to gain increased margins associated with revenues delivered by their managed estate.

69. The CMA therefore, on a cautious basis, includes the Parties' tenanted and leased pubs in its competitive assessment of the Merger on a local basis.

- *Local assessment – use of a primary filter*

70. When analysing whether a merger will result in a SLC in a local area, in mergers involving a large number of local overlaps it is common practice for the CMA to use a filtering methodology in its Phase I investigation to reduce the number of areas requiring an in-depth analysis to a manageable level.²⁶

71. In the present case the CMA found that around 1,000 Spirit pubs overlap with a Greene King pub in a local area. The CMA therefore used a primary filter to prioritise areas that may give rise to *prima facie* competition concerns which it could then focus its analysis on. These prioritised areas were then subject to a more granular local area analysis. This 'second stage' analysis is explained in detail below.

72. The primary filter consisted of the following:

- (a) Competitor set – a defined competitor set depending on whether the pub that the analysis centred on (referred to in this decision as the 'centroid' pub) was classified by CGA as dry-led²⁷ or wet-led.

- (b) Catchment area – defined by drive time isochrones.

²⁶ See for example *Commentary on retail mergers* (OFT1305/CC2com2, March 2011, adopted by the CMA as set out in *Mergers: Guidance on the CMA's jurisdiction and procedure*, Annex D), paragraph 2.4.

²⁷ CGA classifies each pub in the country into one of the categories set out in paragraph 61, based on submissions from pub companies and CGA analysis. Commonly pubs classified as dry-led by CGA will have more than 30% of turnover derived by food, although this may not always be the case.

- (c) Threshold for likely concern – 35% or more combined pub count share plus a 5% or more increment.
73. These parameters and the reasons for their selection are set out in more detail below.
- *The competitor set*
74. The CGA Index contains information on pubs and full-ons,²⁸ proprietary clubs, registered clubs, restaurants and residential. There are further sub-segments within the category of pubs and full-ons, defined as pubs, entertainment bars, hotels and other bars. As a starting point and as is appropriate for a phase 1 process, the CMA took a conservative approach to the primary filter and used the sub-segment of pubs, excluding entertainment bars, hotels and other bars, as the basis for the first filter.
75. As set out in paragraph 29, in the CGA Index pubs are allocated between the following categories:
- (a) Branded Food-Led.
 - (b) Café Bar/Wine Bar/Brasserie/Bar and restaurant.
 - (c) Circuit Bar – Traditional Town.
 - (d) Circuit Bar – Young Persons.
 - (e) Community/Wet-Led/Local.
 - (f) Dry-Led.
 - (g) Rural Character.
76. The CMA therefore considered it necessary to understand the closeness of competition between categories of pubs used by the CGA Index in order to determine those to be taken account as competitors in the primary filter. To do so, the CMA has considered evidence from the Survey conducted by the Parties.

²⁸ Premises operated under a full publican on licence.

- *Survey evidence*

77. The Parties conducted an internet survey²⁹ in a total of 40 pubs.ⁱⁱⁱ The Parties hold the email addresses of a large number of customers who had subscribed to their mailing list at their managed pub sites.³⁰ This allowed the Parties to send customers of a relevant site a link to the Survey.
78. The Parties selected the 40 pubsⁱⁱⁱ at which to conduct the survey in order to have groups of pubs at different points on a market concentration scale. The scale was created by ranking pubs according to their all pub market share by pub count. Since the number of customer records varied at each pub, and the Parties were not expecting a high response rate, they then selected pubs along the scale which had the highest number of guest records in order to maximise the chance of getting a statistically robust sample. This may bias the selection of pubs towards larger sites. However, the CMA has not received any evidence suggesting that competitive dynamics vary significantly between small and large pubs.
79. In order to test whether each category of pubs is achieving as much diversion as would be expected based on the number of pubs within that category in an area, the CMA constructed a measure of expected diversion³¹ within an area and compared this expected diversion to the diversion patterns shown by the Survey. The Survey demonstrated significant variation in the diversion patterns across the areas with some categories of pubs receiving significantly less diversion than would have been expected if all categories of pubs competed equally when compared on a weighted one-to-one basis. On the basis of this evidence, the CMA does not believe that the results from the Survey support the inclusion of all pubs in the primary filter.
80. The CMA's analysis of the Survey shows that within all the surveyed pubs (the majority of which were dry-led), the Branded Food-Led, Circuit Bar – Traditional Town and Dry-Led categories attract more diversion than would be suggested by the number of such pubs in each area. The Parties submitted that the Branded Food-Led, Circuit Bar – Traditional Town and Dry-Led categories refer to dry-led pubs.

²⁹ In retail cases surveys are commonly conducted in retail sites, where a researcher is able to draw a random sample from within the population of people visiting that site. However in this case it was not felt that it was practical to conduct in-site surveys in pubs due to the nature of the consumers visit. See also Mergers consumer survey evidence design and presentation: CC2com1/OFT1230.

³⁰ The Parties do not have contact details for customers who visited leased or tenanted sites.

³¹ An expected diversion count was constructed for each category of pub based on the assumption that all categories would receive diversion in proportion to the number of pubs in that category. The actual survey diversion count was compared to the expected diversion count for each category to determine the extent to which categories were over or under represented assessed against the expected diversion (as explained above).

81. Conversely, the other categories of pubs in the CGA Index classifications attract less diversion than the relatively higher number of such pubs within each area would suggest. This is particularly true for the Community/Wet-Led/Local category, which commonly contains the highest number of sites within an area of any category within the CGA Index, but often achieved less than half of the expected diversion.
82. These results suggest that the dry-led categories of pubs are closer competitors to each other than wet-led pubs. In general, it is reasonable to assume that dry-led pubs constrain wet-led pubs at least to some extent, even if the opposite is not necessarily true. This is because dry-led pubs have drinking areas and offer a broad range of drinks. There is some support for this presumption in the Survey results, albeit based on relatively few surveyed sites. The Survey included eleven wet-led pubs, six of which were part of the Spirit estate and five part of the Greene King estate, and the average sample size was relatively low.³² The results show a similar level of diversion from wet-led to dry-led as from dry-led to dry-led (although not, as explained above, vice versa) but more diversion to the Community/Wet-Led/Local category.
- *Internal documents*
83. The Parties submitted a number of internal documents to the CMA in the course of the investigation. However, these internal documents are almost always prepared at a national level and focus on the other national branded pub chains, which are mostly dry-led, and to a lesser degree some branded restaurants. As such, the CMA finds that they are of relatively limited value when constructing the competitor set for the local area assessment, with the exception of an internal document analysing the impact of [redacted] in a number of local areas. The CMA notes that most [redacted] sites are categorised as Circuit Bar – Traditional Town by CGA, and as such the internal documents support the results of the Survey suggesting that it is appropriate to include this category as a competitor to the Parties' dry-led sites.
- *The Parties' views*
84. The Parties submit that it is not appropriate to distinguish between wet- and dry-led pubs, given that (i) there is no clear dividing line as between wet-led and dry-led, and all pubs compete with each other; and that (ii) there is considerable supply-side substitutability as between wet-led and dry-led pubs. The Parties submitted that an estimated 75% of pubs in the UK have a food

³² There were also some pubs classified as 'Local Pubs' included in the survey that were also wet-led.

offering of some description and, in any event, the majority of pubs have a kitchen and can adjust the proportion of food and drink that they serve. In most cases, the Parties submitted, this is simply a question of expanding the menu and serving food for extended periods during the day.

