

**COMPLETED ACQUISITION BY COTT BEVERAGES LIMITED OF
MACAW (HOLDINGS) LIMITED**

Provisional findings report

Published: 28 March 2006

The Competition Commission has excluded from this published version of the provisional findings report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

Provisional findings report

Acquisition of Macaw (Holdings) Ltd by Cott Beverages Ltd

Contents

	<i>Page</i>
Summary.....	3
Provisional findings	8
1. The reference	8
2. Industry background and the companies	8
Overview of the soft drinks industry	8
Soft drink types and consumption trends	8
Major soft drink producers.....	10
CSD production	11
CSD packaging	15
Retailing of own-label CSDs	15
Retail offerings of own-label CSDs.....	15
Retailer sourcing of own-label CSDs.....	19
Cott Beverages Limited.....	22
Macaw (Holdings) Limited.....	24
Other soft drink producers.....	25
3. The merger.....	27
Rationale for the transaction	27
Transaction process and structure of the merged firm.....	28
Jurisdiction	29
4. Market definition	30
Own-label CSDs.....	30
Own-label CSDs: product dimension	31
Own-label PET-bottled CSDs: geographic dimension.....	46
Other soft drinks.....	49
Own-label PET-bottled aseptic drinks	49
Own-label PET-bottled still drinks, DTT drinks, and bottled water	50
Conclusions on market definition	50
5. Pre-merger competition.....	51
Own-label PET-bottled CSDs.....	51
Market shares.....	51
Pre-merger competition between suppliers of own-label PET-bottled CSDs for different customers.....	54
Retailer-supplier relationships	56
Spare capacity.....	66
Expansion and entry.....	69
Other soft drinks	74
6. Counterfactual	75
7. Effects of the merger	76
Own-label PET-bottled CSDs.....	76
Unilateral effects.....	77
Coordinated effects	81
Own-label canned CSDs and other soft drinks	82
Provisional conclusions.....	84

Appendices

- A Terms of reference and conduct of the inquiry
- B Analysis of end-consumer elasticities
- C Analysis of buyer power
- D Costs of production modification and new entry
- E Production capacity

Glossary

Summary

1. On 28 November 2005 the OFT referred the completed acquisition of Macaw (Holdings) Limited (Macaw) by Cott Beverages Limited (Cott) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act (the Act). Our terms of reference are set out in Appendix A. We are required to publish our final report by 15 May 2006.
2. Cott supplies own-label and tertiary branded carbonated soft drinks (CSDs) in Polyethylene Terephthalate (PET) bottles and aluminium cans, as well as Dilute-to-taste (DTT) and still drinks. It also undertakes contract packing on behalf of third party brand owners. Macaw predominantly supplied own-label PET-bottled CSDs with a limited portfolio of tertiary brands and contract packing. Prior to the merger, Cott and Macaw were the two largest producers of own-label CSDs in the UK and the third and fourth largest producers of CSDs in total.
3. We considered that the relevant market for own-label PET-bottled CSDs could be defined in terms of the production capacity that could be used to produce own-label PET-bottled CSDs at short notice (ie less than one year). The capacity that should be included in this market includes the production lines that are currently producing own-label PET-bottled CSDs and all other production lines that are currently capable of producing PET-bottled CSDs at suppliers of own-label CSDs. It may also include production lines at own-label CSD suppliers that could produce PET-bottled CSDs with some conversion costs. We considered that the geographic market for the supply of own-label PET-bottled CSDs is Great Britain.
4. Despite the high level of supplier concentration in the market prior to the merger, the indicators of competitive outcomes for this market show no evidence of any of the suppliers earning profits from their own-label PET-bottled CSD business in excess of

their cost of capital. Taken together, these indicate a pre-merger situation characterized by prices being set at no higher than competitive levels, and a lack of evidence of market power being exercised by suppliers.

5. Cott's acquisition of Macaw has significantly increased its share of the market in Great Britain for the supply of own-label PET-bottled CSDs. Post-merger, Cott has a market share of around 50 per cent based on its share of production capacity, or 65 per cent based on its share of sales by volume. The two firm concentration ratio has increased from 65 to 89 per cent based on sales volumes. The increase in Cott's market share as a result of the merger is, on the face of it, a significant cause for concern that the merger might lead to a significant lessening of competition (SLC) on either a unilateral or coordinated effects basis.
6. Cott's ability to increase prices unilaterally following the merger depends on the extent to which it is constrained by:
 - (a) the bargaining power of retailers with respect to Cott;
 - (b) the volume of spare capacity at competing suppliers of own-label PET-bottled CSDs; and
 - (c) the threat of entry by new competitors or expansion by existing competitors.
7. Prior to the merger, retailers had significant bargaining power over suppliers of own-label PET-bottled CSDs in the negotiation of prices and other conditions of supply. This is due to some combination of the effective dissemination of the effects of buyer power from large retailers to smaller retailers and the presence of other factors that also provide large and small retailers with effective bargaining power over suppliers. These factors include:
 - the ease with which retailers can switch suppliers;
 - the competitive impact of suppliers' bidding for retailers' business;

- the flexibility of retailers' buying strategies;
- the importance to suppliers of sales volumes;
- the importance to suppliers of retailers' own-label brands; and
- the non-critical nature of own-label CSDs for the smallest retailers and wholesalers.

8. We do not consider that the merger of Cott and Macaw affects the factors set out above that contribute to retailers' bargaining power or any possible dissemination of the effects of buyer power from large retailers to smaller retailers. Retailers will continue to be able to switch easily between suppliers of own-label PET-bottled CSDs, subject to any capacity constraints. Retailers will continue to have considerable control over the price determination process. Sales volumes of own-label brands for both large and smaller retailers will continue to be a key driver of suppliers' profitability and retailers will continue to own the brands that constitute the overwhelmingly dominant route to market for own-label CSD suppliers. Finally, own-label CSDs will continue to be subject to the possibility of delisting by the smallest retailers and wholesalers.

9. For Cott to be able to increase prices unilaterally and profitably following the merger, it would need its competitors to be at or close to full capacity such that they would not be able to attract significant volumes of business by undercutting Cott's increased prices. Given the volumes of spare capacity available, under existing work patterns, at Cott's post-merger competitors, any increase in price by Cott would be likely to result in its competitors not only using existing spare capacity but also taking measures to increase the volume of spare capacity available to them and thus undercut any price increase that Cott sought to impose.

10. We considered the threat of entry by suppliers of other own-label PET-bottled soft drinks, primary branded CSDs and also foreign suppliers. In each case we concluded that entry into the supply of own-label PET-bottled CSDs is unlikely. Sponsorship of new entry by a retailer might assist in addressing the risks associated with this investment. However, we are unable to form an expectation that retailers would sponsor new entry in response to increased prices. Expansion by an existing competitor in own-label PET-bottled CSDs may be more likely than entry. While existing suppliers will be well informed about current market conditions, we consider that they are likely to have difficulty in forecasting capacity utilization due to the short-term nature of supply agreements and the ease with which retailers can switch suppliers and that this would limit any expansion by existing competitors. As a result, it may only have a limited impact in terms of increasing total production capacity and thus in constraining Cott's ability to increase prices unilaterally.

11. Following the merger, there has been a significant increase in concentration among suppliers of own-label PET-bottled CSDs. This has been a source of concern. However, we conclude that retailers' bargaining power together with the degree of spare capacity available for the production of own-label PET-bottled CSDs, and to a lesser extent, the possibility of expansion by existing competitors will, on balance, constrain Cott's ability to increase prices unilaterally or otherwise exercise market power. We provisionally find that the merger of Cott and Macaw has not and may not be expected to result in an SLC in the market for own-label PET-bottled CSDs in Great Britain as a result of the unilateral exercise of market power.

12. In the absence of a finding that unilateral effects are likely to follow from the merger, we considered whether coordinated effects might arise. We recognized that a higher concentration of suppliers may result in a greater risk of coordinated behaviour. However, we heard no evidence to suggest that there had been any history of

coordination in this market in recent years nor any suggestion that the merger would be likely to lead to coordination. We consider that retailers' bargaining power is also a key reason for considering that coordinated effects would not arise following the merger. In particular, retailers could take advantage of the flexibility of their buying strategies through, for example, offering greater volumes of business in a single tender, offering longer supply periods, or altering tender processes, to create sufficient incentive for a supplier to deviate from coordinated behaviour. As a result, we provisionally find that the merger of Cott and Macaw has not and may not be expected to result in an SLC as a result of the coordinated exercise of market power.

13. We provisionally find that the acquisition of Macaw by Cott constitutes a relevant merger situation. We also provisionally find that the acquisition of Macaw by Cott has not resulted and may not be expected to result in an SLC within any market or markets in the UK.

Provisional findings

1. The reference

1.1 On 28 November 2005 the OFT referred the completed acquisition of Macaw by Cott to the CC for investigation and report. The reference was made under section 22 of the Act. Our terms of reference are set out in Appendix A. We are required to publish our final report by 15 May 2006.

1.2 This document, together with its appendices, constitutes our provisional findings in respect of this reference, which we are required to notify to Cott under the CC's Rules of Procedure. Further information, including non-sensitive versions of written submissions and summaries of third-party arguments and views can be found on our website.¹ We refer to these documents as appropriate.

2. Industry background and the companies

2.1 In this section we, first, set out the major features of the soft drinks industry, focusing on CSDs, second, discuss retailing arrangements for own-label CSDs, third, detail the companies that are the subject of this inquiry, and finally, identify other providers of soft drinks.