85. The Parties submitted that the market has seen a shift to a need to offer food in pubs, prompted both by the growth generally in eating out and by the fall in demand for 'traditional boozers' (in part due to the growth in alcohol sales by supermarkets and the smoking ban in 2007 which impacted upon all licensed premises). In support, the Parties submitted that approximately [X]% of Greene King pubs revenue is now derived from food sales, compared to 35% five years ago (in 2009).
86. The CMA notes that, although wet-led pubs may sell food, the offering may be materially different from that of a dry-led pub and, based on the revenue split, it is not the focus of their offering. The CMA understands that there are significant costs involved in moving the focus to food. For instance, third parties have informed the CMA that to convert a pub from wet- to dry-led there will normally need to be a number of structural changes to the building, including: upgrading/expanding/constructing a kitchen; improving the toilet facilities; and increasing the floor space and car parking space to facilitate a greater number of tables and differing travel habits.
87. Third parties submitted that it would take between three and 12 months to develop a food trade and build consumer confidence, depending on the existing offering of the site, and would cost between £50,000 and £800,000 (the majority of third parties indicated a cost of around £250,000). It is not apparent to the CMA that all wet-led pubs will have the ability to make such adjustments to their premises.³³
 - o *Other third party comments*
88. The CMA has contacted a range of competitors and small number of consumer groups and trade bodies. Third parties tended to suggest that in general there is competition between a range of different types of establishments, with branded food pubs facing some competition from other categories of pubs and to some extent restaurants, depending on quality, value for money, and service aspects of their offering, as well as from the wider market for leisure activities. However, third parties also indicated that within a local area closeness of competition will be partly driven by the similarity of the offerings, with two third parties indicating that they believe that

³³ For instance, the CMA noted that there are restrictions with the tenancy and leasehold agreements operated by the Parties on the extent of work that can be undertaken without their permission.

competition issues may arise in local levels due to the Parties' brands³⁴ being particularly close competitors.

- *Conclusion*

89. On the basis of the evidence set out above, and on a cautious basis (as is appropriate in a primary filter), the CMA considers it appropriate to apply the primary filter separately to dry-led pubs and to wet-led pubs, excluding wet-led pubs from the competitor set of dry-led pubs. The CMA considers that the dry-led categories are only Branded Food-Led, Dry-Led and Circuit Bar – Traditional Town pubs. The CMA has considered further the constraint of wet-led pubs on dry-led pubs in its second stage analysis set out below.

90. On a cautious basis, the CMA has included all pubs in the competitor set for wet-led pubs but not other full-ons as defined in the CGA Index.

- *Catchment area*

91. In constructing the primary filter, the CMA considered the catchment area of a particular pub (ie the boundaries of the geographic area from where it attracts the majority of its customers) in order to assess the competition it faces.³⁵ The Parties submitted that the catchment area of a pub differs depending on the urban classification of that pub (eg City Centre or Rural Town).

- *Urbanicity*

92. The CMA uses the term urbanicity to refer to the characteristics of the geographic area in question, eg City Centre or Rural Town. The Parties based their urban classification of pubs on their internal view of the area in which the pub is located. While this approach may reflect the Parties' internal view, it is not necessarily consistent across areas, risks not sufficiently distinguishing between different rural geographies, and is not easily verifiable. In order to produce a measure of urbanicity that is more consistent and more easily verifiable, the CMA has sought to base its classification upon publicly available information.

³⁴ The brands cited were: Farmhouse Inns – Fayre & Square, Flaming Grill, Hungry Horse – Fayre & Square, Flaming Grill, Old English Inns – Chef & Brewer

³⁵ See *Commentary on retail mergers* (OFT1305/CC2com2, March 2011), adopted by the CMA, section 2.

93. The Office for National Statistics (**ONS**) produces a rural/urban classification of output areas,³⁶ which classifies each output area³⁷ as Urban or Rural, with four urban subcategories and six rural subcategories.
94. The CMA matched each output area to a four-digit postcode and used this to associate the ten ONS classifications of urban or rural with each of the pubs within the Parties' estates. The CMA shared its analysis with the Parties who extended it to cover Scotland,^{iv} as the ONS data only covered England and Wales. The CMA does not consider that it is appropriate to define separate catchment areas for each of the ten ONS classifications for urban and rural as a customer's willingness to travel to a pub is likely to be similar across many of the sub-categories.³⁸ The Parties submit that it is appropriate to aggregate these categories as set out below (with brief descriptions):
- (a) City Centre: Central London (zones 1 and 2) and also pubs located on high streets and in other central meeting places in other city centres.
 - (b) City Urban: locations based around City Centres and are defined by inner postcode areas (for example, for London all E, N, NW, SE and SW postcodes etc are treated as City Urban). While these pubs are not designated as City Centre, they are located within built-up areas of large conurbations; for example, areas of London that are not within zones 1 and 2.
 - (c) Other Urban/Suburban: other non-city conurbations, including market towns that trade as a local centre and include postcode areas that have a population size above 10,000 (consistent with the ONS distinction between urban/rural). Suburban areas are outer residential areas around cities and other conurbations in postcode areas that have a population size above 10,000.
 - (d) Rural Town/Village: The Rural Town/Village category includes settlements such as villages and small towns, with a population size of up to 10,000 according to ONS postcode data (ie areas identified by ONS as rural).
 - (e) Rural: These are isolated locations excluding small towns and villages (and therefore intends to capture the Parties' sites in the most remote locations).

³⁶ 2011 Urban Rural classification of output areas England and Wales

³⁷ An output area is based on census information with 181,408 output areas in England and Wales, for more information [see here](#). An output area will contain between 100 people and 40 households and 625 people or 250 households.

³⁸ For example, (a) Urban: city and town; and (b) Urban: city and town in a sparse setting.

- *Catchment area by urbanicity*

95. Typically, catchment areas are constructed by analysing data on customer location to determine the area from which a firm draws 80% of its business, by value.³⁹ However, in this case the Parties do not hold information on the location of all of their customers, and the information that they do hold is not based on the value of the customer’s spend. The Parties therefore submitted that it is more appropriate in the present case to base the catchment area on the area from which 60% of customers travel. The CMA considers that, in the particular circumstances of the case, this is reasonable as the closer a customer is located to a pub, the more likely that they will be to make repeat visits, whereas customers located further away are less likely to visit regularly.
96. Based on their analysis of the customer location information available,⁴⁰ the 60% catchment area for each of the Parties (as submitted by the Parties) can be seen in Table 1 below.