Overview of the soft drinks industry

Soft drink types and consumption trends

2.2 Soft drinks comprise a wide range of non-alcoholic beverages, including CSDs, still drinks (aseptic and non-aseptic), juices and juice drinks, DTT drinks, and bottled waters (still and sparkling). Table 1 describes these different products and provides examples of branded products in each of these categories.

¹www.competition-commission.org.uk.

TABLE 1 Soft drink categories and product examples

<i>Product type</i>	<i>Description</i>	<i>Examples of branded products</i>
CSDs	Includes colas, lemonades and other flavours, mixers, some energy drinks, carbonated flavoured waters	Coca-Cola, Pepsi, Fanta, Irn Bru
Still drinks	Juice based drinks (5 to 25 per cent juice content), flavoured waters, iced teas, sports and energy drinks	Sunny D, Powerade, Lucozade Sport
Aseptic still drinks	A form of still drink that contains no preservatives. The product is flash heat treated and cooled rapidly. Includes fruit drinks, flavoured waters and some energy drinks	H2, Juice Patrol
Juice drinks	Non-carbonated drinks containing 25 per cent or more juice	Libbys, Ocean Spray, Tropicana
DTT drinks	Squash and other cordials (10 to 50 per cent juice content), sold in concentrate form for dilution with water	Robinsons
Bottled water	Still and sparkling (i.e. carbonated) water from springs and treated water sources	Evian, Highland Spring

Source: CC analysis

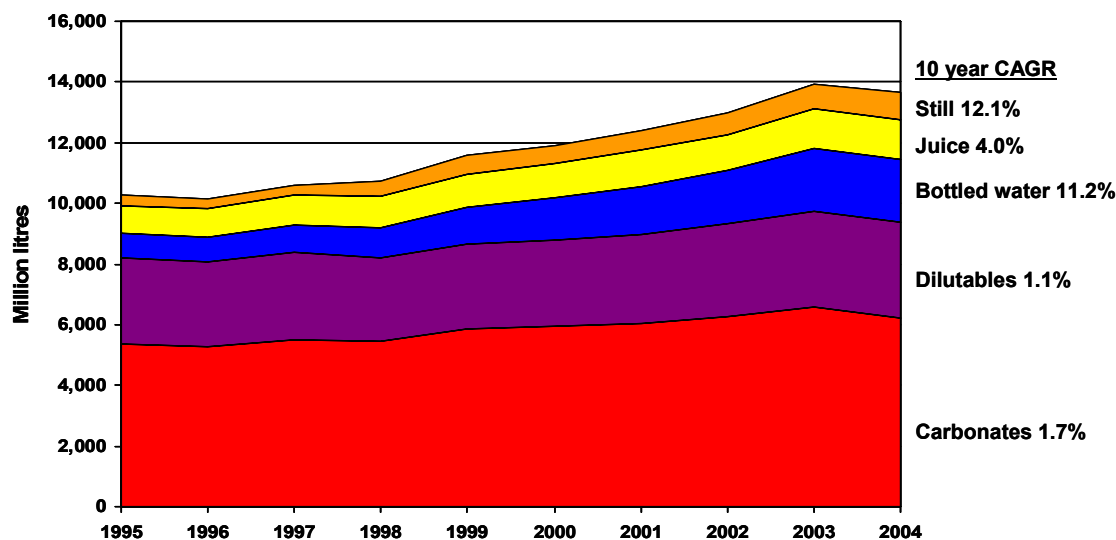
2.3 Whilst carbonated flavoured waters are CSDs, they are differentiated from more traditional CSDs at present by being branded as bottled water; thereby enjoying a healthier image and, it seems, higher margins. The evidence we received suggested that this situation is unlikely to change in the short to medium term. For the purposes of this inquiry, we use the term ‘CSDs’ to refer to the more traditional products and deal separately with sparkling flavoured waters.

2.4 UK soft drink consumption in 2004 was 13.7 billion litres or 230 litres per person (see Figure 1).² CSDs account for 46 per cent of the market by volume. Over the last ten years soft drink consumption has grown on average by some 3.9 per cent a year. Within the overall soft drinks segment, annual growth in still drinks and bottled water has been high at 12.1 per cent and 11.2 per cent, respectively, while annual growth in CSDs and DTT drinks has been low, at less than 2 per cent, and approximately 1 per cent, respectively.

²Zenith International, *Zenith Report on UK Soft Drinks Industry*, July 2005.

FIGURE 1

UK soft drink consumption, 1995 to 2004



Source: Zenith International, *Zenith Report on UK Soft Drinks Industry*, July 2005.

Note: Dilutables at five times concentrated volumes.

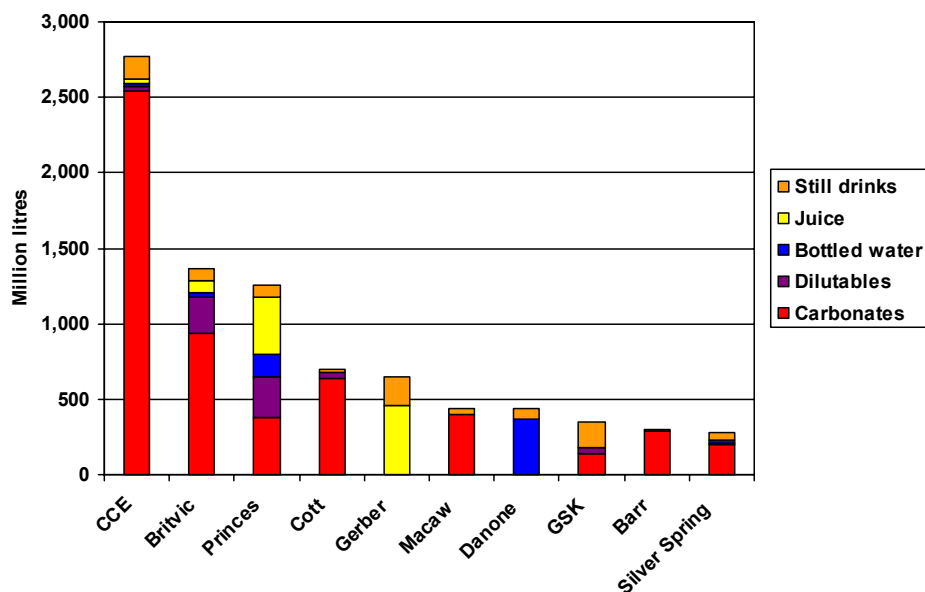
2.5 A number of parties told us that the lower rates of growth in CSDs and DTT drinks reflected public perceptions of the relative healthiness of sport and energy drinks (types of still drink), as well as bottled water, compared with CSDs. Many parties indicated that they expected this trend to continue into the future.

Major soft drink producers

2.6 Major soft drinks companies in the UK, in addition to Cott and Macaw, include CCE, Britvic, Princes, Gerber, Danone, GSK, AG Barr and Silver Spring. FIGURE 2 shows 2004 production volumes for these companies by soft drink category. Further details on Cott are provided in paragraphs 2.36 to 2.41, Macaw in paragraphs 2.42 to 2.46, and other soft drink companies in paragraphs 2.47 to 2.50.

FIGURE 2

UK soft drink production by company, 2004



Source: Zenith International, Zenith Report on UK Soft Drinks Industry, July 2005.
 Note: Dilutables at concentrated volumes.

Supply of CSDs

2.7 CSD supply involves a number of functions, including brand development, product (or recipe) development, physical production of the CSD, and ultimately, its sale to end-consumers. These different functions can be integrated within firms to different degrees and in different combinations. The following describes four common ways of combining these functions.

- (a) Own-label CSDs—the retailer³ is the brand owner and product development is undertaken cooperatively between the retailer, producer and, typically, an independent flavour house.⁴ Most retailers will have an own-label CSD offering. Cott and Macaw are major producers of own-label CSDs as are Princes and

³We define the term ‘retailer’ in paragraph 2.15 below.

⁴Flavour houses are companies which develop flavourings for the food and beverage industry. Flavour houses that work with the soft drinks industry include Frutarom UK Ltd and Belmay Ltd.

Silver Spring. Own-label CSDs represent around 25 per cent of total CSD production volumes.⁵

- (b) 'Primary' branded CSDs—CSD production and brand ownership is integrated in a single company. Leading producers of primary branded CSDs in the UK are CCE (producing primary brands such as Coca-Cola, Fanta, Lilt, Dr Pepper, Sprite and Schweppes), Britvic (Pepsi, 7-Up, R Whites and Tango), GSK (Lucozade) and AG Barr (Irn Bru and Tizer).⁶ Primary branded CSDs represent approximately 65 per cent of total CSD production volumes.
- (c) 'Tertiary' branded CSDs—as with primary branded CSDs, CSD production and brand ownership is integrated in a single company. A major difference between tertiary and primary branded CSDs is that tertiary brands are not promoted to the same degree and are often priced at a similar level to own-label CSDs. Tertiary brands are generally owned by producers of own-label CSDs, including Cott and Macaw, but may also be owned by producers of primary branded CSDs. Tertiary branded CSDs represent no more than 8 per cent of total CSD production volumes.
- (d) Contract packed CSDs—the CSD brand is owned by a company focused on brand and product development and promotion, while production is outsourced. Third party brand owners that outsource production include Virgin (Virgin Cola) and Nichols (Vimto).⁷ Contract packing is generally undertaken by the same firms that produce own-label CSDs. Contract packed CSDs represent approximately 2 per cent of total CSD production volumes.