Table 1: 60% catchment areas for each of the Parties

	<i>Greene King</i>	<i>Spirit</i>
City Centre	[REDACTED]	[REDACTED]
City Urban	[REDACTED]	[REDACTED]
Other Urban	[REDACTED]	[REDACTED]
Suburban	[REDACTED]	[REDACTED]
Rural	[REDACTED]	[REDACTED]

Source: the Parties’ internal information

97. The Parties submitted that the customer location data is not an accurate measure of willingness to travel in City Centre and City Urban areas, due to the number of commuters present in these urbanities. Therefore, the Parties submitted that the following catchment areas should be used in the competitive assessment:
- (a) City Centre: 0.25 miles.
 - (b) City Urban: 1 mile.
 - (c) Other Urban: 3 miles.
 - (d) Suburban: 3 miles.
 - (e) Rural: 20 minutes’ drive time.

³⁹ See [Merger Assessment Guidelines](#), paragraph 5.2.25 and *Commentary on retail mergers* (OFT1305/CC2com2), March 2011, adopted by the CMA, paragraph 2.14.

⁴⁰ The Parties used mailing list information, which customers typically sign up to for an in-pub promotion. The Parties record information on which pub the customer visited and the customer’s home address.

98. The Parties submitted that the proposed catchment areas for City Centre and City Urban take account of the presence of a large number of commuters, who may be travelling a large distance from their home address, but are visiting the pub after work, which made the initial results of the customer location analysis artificially large for these urbanities. The CMA notes that although the Parties correctly recognise that the results may be influenced by the presence of commuters, the Parties do not justify why this will only affect the City Centre and City Urban catchment areas, although the CMA accept that it is likely to have the greatest effect for these catchments due to the number of commuters travelling in to these areas, nor do they justify why the suggested catchment areas are appropriate.
99. Noting the Parties' submission, the CMA undertook its own assessment of the appropriate catchment area, which is set out below.
- *Survey evidence*
100. The CMA has used the results of the Survey conducted by the Parties to test the appropriate catchment areas. Respondents were asked which pub they would have gone to in response to a closure. The CMA considers that the responses should provide a good indication as to the location of sites that are constraining the surveyed pub. The CMA has calculated the drive time between each centroid pub and the various pubs that customers would divert to, and has defined the 'catchment area' of each centroid pub as the drive time that captures 80% of diverting customers.⁴¹ The CMA has then averaged the catchment areas of pubs located in identical urbanities to form a view on the right catchment area for that urbanity.
101. The CMA uses drive time isochrones to define catchment areas, given that isochrones are likely to provide a better measure of the geographic catchment than a simple line of equal distance as they take account of local topography by connecting points of equal travel time.
102. The Survey results broadly support the catchment areas suggested by the Parties in City Urban, Other Urban and Suburban areas. For Other Urban and Suburban areas, the Survey suggests a catchment of around ten minutes' drive time, which is in line with the catchment areas suggested by the Parties' analysis of their internal customer data. In City Urban areas the Parties suggested a one-mile radial catchment, despite the Parties' data suggesting that 60% of customers were coming from [✂] miles. The CMA notes that a ten-minute drive time isochrone is roughly equal to a radial of just over two

⁴¹ The Survey indicated that the majority of respondents drive to the surveyed pubs.

miles in City Urban areas, and as such supports the catchment area suggested by the internal data.

103. There is a wide divergence in the catchment areas suggested by the survey in City Centre areas and the sample size is insufficient to be robust. On a cautious basis the CMA has therefore used a drive time isochrone of two minutes. However, the CMA recognises that a sensitivity check for City Centre (which in the present case relates to Central London) is appropriate in the second stage analysis, as set out at paragraphs 129 to 131 below.
104. In Rural Town/Village and Rural areas, the catchment areas is 14 to 15 minutes based on the Survey. However, in contrast, the Parties have suggested the use of a 20-minute drive time isochrone in Rural areas, which they submit is roughly equal to the five- to ten-mile radial indicated by the customer location data. The CMA notes that the distance band for Rural areas in the customer location data is wide, and as such there is a risk of either over- or understating the catchment area. As such, the CMA has used the 15-minute catchment area indicated by the Survey.
 - *Third party evidence*
105. Third parties differed in their views on how far consumers would be willing to travel to reach a pub with the majority of respondents suggesting that consumers would be willing to travel between five and 20 minutes to reach a Branded Food-Led pub. Only one competitor was able to estimate the distance consumers would be willing to travel in a city centre location, putting it at around one mile.
106. Third parties were also asked over what distance they monitor the offering of other pubs in a local area. Again, the responses varied between operators. One third party indicated that when reviewing the offering in competitor pubs they typically look at pubs up to two miles away, although, for a 'destination' pub this could extend to up to five miles away. Another indicated that this could be up to ten to 15 minutes' drive time, and another that this could be up to ten miles. There was therefore a lack of consistency in third party responses.

- *Conclusion*
107. For the reasons set out above and on a cautious basis, the CMA has based the primary filter on the following drive time isochrones:
- (a) City Centre: 2 minutes.
 - (b) City Urban, Other Urban and Suburban: 10 minutes.
 - (c) Rural and Rural Town and Village: 15 minutes.
- *Threshold for failing the primary filter*
108. In previous retail cases, the CMA has applied a named fascia approach that aggregates those sites operated by a single owner.⁴² In general, the underlying assumption for a fascia count approach is that there will be uniform diversion to different fascia within an area, irrespective of the number of individual sites a company operates in that area. This assumption is generally more likely to hold where there is little variation between the offerings in each of the fascia's sites. In this case the CMA considers it appropriate to depart from this approach as there are a large number of different fascia operating in the pub market, each with a different percentage of leased and managed pubs within their estate. In relation to pubs, each fascia is operating a number of different brands as well as non-branded sites positioned at different points on the price and quality spectrum, often with little to tell the customer that they belong to the same company. The evidence available to the CMA indicates that customers will choose between individual pubs rather than fascia, and as such the number of distinct pubs a company has in an area will be important in determining the level of competition.
109. In previous cases in this sector, the OFT applied a threshold of 25% share of pubs by pub count with a 5% increment to determine whether *prima facie* competition concerns may arise.⁴³ The Parties submit that using a 25% pub share threshold in the present case does not properly take into account the extent of the competitive constraints that exist. In particular, the Parties submitted that the Survey showed diversion from dry-led pubs to restaurants went up to 23% in a local area and for 11 of the 23 dry-led pubs that were

⁴² ME/3777/08 Anticipated Acquisition by Co-Operative Group Limited of Somerfield Limited; ME/1527/75 *The Beach Tavern/The Castle Inn*, 6 June 2000, paragraph 22. See also *Commentary on retail mergers* (OFT1305/CC2com2), March 2011, adopted by the CMA, paragraph 2.7.