2.8 In comparison with branded CSDs, very little, if any, intellectual property resides with an own-label CSD producer. Recipes for own-label CSDs are either owned by the

⁵These volumes are CC estimates based on 2004 data in Zenith International, Zenith Report on UK Soft Drinks Industry, July 2005.

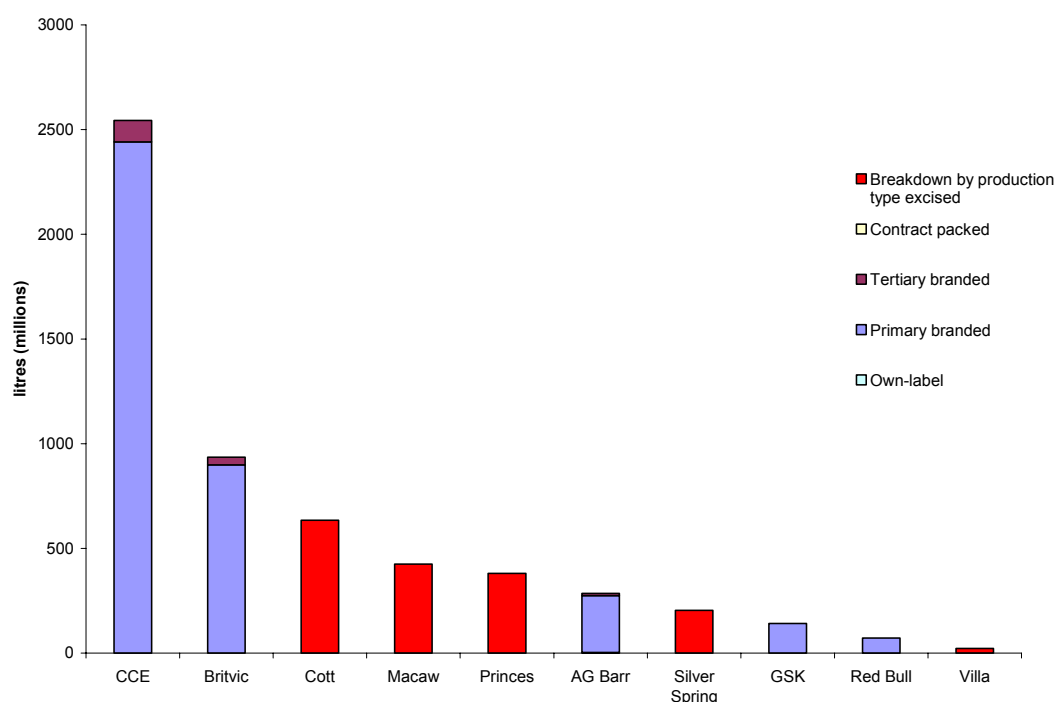
⁶In some cases marketing and production of primary brand CSDs is outsourced to a bottling company under a long-term contract, which creates a finished product from a syrup provided by the brand owner. For example, Coca-Cola is bottled by CCE in the UK and Pepsi is bottled by Britvic.

⁷Virgin Cola is produced by Princes, while Vimto is produced by Cott. GSK also outsources some of its CSD production.

retailer or can be duplicated by other own-label CSD producers in cooperation with a flavour house. Ownership of the brand resides with the retailer. These factors contribute to the ease with which retailers can switch between own-label CSD suppliers (see paragraphs 5.20 to 5.23).

FIGURE 3

CSD sales volumes by company, UK, 2004



Source: Zenith International, *Zenith Report on UK Soft Drinks Industry*, July 2005; CC analysis of company data.

Note: Shares of CSD production volumes devoted to primary and tertiary brands, own-label and contract packing in some cases represent CC estimates. Also, there may be a small amount of double counting of GSK production volumes in contract packed production volumes for Cott.

2.9 FIGURE 3 shows UK CSD sales volumes by company. CCE is the largest producer of CSDs overall as well as the largest producer of branded CSDs. Branded CSDs make up more than 95 per cent of total CSD production for both CCE and Britvic.⁸

⁸In 2004, sales of the Coca-Cola brand range, Fanta, Schweppes, Sprite, Dr Pepper and Lilt constituted 96 per cent of CCE's sales by volume. The remaining 4 per cent of CCE's CSD sales were from the Appeltiser, Burn, Canada Dry, Cresta and Grapetiser ranges. A number of third parties described Cresta as a tertiary brand that could be used to compete with own-label CSDs. For Britvic, in 2004, 62 per cent of sales by volume was generated by Pepsi Cola, 7 per cent by 7 Up, 17 per cent by Tango, 10 per cent by R Whites and the remaining 4 per cent by other CSD brands, including Britvic, Britvic 55, Red Card, Red Devil and Shandy Bass (Source: Zenith International, *Zenith Report on UK Soft Drinks Industry*, July 2005).

Prior to the merger, Cott and Macaw were the two largest producers of own-label CSDs in the UK and the third and fourth largest producers of CSDs in total.

- 2.10 We were told by a number of third parties that the long-term trend among CSD producers in the UK has been one of consolidation. The MMC inquiry into carbonated drinks in 1991⁹ found that there were almost 100 CSD suppliers other than CCE and Britvic. Twelve of these suppliers had market shares in value terms of 1 to 6 per cent, while the rest mostly supplied local markets and accounted for about 4 per cent of the market in value terms between them. One third party told us that consolidation at the retail level and the closure of corner shops had led to consolidation at the supplier level as retailers wanted to deal with fewer suppliers. Two large retailers [redacted] told us that sourcing from fewer suppliers reduced complexities in buying and was usually more economic for suppliers, who could therefore offer a more competitive price.
- 2.11 In most cases, this process of consolidation has led to small family-owned firms either exiting the industry or being purchased by larger producers (such as Cott or Princes). Recent industry exits include Brooks, which went into voluntary liquidation in 2005, and Crystal, which went into administration, also in 2005. In 2004, Nichols outsourced its CSD production to Cott while retaining its ownership of the Vimto brand. Hall & Woodhouse similarly outsourced CSD production in 2004.
- 2.12 Macaw was relatively unusual in that it was a new entrant that commenced its operations on a 'greenfield' production site, unlike Cott, which purchased existing suppliers as a means of entry. Even as a new entrant, though, the majority shareholder in Macaw, Mr Andrew Cawthray, had a family background in the industry.

⁹MMC Report on Carbonated drinks: Cm 1625.

CSD packaging

- 2.13 CSDs are primarily sold in PET¹⁰ bottles or aluminium cans.¹¹ PET bottles come in a range of sizes, including 250 ml, 500 ml, 1 litre and 2 litres, while cans are generally 330 ml in size. In addition to different sizes, bottles and cans may be sold individually or as part of a multi-pack. Common multi-pack formats include six-packs of cans, six-packs of 250 ml bottles, three-packs of 1 litre bottles and two- or four-packs of 2 litre bottles.
- 2.14 Own-label CSDs are sold in both PET bottles and cans, and across all bottle sizes. Own-label CSDs in cans and smaller bottle sizes (250 ml and 500 ml) are generally sold as multi-packs rather than individually.¹² Around one-half [X] of Cott's own-label sales by volume are in 2 litre PET bottles and around a further one-quarter [X] in 1 litre PET bottles. Around 10 per cent [X] of its own-label CSD sales by volume are in cans. Relatively small volumes of own-label PET-bottled CSDs are sold in 250 ml [X], 500 ml [X] and other bottle sizes [X].
- 2.15 The share of sales by volume in cans increases significantly once Cott's tertiary brands and contract-packed CSDs are taken into account, with the share of total sales by volume in cans increasing from [X] per cent to [X] per cent. However, 2 litre PET bottles remain the most important packaging size ([X] per cent).¹³

Retailing of own-label CSDs

Retail offerings of own-label CSDs

- 2.16 Approximately 20 major purchasers of own-label CSDs were identified during the inquiry. These included:

¹⁰Polyethylene Terephthalate, ie the plastic used to make soft drink bottles.

¹¹Small volumes of CSDs are also sold in glass bottles. Neither of the producers of own-label CSDs that are the subject of this inquiry sells CSDs in glass bottles.

¹²Sales in individual bottle sized 500ml or less or in individual cans are predominantly primary branded CSDs.

¹³As we do not have industry-wide data, the Cott figures are the best available proxy for total own-label CSD market shares for these different packaging types. However, given that Cott is one of only two producers of canned own-label CSDs, Cott's production figures will overstate the share of canned own-label CSDs compared to the market as a whole.

- multiple grocery retailers (i.e. supermarkets), including the four large supermarket chains (ASDA, Morrisons, Sainsbury's and Tesco,) and smaller supermarket chains (such as Lidl, M&S and Waitrose);
- buying groups (such as Nisa); and
- grocery wholesalers including cash and carry operators (such as Bookers).

In this report, unless otherwise specified, we use the term 'retailer' to refer collectively to all purchasers of own-label CSDs, 'large retailer' to refer to the four large supermarket chains, and 'smaller retailer' to refer to all remaining purchasers.

2.17 For most retailers, own-label CSDs are an essential part of their overall offering to customers. Annual purchases of own-label CSDs by retailers from their suppliers are set out in Figure 4.

FIGURE 4

Volume of own-label CSD purchases by retailer, 2005, estimated



Source: CC analysis of questionnaire responses.