⁴³ The OFT did not undertake a local level analysis based on a defined isochrone or iso-radial in these transactions; rather, it analysed the extent of local competition on the basis of Petty Seasonal Divisions (PSDs), as a proxy for the alternatives for local consumers. *Yates Wine Lodges/the SFI Group*, ME/1926-05, 11 October 2005; *Punch Taverns plc/Spirit Group Holdings*, ME/2191/06, 19 May 2006; *Greene King plc/Hardys and Hansons plc*, ME/2497/06, 18 July 2006; *Greene King plc/Belhaven Group plc*, ME/1936/05, 22 September 2005.

surveyed diversion to restaurants was greater than or equal to diversion to the other merging party. The Parties also noted that in previous cases where a 25% threshold was used, the OFT included all premises operating under a full publican on-licence. This is therefore likely to include other full-ons, whereas the CMA in the present case excludes them from the primary filter.

110. The CMA acknowledges that there is likely to be some diversion outside of the competitor set established on the basis of the methodology for the primary filter. The Survey demonstrates diversion to a range of other options including to varying extents other full-ons, restaurants, other entertainment and staying at home. The CMA considers that there may also be some constraint on dry-led pubs from wet-led pubs, but has dealt with this specific constraint in the second stage analysis. The competitor set for the primary filter has been established on a cautious basis and therefore the CMA considers that it is reasonable to take account of out of segment constraints in the threshold used.
111. The CMA also notes that, assuming that market shares are symmetric, a four to three reduction in fascia (the fascia count threshold generally used when applying a filtering methodology) would give rise to a combined market share of 33% if the firms were symmetric after the merger. For the reasons set out above, the CMA believes that in the present case it is appropriate to apply a 35% combined pub share threshold. The CMA has used a 35% combined pub share with a 5% increment to determine the set of pubs failing the primary filter.

- *Application of the primary filter*

112. As explained above, the CMA applies the primary filter separately to dry-led pubs and to wet-led pubs, excluding wet-led pubs from the competitor set of dry-led pubs. The primary filter leads to the identification of 56 local areas⁴⁴ where the Parties' combined share of pubs exceeds 35% and the Merger results in an increment in excess of 5%. On the basis that the 35% combined share of pubs takes account of evidence on closeness of competition between pub classifications as well as out of segment constraints, including diversion evidence from the Survey, the CMA considers that the loss of competition as a result of the Merger in these 56 areas may raise *prima facie* competition concerns. Conversely, the CMA considers that, on this basis, in the remaining areas where the Parties' pubs overlap, the Parties will continue to face

⁴⁴ Listed at Annex 1.

sufficient competition after the Merger to exclude a realistic prospect of an SLC.

113. The CMA below conducts a second stage local analysis of the 56 areas that failed the primary filter to determine whether they result in a realistic prospect of an SLC.

- *Second stage analysis*

114. As described above, the application of the primary filter allows the CMA to rule out areas which, on the basis of the methodology used, it considers will not result in a realistic prospect of an SLC. Those that fail the primary filter therefore *prima facie* give rise to the potential for competition concerns. The CMA now conducts a more detailed, secondary analysis of these areas in order to determine the magnitude of the concerns and whether they result in a realistic prospect of an SLC.

115. In order to conduct the secondary assessment, the CMA considered evidence in each of the 56 areas as regards to:

(a) the extent of competitive constraint exerted on dry-led pubs by wet-led pubs;

(b) the geographic proximity of the Parties' pubs in a given area;

(c) the application of a drive time sensitivity in City Centre (ie Central London) locations;

(d) survey evidence in specific areas in which a survey was undertaken; and

(e) the presence of additional effective competitors outside of the competitor set identified by the primary filter;

116. The CMA's consideration of each of these factors is set out below.

- *Wet-led pubs*

117. The Parties submitted that the CMA should take account of the constraint imposed by wet-led pubs on their dry-led estate (which forms the majority of those failing the primary filter). The CMA considered these submissions and the extent to which wet-led pubs constrain dry-led pubs. For the reasons set out below, while not competing as closely with the Parties' dry-led pubs as other dry-led pubs, the CMA recognises that wet-led pubs exert a constraint on the Parties' dry-led pubs to some extent. The CMA took this constraint into account by applying a discount factor to wet-led pubs and re-calculating the

Parties' share of pub count in each of the 56 local areas that failed the primary filter (given that wet-led pubs are present in all of these areas). The results of this are set out at paragraph 124 below.

118. The Parties submitted that wet-led pubs provide a real constraint on dry-led pubs and there is no bright line between wet-led and dry-led pubs. The CMA notes that the food offering in wet-led pubs may be materially different to that offered by dry-led pubs. The CMA considers, as a general proposition, that wet-led pubs do not provide the same degree of competitive constraint on the Parties' dry-led pubs as other dry-led pubs. The greater degree of closeness of competition between dry-led pubs is borne out by the Survey which shows that within all the surveyed pubs (the majority of which were dry-led), the Branded food led, Circuit Bar – Traditional Town and Dry-Led categories attract more diversion than would be suggested by the number of such pubs in each area. As such, the CMA's primary filter captured only those pubs that can be regarded as most closely competing with the Parties' respective offering in any local area. Having excluded the constraint from wet-led pubs on the Parties' dry-led pubs in its primary filter assessment, the CMA sought to determine to what extent the degree of constraint from wet-led pubs should be included in the second stage assessment.
119. The Parties submitted that only approximately 25% of pubs (13,326) in the UK are included in the CGA Data Index categories classified as dry-led (ie Branded food led, Circuit Bar – Traditional Town and Dry-Led), which makes the primary filter very conservative and suggests that a very significant level of food sales from pubs is being disregarded. As set out in paragraph 84 above, the Parties submitted that the majority of pubs (75%) in the UK offer food, regardless of whether they are classified as wet-led or dry-led. The Parties also submitted that the Survey, in some cases, indicated significant diversion from dry-led pubs to wet-led pubs, in one case as much as 62% (although the CMA notes that, in general, the Community/Wet-Led/Local category commonly contains the highest number of sites within an area of any category within the CGA Index, but often achieved less than half of the expected diversion).
120. The CMA recognises that, while not competing as closely with the Parties' dry-led pubs as other dry-led pubs, wet-led pubs exert a constraint on the Parties' dry-led pubs to some extent and are present in all areas. As such, the CMA considers it appropriate to take the level of that constraint into account in its more detailed competitive assessment. To do so, the CMA has re-calculated the Parties' share of pubs with the inclusion of wet-led pubs, but applying a discount factor to reflect the reduced competitive constraint imposed.

121. The discount factor is determined by looking at both the Survey results and the number of pubs in that category (in the isochrone) and setting the discount factor so that expected diversion (as explained in paragraph 79 above) to that category of pubs is equal to actual diversion. For consistency, the CMA has chosen to use the same approach to calculating the discount factor for wet-led pubs as it used when calculating the primary filter; that is calculating an expected diversion count, with wet-led pubs weighted using the discount factor and comparing this to the actual diversion count. The CMA found that for the Community/Wet-Led/Local categories a 0.2 discount factor was appropriate and consistent across urbanities.⁴⁵
122. The CMA has also analysed whether a 0.2 discount factor can be applied to other wet-led categories within the CGA Data Index (Café Bar/Wine Bar/Brasserie/Bar and Restaurant, Circuit Bar – Young Persons, Conference/Exhibition/Function/Banquet, Entertainment, Hotel, and Rural Character). The CMA notes that some of these categories have very few sites in them and, as such, the Survey is less likely to accurately highlight diversion to these categories (for instance there are typically few Rural Character pubs in an isochrone). The CMA's analysis found that other categories would require a higher discount factor than the Community/Wet-Led/Local category and that there was significant variation in this across both categories and urbanities. Therefore, the CMA did not find sufficient evidence to place a discount factor on other categories of wet-led sites.
123. The CMA assigned the 0.2 weighting factor to each pub in an area that is classified as Community/Wet-Led/Local category and recalculated the Parties' combined pub share. The CMA maintained the threshold of 35%, above which it considers that there is *prima facie* grounds for competition concerns arising. Unlike in its application of the primary filter, the CMA does not believe it is appropriate to apply an increment since the CMA has already taken into account the increment caused by the Merger in its primary filter. It is therefore reasonable to assume that there is a merger effect in each of the 56 areas failing the primary filter.
124. The calculation of the Parties' pub share with the inclusion of wet-led pubs on a discounted basis resulted in 30 areas in which the Parties combined pub

⁴⁵ The Parties suggested calculating the ratio of wet- to dry-led pubs using the Community/Wet-Led/Local pub category, and constructing a ratio of survey to proxy diversion between this category and the three dry categories and then taking the median of these estimates. The parties submit that this results in a wet-led pub being 'worth' just under 0.2 of a dry-led pub. Therefore, the methodology used by both the CMA and the Parties supports the inclusion of the Community/Wet-Led/Local category with a discount factor of 0.2.

share was below 35%.⁴⁶ In these 30 areas, given the relatively low combined share of pubs and the existence of third party competitors, the CMA believes that no realistic prospect of an SLC will arise from the Merger.

- *Geographic proximity*

125. The geographic proximity of sites is commonly found to be a significant factor in determining how closely different parties compete. For instance, in Co-op/David Sands, this was one of the factors used to determine whether additional competitors should be included in an area.⁴⁷ In the present case, the CMA observed from the Survey that diversion ratios commonly declined with distance, with only a few sites that are more than half the relevant isochrone⁴⁸ away from the centroid pub achieving diversion above 10%. As a result, the CMA believes that an SLC is more likely in areas where the Parties are located within half the relevant isochrone of each other.
126. However, the CMA considers that competition concerns are only less likely to arise on this basis if there are also third party competitor pubs which customers can switch to in the event of a price rise, thus constraining the Parties. The CMA considers that, even if the Parties' pubs are not located within half an isochrone of each other, there may still be some scope for unilateral effects if there are no other pubs closer to the centroid pub than the other Party's pub.
127. On this basis, the CMA believes that, absent area-specific evidence to the contrary, there is no realistic prospect of an SLC in an area where:
- (a) the Parties' pubs are not within half the relevant isochrones of each other; and
 - (b) where there are at least two competitors closer to the centroid than the other merging Party.
128. This applied to the following two areas (listed by the name of the centroid pub): 65 & King (located in Greater London); and Royal Oak (located in Berkshire). In view of the absence of evidence suggesting that competition concerns may nevertheless arise in these areas, the CMA believes that the Merger does not result in a realistic prospect of an SLC in these areas.

⁴⁶ Listed by the name of the centroid pub: Glass Horse, Tommy Flynn's Bar & Steakhouse Grill, Ship Inn, Kittoch, Badger Box, Beekeeper, Gypsy Queen, Tree Tops, Wheelhouse, Monk's Bridge Farm, Elmwood Farm, Tandem, Golden Pheasant, Phoenix, Sherwood, Queen, Belfry, Blue Bell, White Cart, Ye Olde Swan, Bowman, Broadway, Carr Mill, Drakehouse Mill, Friar Tuck, Gynsills, Museum Inn, New Florence, Ridgeway Arms, Bridge Inn.

⁴⁷ ME/5317/12 Anticipated Acquisition by Co-Operative Group Limited of David Sands Limited, February 2012.

⁴⁸ That is, one minute in City Centres, five minutes in urban areas, and 7.5 minutes in rural areas.

- *City Centre drive time sensitivity*

129. The Parties have conducted drive time sensitivities for a number of areas, which flex the isochrone and look at the resultant change in the share of pubs as a result.

130. The CMA considers it most appropriate to apply a sensitivity check in areas where the evidence on which the drive time catchment area is based is less robust and there are additional reasons to believe this may not adequately reflect the geographic scope of competition. In the present case, the CMA considers that this only applies to the catchment area used in city centre locations (ie Central London). In Central London areas a two-minute drive time was used. As noted at paragraph 103 above, there is a wide divergence in the catchment areas suggested by the survey in City Centre areas and the sample size is insufficient to be robust. In addition, the CMA notes that a two-minute drive time may be an insufficient proxy for walking distances which are more likely to reflect distances travelled by customers in Central London.

131. The CMA therefore applies a sensitivity of plus 30 seconds and, separately, minus 30 seconds to those Central London isochrones that failed the primary filter. This results in four areas falling to a combined pub share of below 35%: the Grafton Arms; the Old Star; the Adam and Eve; and the Jeremy Bentham. In addition, the CMA also notes that there remain two third party pubs geographically located between the Parties' pubs in each of the Old Star and the Adam and Eve. In addition, the Central London locations have particular characteristics, for example a high concentration of pubs and particular travel patterns given the use of Tube lines to travel. For these reasons, the CMA believes that no realistic prospect of an SLC will result from the Merger in relation to the Grafton Arms, the Old Star, the Adam and Eve and the Jeremy Bentham.

- *Survey evidence*

132. Two areas failing the primary filter (and not cleared on any other basis in the second stage assessment) were surveyed as part of the Survey: the Kings Arms, a Spirit pub located in Sandford-on-Thames, and the Travellers Joy, a Greene King pub located in the isochrone using the Bull Inn as a centroid. The CMA has therefore considered the results of the Survey in these specific areas. The CMA calculated diversion ratios between the Parties, the results of which were a diversion ratio of [X]% from the Kings Arms to Greene King and a diversion ratio of [X]% from the Travellers Joy to Spirit.