2.18 The four large retailers purchase significantly larger volumes of own-label CSDs than other retailers and, together, account for nearly three-quarters of all own-label CSD purchases. (Each of the four large retailers purchases 10 [✂] to 20 [✂] million

cases of own-label CSDs a year compared with up to five million cases¹⁴ for the smaller retailers.)

- 2.19 In addition to purchasing greater volumes, larger retailers offer a broader range of own-label CSDs. The four large retailers, on average, have approximately 100 stock keeping units (SKUs) for own-label CSDs.¹⁵ Smaller retailers maintain a smaller number of own-label CSD SKUs (ranging from 5 to 70). In many cases, this will reflect smaller average store sizes and more limited shelf space. For some of the smallest retailers and wholesalers, an own-label CSD offering may be less critical. We discuss this further in paragraph 4.44. These retailers may be more likely to sell tertiary branded CSDs.
- 2.20 The difference in the scope of own-label CSD offerings between larger and smaller retailers is reflected in the range of flavours and packaging variations, and the level of quality differentiation within their own-label CSD offering. For example, larger retailers may offer certain own-label CSDs in standard, value (cheapest on display) and premium ranges.
- 2.21 CSDs in the value range tend to be limited to common flavours, such as cola and lemonade, and packaged in 2 litre PET bottles. Premium offerings also tend to be limited in flavours. There are examples of premium offerings in colas, mixers and traditional lemonades.
- 2.22 Table 2 shows indicative retail prices for 2 litre PET bottles of own-label and primary branded CSDs. There is a major difference in the price of own-label and branded CSDs. The size of this difference varies across flavours with branded colas, for

¹⁴A case usually consists of around 12 litres eg six 2 litre bottles or 12 1 litre bottles.

¹⁵Each SKU is a unique identifier for a single product line. In the case of a retailer's own-label CSDs, every combination of flavour and packaging type will have its own SKU, for example, its own-label PET-bottled 2 litre cola will be one SKU, while its own-label PET-bottled 2 litre lemonade will be another SKU. Numbers of SKUs are estimated based on CC analysis of questionnaire responses.

example, able to sustain a significantly greater price premium over own-label colas compared with branded as against own-label lemonades.¹⁶

TABLE 2 Indicative price ranges for own-label and branded CSDs (PET-bottled, 2 litres)

<i>Product</i>	<i>Indicative price</i>	<i>Product examples</i>
Cola		
Value (own-label CSD)	15–20p	Tesco Value, Sainsbury's Economy
Standard (own-label CSD)	35–40p	Tesco's Cola, ASDA Cola
Premium (own-label CSD)	65–70p	Sainsbury's Classic Cola
Primary brand	135–140p	Coca-Cola
Lemonade		
Value (own-label CSD)	15–20p	Tesco Value, Sainsbury's Economy
Standard (own-label CSD)	25–30p	ASDA Lemonade
Premium (own-label CSD)	35–40p	ASDA Traditional Lemonade
Primary brand	85–90p	R Whites
Energy		
Standard (own-label CSD)	70–75p	Tesco's Active Glucose Drink, ASDA Energy Drink
Primary brand	100–150p	Lucozade

Source: Product prices quoted on retailer websites: www.asda.com, www.tesco.com, www.sainsburystoyou.com, 28 February 2006.

Note: Energy drinks are sold in 1 litre bottles.

2.23 A number of CSD suppliers seek to assist retailers in determining the scope of their CSD offer, including both branded and own-label CSDs, through offering category management services. CCE said that it was involved in 'category planning' in partnership with retailers of all sizes and that this involved using customer data to maximize category growth. Princes told us that it offered category management to all of its customers, and had recently been involved in providing this service to [X]. Neither Cott nor Macaw, however, has extensive involvement in category management. Retailers indicated that the category management services offered by CSD suppliers were not particularly influential in their decision-making.¹⁷

¹⁶Retail prices, particularly for branded CSDs, are subject to periodic discounting, including deep discount promotions, such as 'buy one, get one free' offers meaning that indicative retail prices may not provide the full picture. More detailed analysis of price differences between branded and own-label drinks is set out in paragraph 4.33 and Annex B.

¹⁷This is of further relevance in our consideration of how retailers might react to increases in the price of own-label CSDs (see paragraphs 4.40 to 4.42).

Retailer sourcing of own-label CSDs

- 2.24 Own-label CSD sourcing, for most retailers, is strongly focused on obtaining the lowest possible price.¹⁸ A primary driver for this is the competition between retailers in their pricing of own-label CSDs for sale to end-consumers. Retail-level competition in own-label CSDs is enhanced by the inclusion of own-label CSDs in retailers' Known Value Items (KVIs).¹⁹
- 2.25 To minimize purchase prices, retailers will either negotiate directly with suppliers or conduct tenders. Prices are negotiated individually with customers, rather than suppliers selling on the basis of price lists. Tenders may be conducted either through paper submission or electronically via an e-auction.²⁰ Some, although not all, industry participants regard e-auctions as the most effective means of securing the lowest price from suppliers.²¹ Where an e-auction is conducted, this may be followed by a further round of direct negotiation before any supply agreement is finalized.
- 2.26 In procuring own-label CSDs, large retailers tend to use more than one supplier for their various SKUs and in some cases they split the procurement of individual SKUs between suppliers.²² Smaller retailers, however, are more likely to use a single own-label CSD provider.²³

¹⁸Nine retailers [X] told us that price was a key factor in choice of supplier for own-label CSDs. Other factors mentioned by these retailers as being taken into account in the choice of supplier include product quality (by seven retailers) [X], capacity (by three retailers) [X], service levels (by three retailers) [X], innovation (by two retailers) [X] and security of supply (by two retailers) [X].

¹⁹KVIs are grocery items for which there are high levels of consumer awareness of the normal retail price, and which are therefore a particular focus of comparisons and competition between retailers.

²⁰An e-auction is an electronic auction. It typically involves a retailer pre-selecting a number of suppliers to tender for a collection, or lot, of SKUs. These suppliers then compete in an online auction which takes place at a set time and for a set period. Bidding starts at a price that is typically below the retailer's current purchase price and suppliers bid the price down to the lowest price at which any supplier is willing to accept.

²¹For example, [X] told us that e-tendering had enabled retailers to reduce costs for supply of own-label CSDs. It anticipated that these lower prices would form the basis for future procurement processes. At a hearing, Villa told us that the entry price for an e-auction was generally set at either the current price or lower so to have a chance of maintaining the business the supplier generally had to take a price cut even if there was no-one else bidding. There is, however, no reason, in principle, why an e-auction should be more successful in achieving lower prices than a paper-based tender.

²²An example of this latter form of multi-sourcing has been the supply of Classic Cola to Sainsbury's, where 2 litre PET bottles were sourced from both Cott and Macaw.

²³In their response to a CC questionnaire, four retailers [X] told us that they multi-sourced their supply of own-label CSDs, while three retailers [X] told us that they did not multi-source due to their low volume requirements.

2.27 A supply agreement for own-label CSDs will set prices but retailers do not make any volume commitments to their suppliers. The actual agreement between the retailer and the supplier can be relatively informal. Three retailers [X] told us that formal agreements or written contracts with suppliers were rare. One of these [X] told us that most negotiations were not formally documented.

2.28 Supply agreements for own-label CSDs are typically subject to annual review.²⁴ Retailers' focus on price appears to be the main factor leading to the short duration of these supply agreements. At the end of a 12-month period, a retailer may continue the existing supply agreement at the existing price, extend it at a reduced price (often as a result of threatening to re-tender the business), or put the business out to tender. Any attempt by a supplier to increase prices either as a means of improving margins or passing through cost increases is likely to be met by a re-tender of supply by the retailer although we were given a very few examples of retailers accepting cost-based price increases.²⁵

2.29 Once an agreement is in place, retailers may ask their suppliers for one-off financial contributions or otherwise change conditions of supply to their advantage. Suppliers may be told that failure to meet these requests will lead to a re-tendering of the retailer's own-label CSD purchases. Examples of these kinds of requests include the following:

- Villa Soft Drinks told us that when one of its customers [X] took over another retailer [X], it demanded that all suppliers pay an additional rebate expressed as a percentage of sales or risk losing their business. The customer subsequently de-merged the two businesses but the rebate was still required.

²⁴Five retailers [X] told us that agreements for the supply of own-label CSDs were of 12 months' duration or on a rolling basis or subject to annual review. Two retailers told us that their agreements for the supply of own-label CSDs were for two to three years [X]. Princes also told us that own-label supply agreements typically lasted for 12 months.

²⁵In March 2006 Tesco commenced negotiating new supply agreements for its own-label PET-bottled CSDs [X]. Princes had, one year ago, been able to secure the Tesco business by offering a substantial reduction on existing prices. Part of the reason the Tesco business had been put out to tender at that time had been the request for a price increase by one of its then suppliers, [X] as a means of passing on increased PET costs.

[✂]

2.30 We considered the extent to which retailer behaviour was influenced by the Supermarket Code of Practice, which has been in effect since March 2002. The Supermarket Code of Practice was negotiated by the Office of Fair Trading following the CC's investigation into the supply of groceries from multiple stores in the United Kingdom. The Code was adopted by all retailers then enjoying at least an 8 per cent share of grocery purchases for resale from their stores, namely ASDA, Sainsbury's, Safeway, and Tesco.²⁶ The aim of the Code is to prevent the undue exercise of buyer power by supermarkets, in the circumstances identified in the CC's Supermarkets Report,²⁷ that has effects which were deemed to be against the public interest. However, the Code is not intended to restrict *countervailing* buyer power in relation to suppliers that may have the ability to exercise market power. Countervailing buyer power in relation to own-label CSDs is discussed in paragraphs 5.34 to 5.46.