133. The CMA has not formally calculated measures of pricing pressures in these areas but in order to give an indication as to what level of diversion is likely to

result in a problematic pricing pressure measure it has requested information on margins at two of the surveyed pubs and used these as a proxy for margins in the area. The margins of the Kings Arms and the Travellers Joy indicate that the diversion ratios indicated by the Surveys are not likely to result in a GUPPI greater than 10%.

134. The CMA considers that the diversion ratios are not at a level which would generally give rise to concerns.⁴⁹
135. The CMA also notes that there is only one Spirit and one Greene King site located in the Kings Arms catchment area, and as such it may be reasonable to assume that diversion is likely to be symmetric between the parties. Therefore, the CMA considers that sufficient competition should remain to constrain the other Spirit sites in this isochrone.
136. The CMA also notes that in relation to Travellers Joy, while there is only one Greene King site located in this catchment area, there are four Spirit sites; however, the primary filter is only failed based on the Bull Inn's isochrone and not the other Spirit sites – hence these other sites are not flagged as raising competition concerns. Therefore, the CMA considers that sufficient competition should remain to constrain the other Spirit sites in this isochrone.
137. For these reasons, the CMA finds that no realistic prospect of a SLC will arise as a result of the Merger in relation to the Kings Arms and the Bull Inn.
 - *Additional competitors*
138. As explained in paragraph 89 above, the CMA applied its primary filter to dry-led pubs on the basis of a competitor set that included only Branded Food-Led, Dry-Led and Circuit Bar – Traditional Town pubs, and therefore excluded other classifications of pubs, including wet-led pubs.
139. The Parties submitted that their dry-led estates compete with wet-led pubs that have a food offering and provided the CMA with information on a local basis about such competitors. This information consisted of the following details:
 - (a) The location of the pub, including the drive time to the centroid pub and a map.
 - (b) The Parties' interpretation of the nature of the offering of the pub.

⁴⁹ In *Somerfield/Morrisons* (2005), the CC used a diversion ratio threshold of 14.3% as a sense check as to whether an SLC should arise, paragraph 7.12.

- (c) The facilities amenities available at the site, such as car parking, a beer garden, function room, etc.
 - (d) The price of a pint of beer, a pint of lager, a burger and chips, and a fish and chips.
 - (e) Links to the pubs website and photos of the exterior and interior of the pub.
 - (f) Links to TripAdvisor ratings of the pub.
140. The CMA notes that the threshold for including additional competitors in a local area is high. There have been relatively few cases where the CMA or the OFT have taken account of the constraint imposed by additional fascia/sites outside of the primary filter without direct empirical evidence of that constraint (such as survey evidence in the relevant local area). In Co-operative/David Sands (one of the few such cases), the OFT noted that:
- ‘The OFT has assessed the additional competitors on the following characteristics: geographical proximity to the parties’ stores, product offering, store size (net sales area), opening hours, parking availability and association with a multi-store operator (such as a regional chain of stores). The parties provided a range of documentary evidence to inform the OFT’s assessment of competing fascia in these six local areas based on the above criteria’.⁵⁰
141. The CMA also considers that in a phase 1 investigation it is extremely difficult to conduct an objective assessment of the non-price indicators of competition put forward by the Parties, such as images of the sites, details of amenities and menu details to determine whether they are likely to compete with the Parties’ offerings.
142. Nevertheless, the CMA recognises that in a particular area, a wet-led pub with a material and comparable food offering, the same or better facilities and comparable prices is likely to constrain the Parties in that specific area to at least some extent.

⁵⁰ ME/5317/12 Anticipated Acquisition by Co-Operative Group Limited of David Sands Limited, February 2012, paragraph 49.

143. The CMA has therefore analysed the local area information submitted by the Parties and considers that a third party pub identified by the Parties represents a realistic competitor where:
- (a) the competitor is located close to the centroid pub;
 - (b) the competitor offers the same or better facilities and amenities than the centroid pub (partly verified by TripAdvisor ratings where the third party is equal to or better than the review for the Parties); and
 - (c) where the prices for beer, lager, burgers and chips, and fish and chips are no more than 10% more expensive than the Parties.
144. However, the CMA has not applied a strict approach to each of these criteria individually but has instead considered to what extent, on the basis of all of the factors taken together and compared against each of the Parties' pubs in the relevant isochrones, it is realistic that the third party pub would be a credible alternative to customers in the event of a price rise and therefore will continue to constrain the Parties post-Merger.
- *Barley Mow*
145. The CMA's analysis resulted in two third party pubs meeting the criteria above and therefore being identified as an effective additional competitor in one local area which failed the primary filter. This is the area in which Spirit's Barley Mow was the centroid pub, located in Oxfordshire. The third party-owned Wagon and Horses pub is located five minutes from the Barley Mow. Information supplied by the Parties, and verified by the CMA, shows that beer, lager and food prices are cheaper at the Wagon and Horses than at the Barley Mow. Additionally, the Wagon and Horses has the same or better facilities than the Barley Mow and a similar rating on TripAdvisor, meaning that it satisfies all the CMA's criteria for a competitor set out above. The third party-owned Seven Stars pub is located seven minutes' drive from the Barley Mow. Information supplied by the Parties, and verified by the CMA, shows that beer and food are a slightly cheaper than in the Barley Mow, but lager is more expensive. Due to its location closer to the Barley Mow, extensive food menu priced similarly to the Barley Mow and its similar facilities to the Barley Mow, the CMA believes that the Seven Stars also represents a competitor to the Parties.
146. The CMA does not consider that the presence of these additional competitors alone is sufficient to find that there is no realistic prospect of an SLC arising in relation to the Barely Mow. However, the CMA notes that the combined pub share calculated with the inclusion of wet-led pubs on a discounted basis (see

further at paragraph 123 above) results in a combined pub share of only marginally above 35%. There are 24 other dry-led pubs and 76 wet-led pubs present in the isochrone, giving the Parties a 38% share of dry-led pubs and a 37% weighted share of all pubs. Greene King's pubs are located in partial ring around the outer periphery of the isochrone, with the closest dry-led pub seven minutes away and the furthest 15 minutes away. Spirit operated the dry-led Barley Mow, a further three dry-led pubs (one of which has been closed since January 2015) and one wet-led pub in this area. Greene King operates six dry-led pubs and 26 wet-led pubs in the isochrone. The Parties submitted that the Parties are not close competitors since two of the Spirit dry-led pubs are branded Chef & Brewer, a mid-market offering, and four of the dry-led Greene King pubs are branded Hungry Horse, a value food offering.

147. Therefore, due to the presence of a number of competitors geographically located closer to the centroid than the other Party's pub, a degree of differentiation between the Parties' offerings and the combined pub share only being marginally above 35%, the CMA believes that no realistic prospect of an SLC will arise as a result of the Merger in relation to the Barley Mow isochrone.