2.31 Although this is not the subject of our inquiry, it seems that certain retailer practices in relation to their supply of soft drinks may not be consistent with the Supermarket Code of Practice. In some cases, however, the Code does not apply to the retailers concerned.

2.32 The general pattern in terms of retailer procurement of own-label CSDs is one of:

- retailers having an intense focus on prices with retailers regularly seeking price reductions;
- frequent re-tendering or threats to re-tender by retailers as a means of securing lower prices; and

²⁶Somerfield's market share was found by the CC to be above the 8 per cent threshold but this had fallen below 8 per cent by the time the CC reported and remedies were sought.

²⁷ CC, *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*, Cm4842, 2000.

- a shifting of costs and risks, where possible, by retailers on to suppliers.

2.33 Retailers' focus on achieving reduced prices from suppliers has resulted in suppliers looking to re-formulate their own-label CSD products so as to reduce costs and thus maintain margins. We discuss suppliers' margins and profitability further in paragraph 5.7.

2.34 The general pattern outlined in paragraph 2.32 is not significantly differentiated between small and large retailers. However, there are some retailers that do take a different approach to sourcing own-label CSDs. [redacted], for example, historically appears to have been less aggressive in its approach to suppliers. [redacted] Waitrose told us that it may be possible to save money by conducting an e-auction, but it did not want to risk destroying its relationship with its supplier base because that might cost it more in the longer term. In these cases, retailers tend to have longer-term relationships with their suppliers although this is not necessarily formalised in terms of supply agreements with longer durations.

2.35 The intensity of retailers' focus on prices in this sector seems to have increased in recent years. As shown by the examples in the previous paragraph, this is not uniform across the sector, but in a number of cases it appears to have led to the breakdown of long-standing supply arrangements, and consequently, an increase in the rate of 'churn' in retailer-supplier relationships.

Cott Beverages Limited

2.36 Cott Beverages Limited is the UK subsidiary of Cott Corporation, a Canadian registered company listed on the Toronto and New York Stock exchanges. Cott supplies own-label and tertiary branded CSDs in PET bottles and cans, as well as DTT and still drinks, to retailers. It also undertakes contract packing on behalf of

third party brand owners, and has a small business selling concentrates elsewhere in Europe. Production is undertaken at plants in Pontefract, Yorkshire (primarily canned CSDs) and Kegworth, Leicestershire.

2.37 The accounts for Cott Beverages UK for the most recent financial year pre-merger, being the year to 1 January 2005, show that it employed an average of 374 people in the period and generated a profit before tax of £7 million on a turnover of £106 million. In that year, Cott derived [X] per cent of its revenue from CSDs (including [X] per cent from contract packing and [X] per cent from still drinks) and [X] per cent from DTT drinks.

2.38 Cott entered the UK market in 1994²⁸ with the launch of Classic Cola in collaboration with Sainsbury's. This was followed by the acquisition of a 51 per cent interest in the Pontefract canning plant operated by Benjamin Shaw (Pontefract) Limited. Cott's business in the UK expanded through the acquisitions of:

- the remaining 49 per cent of Benjamin Shaw (Pontefract) Limited in 1995;
- the Featherstone plant of Crystal Drinks Limited in 1995;²⁹ and
- the business of Hero Drinks Group (UK) Limited, based in Kegworth, in 1997.

2.39 Cott's parent, Cott Corporation, is the fourth largest soft drinks manufacturer in the world after Coca-Cola, PepsiCo and Cadbury Schweppes.³⁰ It is the world's largest own-label soft drink supplier with core operations in the USA, Canada, UK and Mexico.

2.40 Cott Corporation, which had been a regional CSD manufacturer in Canada since the 1950s, entered the own-label soft drinks business in North America in the early

²⁸Cott Retail Brands Limited, European holding company, established 24 December 1993.

²⁹This plant was subsequently sold to Crystal in 1999.

³⁰Cadbury Schweppes' UK soft drinks business was sold to CCE in 1999.

1990s. Key to Cott Corporation's entry into this business was the launch of 'President's Choice' own-label brand for Loblaw's in Canada and 'Sam's Choice' own-label brand for Wal-Mart in the US.³¹ Cott Corporation has had a long-term relationship with Wal-Mart in the USA, in particular, since this time.

2.41 In the year ended 1 January 2005, Cott Corporation generated a profit before tax of US\$78.3 million on a turnover of US\$1,646.3 million.³² UK turnover (including Europe) was US\$195 million representing 12 per cent of worldwide sales.

Macaw (Holdings) Limited

2.42 Macaw (Holdings) Limited was the parent company of the trading entity Macaw (Soft Drinks) Limited (together Macaw). Macaw was established in 1990 principally by Mr Andrew Cawthray who, at the time of its acquisition by Cott, was the Managing Director and majority shareholder. Mr Cawthray's background prior to establishing Macaw was one of involvement in the supply of CSDs through his family's ownership of the Barraclough's soft drinks business.

2.43 The establishment of Macaw was supported by two retailers [REDACTED]. [REDACTED]

2.44 Prior to the acquisition by Cott, Macaw operated two production plants in Nelson, Lancashire. One plant contains a number of [REDACTED] lines for the production of PET-bottled CSDs and DTT drinks. The second plant contains an aseptic production line, the only aseptic PET line in the UK owned by a supplier of own-label soft drinks.

³¹Cott told us that it is estimated that Cott Corporation produces (either directly or via third party contract packing arrangements) some [REDACTED] per cent of all own-label CSDs sold in the USA and [REDACTED] per cent of those sold in Canada. The range of own-label products supplied by Cott Corporation has expanded to include clear and sparkling flavoured beverages, juices, bottled waters, energy drinks and iced teas.

³²Cott told us that the majority of sales were accounted for by the USA (US\$1.2 billion or 73 per cent of group sales) and Canada (US\$189 million or 11 per cent of group sales).

2.45 Macaw predominantly supplied own-label CSDs with a limited portfolio of tertiary brands and contract packing. In the year to 1 January 2005 it derived [X] per cent percent of its revenue from CSDs, including [X] per cent from contract packing and the remainder from aseptic drinks.

2.46 In the last financial year prior to the merger, the year-ended 30 September 2004, the Macaw Group employed an average of 297 people and generated a profit before tax of £[X] million on a turnover of £[X] million.

Other soft drink producers

2.47 Besides Cott and Macaw, other significant producers of own-label CSDs in the UK are:

- Princes—the second largest producer of own-label CSDs in the UK (following the merger of Cott and Macaw). The ultimate parent of Princes is the Mitsubishi Corporation. Princes produces branded and own-label food and soft drinks. In soft drinks, Princes produces PET-bottled and canned CSDs, bottled water, and still drinks at seven different production sites.
- Silver Spring—the third largest producer of own-label CSDs in the UK, following the merger of Cott and Macaw. It is a family-owned firm that produces, in addition to CSDs, branded and own-label still drinks and bottled water. All drinks have been packaged in PET bottles since the closure of its canning line in 2003. Silver Spring's brands include the Perfectly Clear and Silver Spring brands. Silver Spring has a single production site in Folkestone, Kent.
- Villa—a producer of CSDs, still drinks, and bottled water in the branded, own-label and contract packing segments. Villa's brands include Hadrian spring water. Villa has a single production site in Southwick, Sunderland.

2.48 Other producers of branded and own-label CSDs in the UK include:

- AG Barr—a producer of, primarily, branded soft drinks. Its CSD brands include Irn Bru and Tizer. As well as CSDs, AG Barr produces bottled water and still drinks.³³
- Britvic—the second largest soft drinks supplier in the UK. It produces the Pepsi, Tango and 7UP brands in Great Britain and also manufactures products under the Robinsons and Britvic brands. As well as CSDs, Britvic produces bottled water, DTT drinks, and still drinks.
- CCE—the UK subsidiary of Coca-Cola Enterprises Inc—the marketer, manufacturer and bottler of brands owned by The Coca-Cola Company. As well as CSDs, CCE produces bottled water, DTT drinks, and still drinks. Key CCE brands sold in the UK include Coca-Cola, Fanta, Schweppes, Sprite and Dr Pepper.
- GSK—a health care company that produces branded CSDs, DTT drinks and still drinks. Its key brands, Lucozade and Ribena, are sold in a variety of flavours and formats.
- Norbev—located in Northern Ireland, produces CSDs, bottled water and still drinks under contract packing and own-label arrangements.
- Radnor Hills—a family-owned business located in mid-Wales, produces branded and own-label bottled water, still drinks and CSDs.

2.49 Other soft drink producers in the UK include:³⁴

- Gerber—the largest producer of fruit juice and nectars in Great Britain;
- Greencore (previously trading under the name Campsie Spring)—a producer of own-label and contract packed water;
- Highland Spring—a producer of branded and own-label bottled water;
- Montgomery Spring—a producer of branded and own-label bottled water.

³³AG Barr also takes a small amount of own-label CSD production for [§].

³⁴A number of the soft drink producers in this list may also produce small volumes of CSDs, particularly flavoured, sparkling water.

- Shepley Spring—a producer of branded and own-label bottled water;
- Strathmore—a producer of branded still drinks and bottled water.