- *The Farmhouse*

148. The CMA additionally found that additional effective competitors existed in regards to Greene King's Farmhouse pub in Ipswich, based on the information provided by the Parties. The Parties overlap based on a ten-minute isochrone around The Farmhouse pub, with Greene King operating the centroid pub and Spirit operating the Red Lion. Both of the Parties' pubs in this area are dry-led, with the Farmhouse being branded Hungry Horse and the Red Lion branded Chef & Brewer. There are two other dry-led pubs and six wet-led pubs present in the isochrone, giving the Parties a 38.5% weighted share of all pubs.

149. Three of the pubs identified by the Parties as competitors, using the criteria set out above, are geographically closer to the centroid pub than the other merging party, with two of them (the Black Tiles and Douglas Bader) situated in between the Parties' sites. The Black Tiles is located five minutes from the Farmhouse and around two minutes from The Red Lion. Information supplied by the Parties, and verified by the CMA, shows that beer and lager are a similar price to the Farmhouse. The Black Tiles offers the same or better facilities to the Red Lion and similar food prices. Therefore, due to its location between the Parties' sites, extensive food menu priced at a similar point to the Spirit pub and its similar facilities to the Spirit pub, the CMA believes that the Black Tiles represents a competitor to the parties.

150. The Douglas Bader is located seven minutes' drive from the Farmhouse and six minutes' drive from the Red Lion. Information supplied by the Parties, and verified by the CMA, shows that beer and lager are a slightly cheaper than in the Farmhouse. Food at the Douglas Bader is more expensive than the Farmhouse but cheaper than the Red Lion. The CMA notes that the Douglas Bader offers the same or better facilities than the Red Lion. Therefore, due to its location between the Parties, extensive food menu at a price point between the Parties' sites and its similar facilities to the Red Lion, the CMA believes that the Douglas Bader represents a competitor to the parties.

151. The CMA also notes that there is a degree of differentiation between the Parties pubs in this area, one being a mid-market Chef & Brewer, and the other a value food Hungry Horse. There is also a dry-led competitor pub located closer to the centroid pub than the other party. In addition, the pub share of the Parties in this area, after the inclusion of wet-led pubs at a discounted rate, is only marginally above 35%. For these reasons the CMA believes that no realistic prospect of an SLC will arise from the Merger in relation to the Farmhouse isochrones.

- *Result of second stage analysis*

152. After the application of the factors set out in paragraph 115 above, the CMA finds that a further 40 local areas do not give rise to a realistic prospect of an SLC. However, there remain significant competition concerns in relation to the 16 local areas listed below (listed by the name of the centroid pub) for the reasons set out above. In particular, the Merger gives rise to a pub share of over 35%, even taking account of the appropriate degree of competitive constraint from wet-led pubs, the fact that the Parties' pubs are within close geographic proximity, there are no additional third party pubs which can be considered to be effective competitors on the basis of the competitive offering, and that the application of a drive time sensitivity does not alter the competitive assessment.

Table 2: 16 local areas which give rise to a realistic prospect of an SLC

<i>Centroid pub name</i>	<i>Party</i>	<i>Postcode</i>
Brewery tap	Greene King	OX145BZ
Bystander	Greene King	OX136DN
Fish	Greene King	OX144NQ
Wallingford Arms	Spirit Pub Company	OX118QJ
Shamblehurst Barn	Greene King	SO302RX
Crusader	Greene King	NG118SG
Ladygrove	Greene King	OX117SZ
Coach & Horses	Spirit Pub Company	B369AR
Fairham Hotel	Spirit Pub Company	NG118LT
Gedling Inn	Spirit Pub Company	NG43HL
Lumbertubs	Spirit Pub Company	NN36AH
Old Colonial	Spirit Pub Company	NG27RS
Raven	Spirit Pub Company	B346DR
Fox	Greene King	OX136RZ
Hare	Greene King	OX128RH
Plough	Greene King	OX128JW

Provision of overnight accommodation

153. The Parties each operate a small number of hotels as well as a number of pubs and restaurants that offer overnight accommodation.
154. At the national level, the Parties' combined market share of overnight accommodation is very small, estimated at less than [X]%.⁵¹ The CMA considers that this is not at a level at which the Merger is likely to give rise to competition concerns.
155. At a local level in there are in excess of 13 competitor hotels, inns and B&B operations present within five miles of each of the Parties' overlapping sites as set out in Table 3 below.

Table 3: Parties' overlapping sites

<i>Spirit premises</i>	<i>Number of rooms</i>	<i>Town</i>	<i>Greene King rooms</i>	<i>Distance between parties</i>	<i>Hotels within 5 miles</i>	<i>Inns/B&Bs within 5 miles</i>
Old Mill	26	Warwick	31	3.9	35	34
Ethorpe	36	South Bucks	11	3	22	14
Wheatsheaf Hotel	17	Runnymede	34	4.9	26	25
Bridge Inn	11	Wirral	32	1.6	51	19
White Rabbit	15	New Forest	11	0.2	21	25
Charnwood Arms	34	NW Leicestershire	28	3.2	6	11
Livingston Inn	13	West Lothian	10	4.1	8	14
Bay Horse	28	Wigan	40	4.6	23	8
Cross Keys	20	Redcar	28	4.4	4	9
Castle Hotel	22	Blaby	28	3.6	27	15

Source: Information provided by the Parties

156. The CMA notes the close proximity of the Parties' accommodation in the New Forest and therefore considered the location of third party providers to determine whether any competition concerns may arise. The CMA considers

⁵¹ Based upon the British Hospitality Association's figure of approximately 45,800 hotels in the UK.

that, despite the relative proximity of the Parties' accommodation sites which may suggest that they are competing closely, there are a number of third party competitors also within close proximity of the Parties' sites.

157. For these reasons the CMA considers that the Merger does not give rise to a realistic prospect of an SLC in the market for the provision of overnight accommodation on either a national or local basis.

Conclusion on horizontal unilateral effects

158. As set out above, the CMA considers that competition concerns arise in the market for the operation of pubs on a local basis in 16 local areas (listed at paragraph 152 above). Specifically, in these areas the Merger gives rise to a pub share of over 35%, even taking account of the appropriate degree of competitive constraint from wet-led pubs, the Parties' pubs are within close geographic proximity, and there are no additional third party pubs that can be considered to be effective competitors on the basis of their competitive offering. Accordingly, the CMA found that the Merger raises significant competition concerns as a result of horizontal unilateral effects in relation to the market for the operation of pubs in 16 local areas defined by catchment areas.