2.50 Foreign soft drink producers that export to the UK include:

- Glenpatrick—an Irish producer of branded and own-label CSDs, bottled water and still drinks.
- Hansa—a German producer of branded and own-label bottled water and CSDs.
- Shannon—an Irish producer of branded and own-label CSDs, bottled water and still drinks.
- Red Bull—an Austrian producer of branded CSDs, primarily the energy drink Red Bull.
- Roxane—a French company that produces branded and own-label CSDs and bottled water.

3. The merger

Rationale for the transaction

3.1 Cott told us that its rationale for the acquisition of Macaw was that it:

- (a) enabled Cott to grow substantially its own-label business;
- (b) provided significant cost synergies in terms of improved procurement, production optimization, and logistics;
- (c) provided access to Macaw's new aseptic production facility;
- (d) enhanced Cott's position as a supplier of DTT drinks; and
- (e) enabled Cott to develop an improved relationship with Tesco.

3.2 Mr Andrew Cawthray, the major shareholder in Macaw, told us that he had had a number of approaches from Cott over the three to four years prior to Cott's acquisition of Macaw. In Autumn 2004 Macaw was again approached by Cott as well as [REDACTED], which both gave written offers. In addition, [REDACTED] expressed an interest in

acquiring Macaw. We were told that these approaches occurred at a time between Autumn 2004 and Summer 2005, when Macaw was strengthening its balance sheet before a new round of capital investment was required and, as such, represented a favourable time to sell the business.

Transaction process and structure of the merged firm

3.3 Following these approaches the owners of Macaw asked Rothschild to seek expressions of interest from prospective purchasers. Rothschild made an initial approach to [REDACTED] potential buyers. Of these, [REDACTED] put in first round bids at the end of March 2005 and [REDACTED] of these bidders progressed to a second round. Final offers were received from Cott and [REDACTED] in early May.

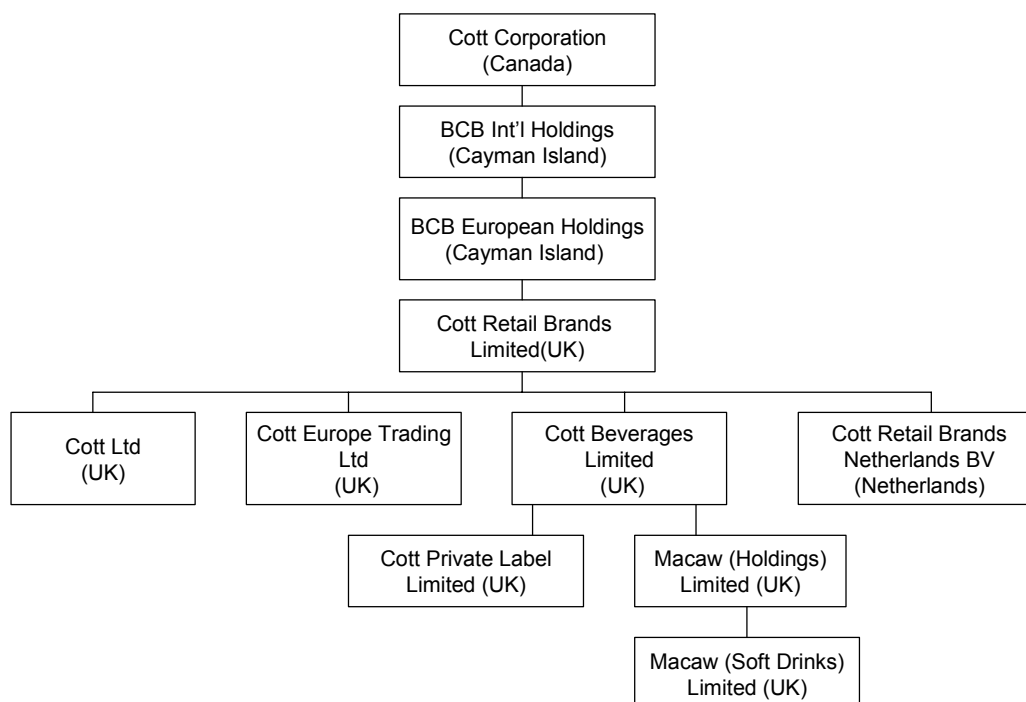
3.4 Cott's offer was chosen on 10 August 2005, and Cott Beverages Limited acquired the entire issued share capital of Macaw (Holdings) Limited and its trading subsidiary Macaw (Soft Drinks) Limited³⁵ for an all cash consideration of £75.7 million (US\$135 million³⁶). Figure 5 shows the combined group structure following the merger.

³⁵Cott did not acquire Macaw's Employee Benefit trust companies—Macaw (Soft Drinks) Limited Employee Benefit Trust, Thorneybolt (No 143) and Thorneybolt (No 234).

³⁶Cott press release 10 August 2005.

FIGURE 5

Post-transaction combined Group structure for Cott and Macaw



Source: Cott.

Note: All subsidiaries are 100 per cent owned.

Jurisdiction

3.5 Under our terms of reference (see Appendix A), we are required to investigate and report on whether a relevant merger situation has been created. A relevant merger situation exists where two or more enterprises have ceased to be distinct and where the share of supply test or the turnover test specified in section 23 of the Act is satisfied.

3.6 As a result of the transaction described in paragraph 3.4, Cott and Macaw have ceased to be distinct enterprises.

3.7 The share of supply test is satisfied if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK. Here, we look at the supply, over the course of the past few years, of own-label CSDs in the UK. The parties' combined share of supply of

own-label CSDs is 65 per cent, based on sales of own-label CSDs in 2004. As this is greater than a one-quarter share of supply in the UK the share of supply test in section 23 of the Act is met. Since the share of supply test is satisfied we are not required to consider the turnover test in section 23(1)(b) of the Act.

- 3.8 We therefore find that the acquisition of Macaw by Cott resulted in the creation of a relevant merger situation. The parties do not dispute that a relevant merger situation exists.

4. Market definition

- 4.1 This section sets out our definition of the relevant product and geographic market for the supply of own-label CSDs as well as considering the relevant markets for other soft drinks supplied by Cott and Macaw. The CC's guidelines³⁷ state that the key to market definition is substitutability—the extent to which customers can readily switch between products, or suppliers can readily switch their facilities between the supply of alternative products.

- 4.2 In assessing the likelihood of this substitutability, we apply the SSNIP (small but significant non-transitory increase in price) test at the 5 per cent level, consistent with CC guidelines. Where we refer to price increases in this section, we are therefore referring to a 5 per cent price increase.

Own-label CSDs

- 4.3 In this section we consider the product market for own-label CSDs, first, from a supply-side substitutability perspective, and second, from a demand-side substitutability perspective. We then examine the geographic dimension of the market.

³⁷CC, Merger References: Competition Commission Guidelines (CC2), June 2003

Own-label CSDs: product dimension

- 4.4 In assessing the product market for own-label CSDs, we consider whether there are narrower markets for own-label CSDs segmented by packaging type, packaging size, or flavour. We address these issues in our analysis of supply-side substitutability, and in relation to packaging type, also in our analysis of demand-side substitutability.
- 4.5 We also consider whether the market for own-label CSDs is broader such that it also includes contract packed, tertiary branded and primary branded CSDs, and whether it includes other own-label or branded soft drinks, such as bottled water, still drinks and DTT drinks. We address these issues in our analysis of both supply- and demand-side substitutability.

Supply-side substitutability

- 4.6 Supply-side substitution is generally regarded as possible if adjustment costs for potential suppliers are low and switching could take place within one year. We assess below the likelihood of supply-side substitution:
- (a) from cans to PET bottles;
 - (b) between different sized PET bottles;
 - (c) between different CSD flavours;
 - (d) from tertiary branded and contract packed CSDs to own-label CSDs;
 - (e) from primary branded to own-label CSDs; and
 - (f) from other soft drinks (still drinks, DTT drinks and bottled water) to CSDs.

(a) Cans to PET bottles

- 4.7 A production line producing canned CSDs (or other canned soft drinks) cannot be readily converted to producing CSDs in PET bottles. A producer of canned CSDs that wished to commence production of PET-bottled CSDs would need to invest in a completely new packaging line. As the cost of this new capacity would be significant,

and would, in essence, be a completely new investment, we consider that from a supply-side perspective, there are separate markets for canned and PET-bottled CSDs.

- 4.8 We discuss whether there is sufficient demand-side substitutability between canned and PET-bottled CSDs to include these products in the same market in paragraphs 4.38 to 4.39.

(b) Between different PET bottle sizes

- 4.9 PET production lines can be readily switched between producing different PET bottle sizes. Some costs are likely to be incurred in increasing the flexibility of an existing line that is currently capable of producing a limited range of bottle sizes. However, it seems that, in practice, suppliers are potentially capable of producing the full range of bottle sizes.³⁸ We therefore find that the market for own-label PET-bottled CSDs is not segmented by bottle size.

(c) Between different CSD flavours

- 4.10 Production lines for PET-bottled CSDs are capable of switching between flavours in very short timescales and at minimal cost. Silver Spring told us that in a typical 12-hour shift a line may be used to bottle ten different flavours. Princes told us that it switched between flavours several [REDACTED] times a day on each line with a changeover time of up to 45 minutes. Cott told us that it switched between flavours several [REDACTED] times a day on one of its larger lines, and that if the same bottle size is used, changing flavours simply requires rinsing out the production line and replacing labels in a changeover time of less than one hour [REDACTED].