Vertical effects

Brewing activities

159. Greene King brews its own beer, ale, lager and stout and sells it to both on-trade customers (including its own pubs and other pub operators) and off-trade retailers (including to supermarkets such as Sainsbury's). Greene King and Spirit currently have a supply agreement under which Greene King supplies Spirit with [redacted] barrels of beer annually.
160. The CMA therefore considers whether vertical effects in the supply of beer may arise as a result of the Merger. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.
161. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in a substantial lessening of

competition in the foreclosed market(s), not merely where it disadvantages one or more competitors.⁵²

162. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors; (b) the incentive of it to do so; and (c) the overall effect of the strategy on competition.⁵³
163. In the present case, Greene King's national market share of the supply of beer and lager is very low; less than [X]% for supply to on-trade, and less than [X]% for supply to off-trade. If lager is considered separately, Greene King's national market share is less than [X]% for the supply to either on-trade or off-trade, while for other beer its national market share is approximately [X]% for the supply to on-trade and [X]% for the supply to off-trade. Similarly, on a regional basis, Greene King's share of regional markets for on-trade does not exceed [X]% and its regional share for off-trade does not exceed [X]%.⁵⁴
164. The CMA considers that Greene King would lack the ability to foreclose other pubs from access to its brewing operations due to Greene King's low upstream market share in the supply of brewing and the lack of any increment. The CMA considers that there will therefore be a significant number of other options available to customers. In addition, Greene King would lack the ability to foreclose other brewers from the supply of beer to pubs given that the combined entity will only hold a combined market share in the operation of pubs of [X]% (see further at paragraph 53), therefore not representing a significant purchaser such as to close off access to an important purchaser in the market.
165. For these reasons, the CMA considers that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in the supply of beer.

Barriers to entry and expansion

166. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might prevent a substantial lessening of competition, the CMA considers whether such entry or expansion would be timely, likely and sufficient.⁵⁴

⁵² In relation to this theory of harm 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.

⁵³ [Merger Assessment Guidelines](#), paragraph 5.6.6.

⁵⁴ [Merger Assessment Guidelines](#), from paragraph 5.8.1.

167. The Parties submit that entry barriers for pub operations are not significant, evidenced by the large number of independent pubs in the UK market. The Parties submit that annually there are over 200 new pub openings in the UK.
168. With regards to the ease of expansion, the Parties submit that expansion can be achieved through extending opening hours, adding a new menu, putting on entertainment, installing more tables/chairs and adding additional kitchen or bar staff.
169. Third parties have indicated that barriers to entry vary depending on the type of locations, as in some locations it is more difficult to find suitable site or get planning permission. Third parties generally indicated that it would take between 18 and 24 months to open a site at a cost of around £2.5 million.
170. The CMA has not been provided with sufficient evidence that entry or expansion is likely to occur in a specific local area where competition concerns arise. For these reasons set out above, the CMA considers that entry or expansion would not be sufficient to prevent a realistic prospect of a substantial lessening of competition as a result of the Merger.

Third party views

171. The CMA contacted customers and competitors of the Parties. A few third party customers raised concerns regarding local area overlaps which could reduce the level of competition in those local areas and give the merging Parties market power. These concerns have been considered by the CMA in its local area analysis set out above.

Decision

172. Consequently, the CMA 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.
173. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised pursuant to section 33(3)(b) whilst the CMA is considering whether to accept undertakings under section 73 of the Act in lieu of a reference. Pursuant to section 73A(1) of the Act, the Parties have until 18 May 2015 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If the Parties do not offer an undertaking by this date, if the Parties indicate before this date that they do not wish to offer an undertaking, or if pursuant to section 73A(2) of the Act the CMA decides by 26 May 2015 that there are no reasonable grounds for believing that it might accept the undertaking offered

by the Parties, or a modified version of it, then the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

Sheldon Mills
Senior Director, Mergers
Competition and Markets Authority
11 May 2015

ⁱ With reference to paragraph 44, the CMA wishes to note that the Parties suggested catchment areas based on distance rather than drive time, as set out in paragraph 102.

ⁱⁱ In paragraph 51, the CMA wishes to note that 'beer tie agreements' should refer to 'beer supply agreements'.

ⁱⁱⁱ With reference to paragraphs 77 and 78, the CMA wishes to note that the Parties conducted an internet survey of 42 pubs, including two pilot surveys.

^{iv} The Parties wish to note that the Parties used urban/rural classification set out in the Scottish Government Urban/Rural classification 2013-2014.

ANNEX 1

Table A1: Areas failing the primary filter

<i>Pub name</i>	<i>Party</i>	<i>Postcode</i>
Grafton Arms	Greene King	W1T5DU
Old Star	Greene King	SW1H0DB
65 & King	Spirit Pub Company	W24UJ
Adam & Eve	Spirit Pub Company	SW1H9EX
Jeremy Bentham	Spirit Pub Company	WC1E6JL
Glass Horse	Greene King	WA95DW
Brewery Tap	Greene King	OX145BZ
Bystander	Greene King	OX136DN
Fish	Greene King	OX144NQ
Tommy Flynn's Bar & Steakhouse Grill	Greene King	HA01ET
Wallingford Arms	Spirit Pub Company	OX118QJ
Ship Inn	Spirit Pub Company	SK94JE
Farmhouse	Greene King	IP52GA
Kittoch	Greene King	G744US
Shamblehurst Barn	Greene King	SO302RX
Badger Box	Greene King	NG179BX
Beekeeper	Greene King	NG95AE
Crusader	Greene King	NG118SG
Gypsy Queen	Greene King	S201FW
Tree Tops	Greene King	NG35RF
Wheelhouse	Greene King	NG82BH
Monk's Bridge Farm	Greene King	S253QB
Elmwood Farm	Greene King	S201DJ
Ladygrove	Greene King	OX117SZ
Tandem	Greene King	OX15PG
Golden Pheasant	Greene King	DE249EE
Phoenix	Greene King	S123XF
Sherwood	Greene King	S124WG
Queen	Greene King	SO239PG
Belfry	Spirit Pub Company	S201EQ
Blue Bell	Spirit Pub Company	NG96DN
White Cart	Spirit Pub Company	G768HX
Ye Olde Swan	Spirit Pub Company	MK63BS
Bowman	Spirit Pub Company	NG157PY
Broadway	Spirit Pub Company	WV125UJ
Bull Inn	Spirit Pub Company	SS54RN
Carr Mill	Spirit Pub Company	WA119AD
Coach & Horses	Spirit Pub Company	B369AR
Drakehouse Mill	Spirit Pub Company	S207JJ
Fairham Hotel	Spirit Pub Company	NG118LT
Friar Tuck	Spirit Pub Company	NG56NW
Gedling Inn	Spirit Pub Company	NG43HL
Gynsills	Spirit Pub Company	LE38HB
Kings Arms	Spirit Pub Company	OX44YB
Lumbertubs	Spirit Pub Company	NN36AH
Museum Inn	Spirit Pub Company	CA27QJ
New Florence	Spirit Pub Company	ST34TP
Old Colonial	Spirit Pub Company	NG27RS
Raven	Spirit Pub Company	B346DR
Ridgeway Arms	Spirit Pub Company	S205AZ
Royal Oak	Spirit Pub Company	RG315NW
Bridge Inn	Greene King	BS494AU
Barley Mow	Spirit Pub Company	OX143EH
Fox	Greene King	OX136RZ
Hare	Greene King	OX128RH
Plough	Greene King	OX128JW