³⁸[REDACTED]

4.11 Since all suppliers of own-label PET-bottled CSDs are capable of producing the full range of flavours on any one production line with minimal changeover costs, we find that the market for own-label PET-bottled CSDs is not segmented by flavour.

(d) Tertiary branded and contract packed CSDs to own-label CSDs

4.12 As shown in Figure 3, Cott, Macaw and other suppliers of own-label PET-bottled CSDs undertake contract packing of CSDs and supply tertiary branded CSDs. CCE and Britvic both produce very limited volumes of tertiary branded CSDs and [REDACTED].

4.13 Cott and other suppliers of own-label PET-bottled CSDs told us that contract packing of CSDs was undertaken on the same production lines as own-label CSDs. Switching from contract packed CSDs to own-label CSDs was as simple as changing flavours, bottle size and labels. Cott also told us that it was easy to switch production between tertiary branded and own-label CSDs. It was simply a case of rinsing out a production line and changing the labelling, in a similar way to changing flavours. This was confirmed by other suppliers.

4.14 As a result, we consider that suppliers already producing own-label PET-bottled CSDs would undertake such supply-side substitution. For the same reasons set out in paragraphs 4.15 to 4.19 we consider it unlikely that these suppliers would engage in supply-side substitution from tertiary branded and contract packed CSDs to own-label CSDs.

(e) Primary branded CSDs to own-label CSDs

4.15 Suppliers of primary branded CSDs told us that entering own-label CSD production could happen relatively quickly and at a low cost. [REDACTED] told us it would take only [REDACTED] with minimal costs of [REDACTED]. GSK told us that it would take 4 to 16 weeks at a cost of £20,000 to £250,000. However, we need to consider whether a supplier of primary

branded CSDs would *actually* switch into producing own-label CSDs in response to an increase in the price of own-label PET-bottled CSDs.

4.16 Cott told us that it considered AG Barr and Britvic to be two examples of primary branded CSD producers that could switch into producing own-label CSDs. However, AG Barr, which currently supplies own-label cola only to [REDACTED], pulled out of wider own-label supply 15 years ago and told us that it had ‘no intention of seeking further own-label business or increasing own-label activity’. [REDACTED]

4.17 In addition, [REDACTED]. GSK told us that it had no plans to start producing own-label CSDs.

4.18 Princes, Silver Spring and Villa told us that they did not see the production of own-label CSDs by CCE or Britvic as a competitive threat.

4.19 In the light of this evidence, we consider that supply-side substitution from primary branded CSDs into own-label CSDs in response to an increase in the price of own-label PET-bottled CSDs is highly unlikely. We consider whether primary branded CSDs are a demand-side substitute for own-label CSDs at the retail level in paragraphs 4.33 to 4.37 and at the wholesale level in paragraphs 4.40 to 4.44.

(f) Other soft drinks to own-label CSDs

4.20 We were told that there were two types of production line currently producing soft drinks other than CSDs that could potentially produce CSDs. These were, first, production lines that had an existing CSD production capability but were currently used for producing other types of soft drinks, such as DTT drinks, and second, production lines with no existing CSD production capability that could be converted to enable production of CSDs with some conversion costs.

4.21 [X] told us that on its CSD capable production lines it was possible to switch between still drinks and CSDs in as little as [X] minutes. Both [X] and [X] produce still drinks, DTT drinks and bottled water on the same production lines that produce CSDs. Supply-side substitution from these lines is therefore very quick and incurs minimal costs. [X]

4.22 For those production lines that currently produce other soft drinks (such as bottled water, DTT drinks and still drinks) but cannot produce CSDs, estimated conversion costs for a line capable of annually producing 5 million cases (approximately 30 million 2 litre bottles) with new or refurbished equipment³⁹ are set out in Table 3.⁴⁰ In each case the estimated time for undertaking such a conversion is 12 to 16 weeks.⁴¹

TABLE 3 Time and cost of converting other soft drink production lines to CSD production

<i>Switching to CSD production from:</i>	<i>Requires installation of:</i>	<i>Conversion cost (refurbished equipment) £'000</i>	<i>Conversion cost (new equipment) £'000</i>
Still and DTT drinks	Filler and carbonator	400	650
Still water	Syrup room, mixer/carbonator and filler	600	950
Sparkling water	Syrup room and mixer/carbonator	200	300

Source: CC analysis, Central Bottling International, [X].

Note: Some incidental costs associated with converting production lines may not be captured in this table.

4.23 We need to consider, however, whether a producer of other PET-bottled soft drinks would *actually* switch into producing own-label PET-bottled CSDs in response to an increase in the price of own-label PET-bottled CSDs. We consider, in turn, the situation for current producers of own-label PET-bottled CSDs, producers of own-

³⁹Refurbished equipment, combined with new equipment where necessary, costs around 60 per cent of the price of new equipment. The main advantage of using refurbished equipment is cost, speed of delivery, and that it carries a guarantee similar to that provided on new equipment. However, it may not be as fast or as flexible as new equipment. Also, second hand equipment of suitable configuration may not always be available, and in this case, additional costs would be incurred in purchasing new equipment.

⁴⁰Production lines for aseptic drinks and juices are so different from CSD production lines that conversion of these lines to CSD production cannot be readily carried out. We do not therefore consider that supply-side substitution would occur from aseptic and juice production lines to CSD production.

⁴¹Time scales are for refurbished equipment. New equipment may take longer due to the time required for design and manufacturing.

label bottled water and still drinks,⁴² and producers of primary branded bottled water, still drinks and DTT drinks.

4.24 For current producers of own-label PET-bottled CSDs, we consider that supply-side substitution between other PET-bottled soft drinks and own-label PET-bottled CSDs would take place in response to an increase in the price of own-label PET-bottled CSDs on those production lines that are currently capable of producing PET-bottled CSDs.

4.25 We also consider that for current producers of own-label PET-bottled CSDs supply-side substitution between other PET-bottled soft drinks and own-label PET-bottled CSDs might take place on those production lines that are capable of conversion but would incur some conversion costs in order to produce PET-bottled CSDs in response to an increase in the price of own-label CSDs. Our analysis (see Appendix D) shows that, in almost all cases, if a soft drink producer expects to have spare capacity on a line for a protracted period and is sufficiently confident of being able to sell CSDs from the converted capacity for a significant period, the value of the ten-year cashflows mean it would be financially attractive to convert the line to enable it to produce CSDs. Payback periods⁴³ for the investment in converting a production line to give it CSD capacity are in the order of two to three years when considering a 5 per cent price increase in own-label PET-bottled CSDs.⁴⁴ However, we consider that the general pattern of retailer procurement (see paragraph 2.32) is likely to have the effect of limiting a supplier's confidence in its ability to sell CSDs from the converted capacity in the necessary volumes and for long enough to recover its

⁴²Producers of own-label DTT drinks are not considered here as this segment is supplied almost entirely by Cott and Princes, which are both current producers of own-label CSDs.

⁴³Given the reluctance of retailers to enter long-term commitments, we believe that in this case it is more useful to consider payback periods than other measures of investment return, such as net present values or internal rates of return. We do, however, also analyse net present values and internal rates of return in Appendix D.

⁴⁴This payback period is based on the original cost of the line being treated as a sunk cost, so the cashflows from CSD sales are high relative to the incremental investment made to convert the line. Cott notes that the payback period would be shorter if a favourable product mix could be achieved.

investment, and that this might deter it from undertaking such a conversion. This is reflected in our conclusion at paragraph 4.30.

4.26 While we consider that current producers of own-label PET-bottled CSDs would engage in supply-side substitution from other PET-bottled soft drink production into own-label PET-bottled CSDs in response to a price rise, major producers of own-label PET-bottled water and still drinks (that do not currently produce traditional own-label PET-bottled CSDs⁴⁵) told us that they would not consider supply-side substitution into own-label PET-bottled CSDs in response to an increase in own-label PET-bottled CSD prices.

4.27 Four own-label water suppliers [redacted] account for approximately two-thirds [redacted]⁴⁶ of the own-label water segment.⁴⁷ We asked these companies whether they would consider producing own-label CSDs in response to a 5 per cent price rise. They told us that they would not be interested due to, among other things, growth prospects in the water market, capacity constraints, branding and health issues associated with CSDs and in one case [redacted], water abstraction constraints.⁴⁸ The lead supplier of still drinks (Gerber), whom we asked the same question, told us that it was not likely that it would enter the own-label CSD segment in the next two to three years.

4.28 Cott submitted that own-label water companies producing flavoured sparkling water, which requires CSD production capability, would be likely to commence supplying more traditional own-label CSDs in response to a 5 per cent price rise. We agree that flavoured sparkling water may be classified as a CSD. However, the evidence provided by own-label water companies (as outlined in the previous paragraph) does

⁴⁵We consider the situation of own-label water suppliers that also produce flavoured sparkling water in paragraph 4.28.

⁴⁶Share based on 2004 sales volumes, Zenith International, 2005. The remaining own-label water suppliers are primarily current suppliers of own-label CSDs.

⁴⁷Other major own-label water suppliers (for example, Princes and Silver Spring) have already been considered as they also supply own-label CSDs.

⁴⁸Cott noted that water abstraction constraints should not constrain production of own-label CSDs as this can be undertaken with mains water.

not support the view that these companies would seek to compete more generally to supply own-label PET-bottled CSDs in the event that own-label PET-bottled CSD prices were to increase by 5 per cent.⁴⁹

4.29 We do not consider that supply-side substitution in response to a price rise would be likely by producers of own-label or branded PET-bottled water, still drinks or DTT drinks into own-label PET-bottled CSDs that do not currently produce own-label PET-bottled CSDs. We also do not consider that own-label water companies producing flavoured sparkling water, but not other CSDs, would be likely to commence supplying more traditional own-label CSDs in response to a 5 per cent price rise.

4.30 As a result, we consider that supply-side substitution between own-label PET-bottled water and still drinks to own-label PET-bottled CSDs is limited to production capacity owned by current suppliers of own-label PET-bottled CSDs that is currently capable of producing PET-bottled CSDs.⁵⁰ It might also include those production lines at existing own-label CSD producers currently capable of producing PET-bottled soft drinks that would incur some conversion costs to make them capable of producing PET-bottled CSDs. However, we do not find it necessary to reach a decision on this latter point because it would not change our conclusion regarding the sufficiency of spare capacity to support switching by retailers between suppliers (see paragraphs 7.7 to 7.9).

Demand-side substitutability

4.31 The market for own-label PET-bottled CSDs (as defined in paragraph 4.30) should be broadened to include branded CSDs, own-label canned CSDs and other PET-bottled soft drinks if there is sufficient demand-side substitutability between these

⁴⁹At present, flavoured carbonated waters are differentiated from more traditional CSDs by being branded as bottled water; thereby enjoying a healthier image and, it seems, higher margins. The evidence we received suggested that this situation is unlikely to change in the short to medium term.

⁵⁰This excludes CSD capable production capacity owned by own-label water suppliers that currently only produces sparkling flavoured water.

products in response to a price rise. In assessing demand-side substitutability, we separately consider the potential for demand-side substitution to widen the market at:

- (a) the retail level, ie the level at which Cott and Macaw's retail customers compete with one another to sell own-label CSDs to final consumers; and
- (b) the wholesale level, ie the level at which Cott and Macaw compete in the supply of own-label CSDs to retailers.

4.32 We consider, first, demand-side substitution at the retail level, assuming that a price increase at the wholesale level is passed through to end-consumers, and second, assess whether retailers would themselves engage in demand-side substitution in response to a price rise.

(a) Retail level demand-side substitution

4.33 At the retail level, own-label CSD prices are significantly less than branded CSD prices. Indeed, we were told that the relative price difference between own-label and branded CSDs exceeds that between own-label and branded products in any other grocery category. Indicative retail prices for various 2 litre branded and own-label CSDs are set out in Table 2. We are aware, however, that the indicative retail prices for branded CSDs, in particular, may not be a wholly accurate representation of the actual price difference due to periodic promotional offers, such as buy one, get one free promotions. As a result, we examined the price differentials on a volume-weighted average basis.

4.34 Even on a volume-weighted average basis, though, these price differences are still large. For example, for one large retailer [redacted] we found that the volume weighted average price of a 2 litre PET-bottled Pepsi Cola was more than 100 per cent [redacted] greater than that of the standard 2 litre own-label PET-bottled cola for the period 2003 to 2005 (see Appendix B). In lemonade where, we were told, the product

brands are weaker, the volume weighted average price of a Schweppes 2 litre PET bottle was more than 50 per cent [✂] greater than that of 2 litre own-label PET-bottled lemonade. For energy drinks, the volume weighted average price of a 1 litre bottle of Lucozade was 68 per cent greater than that of the own-label glucose energy drink.

4.35 Such is the significance of this price difference, even when promotions are taken into account, that the price gap between own-label and primary branded CSDs would still be large even if the retail price of own-label CSDs were to increase by 5 per cent. Although Cott noted that the relevant consideration for demand-side substitution is the willingness of consumers to switch at the margin, a number of retailers told us that the size of this price gap meant that any switching from own-label to primary branded CSDs, as a result of a 5 per cent increase in the price of own-label CSDs, would be trivial.

4.36 Cott provided evidence from a BMRB consumer survey and TNS Superpanel data that implies that own-label and branded CSDs may be substitutable. The BMRB survey methodology, sampling and weighting procedures all appeared to be sound. However, the price sensitivity question was fundamentally flawed. We consider that some respondents are likely to have been misled by the inclusion in the survey of a phrase to illustrate a 10 per cent price rise that gave the impression that the price increase being tested for a 2 litre PET bottle of own-label CSD was from £1.00 to £1.10, more than twice the typical price.⁵¹ As a result, we consider that the results from the survey, including the subsequent price elasticity estimate, to be unreliable.

4.37 The TNS Superpanel data relates to deep discounts (for example, buy one, get one free offers) rather than the SSNIP test relevant to market definition. We found no

⁵¹Moreover, the CC guidelines refer to a SSNIP test of 5 per cent, not 10 per cent.

corroborative evidence of substitutability in the retail price data submitted to the inquiry by retailers. Our analysis of the data is set out in Appendix B. This shows that even deep discount promotions on branded CSDs lead to limited switching between own-label and primary branded CSDs.

4.38 We also considered whether there was any demand-side substitutability between own-label canned and PET-bottled CSDs. For individual canned CSDs the most obvious demand-side substitute would be a 250 or 500 ml bottle. However, as set out in paragraph 2.14, production volumes for own-label CSDs in these bottle sizes are relatively small and are almost exclusively sold in multi-packs. As a result, the opportunity for demand-side substitution between purchases of individual cans and PET bottles of own-label CSDs is limited.

4.39 We also considered the potential for demand-side substitution between multi-packs of own-label CSD cans and 2 litre PET bottles.⁵² Our analysis in Appendix B, however, shows that the price of a six-pack of 330ml own-label CSD cans is nearly four times the price of a 2 litre PET bottle of own-label CSD and there is little substitution between these products.

(b) Wholesale level demand-side substitution

4.40 At the wholesale level, a retailer might in principle choose to re-allocate shelf-space in response to an increase in own-label CSD prices if it believes that shelf-space allocation can influence the willingness of consumers to switch to primary branded CSDs. Thus, in response to a 5 per cent increase in wholesale own-label CSD prices, a retailer might, in principle, choose to increase space for primary branded CSDs and reduce that for own-label CSDs so as to maintain profitability. It might also do so as a means of disciplining the supplier of own-label CSDs.

⁵²The opportunity for demand-side substitution between purchases of multi-packs of own-label CSD cans and multi-packs of 500 ml PET bottles is limited due to the limited availability of multi-packs of 500 ml PET bottles.

4.41 A number of retailers indicated that shelf-space was not managed in this way. These retailers told us that shelf space was allocated in line with the rate of sale for each product. CCE, which offers advice to a number of retailers on category management, also argued that shelf space was allocated based on a product's rate of sale due to the need to manage stockholdings efficiently and the limited off-shelf stockholding capacity of supermarkets. In other words, any reduction in shelf-space for own-label products in response to a price increase would be limited by the risk of shelf stock running out too quickly due to the rate of sale for the own-label products. In addition, as set out at paragraph 2.23, category management services offered by CSD suppliers does not have a significant effect on shelf space allocation for own-label CSDs. We therefore consider that any switching of shelf-space allocation from own-label products to primary branded products would not be sufficient to make a price increase in own-label PET bottled CSDs unprofitable.

4.42 Indeed, most retailers suggested that own-label and primary branded CSDs were quite separate product offerings. Retailers, other than the very smallest, also consider own-label products to be a critical part of their offering and, in some cases, a KVI (see paragraphs 2.16 and 2.24), thereby limiting their capacity to de-list products or reduce shelf-space.

4.43 [REDACTED]

4.44 All the examples cited in relation to PET-bottled CSDs relate either to the smallest retailers and wholesalers, where having an own-label offering may not be critical. Further, it was unclear whether any threats to delist would have been carried into effect. We consider that there is a possibility that the smallest retailers and wholesalers would de-list these products if they cannot be offered to their customers competitively. However, we consider that the extent of retailer switching would be

limited and uncertain, and we do not consider their level of substitution would be sufficient to justify widening the product market.

Further arguments on product market definition submitted by Cott

4.45 Cott submitted a number of additional arguments as to why own-label and branded CSDs should be included in the same market. These included:

- (a) the historic rationale for own-label CSDs;
- (b) similar product characteristics of own-label and branded CSDs; and
- (c) previous decisions by competition authorities.

4.46 We address each of these issues below.

(a) Historic rationale for own-label CSDs

4.47 Cott submitted that retailers introduced own-label CSDs to have a competing, substitutable offering that provided them with the means to discipline increasingly concentrated owners of primary branded CSDs on price and service. Cott argued that this rationale is still present.

4.48 We note, however, the widening price differential between own-label and branded CSDs that has emerged in recent years. Cott submitted that this 'price differential has come about as a result of retailers relentlessly driving down the price of own-label, particularly in the two litre CSD category, as part of the process of retail price competition and the entry of hard discounters (for example, Aldi, Lidl and Netto)'. It went on to say that 'to a large extent the price gap is a result of intense retailer competition, motivated by the fact that this is a KVI'. We observed that the widening price gap may also reflect the success of branded CSD producers in using advertising and promotion to differentiate their products from own-label CSDs.

4.49 We consider that this widening price gap demonstrates the change in the market dynamic since the introduction of own-label CSDs and strongly suggests that branded CSDs no longer represent the same competitive constraint on own-label CSDs as may have been the case when these products were first introduced.

(b) Similar product characteristics

4.50 Cott submitted that to all intents and purposes branded and own-label CSDs are identical from a consumer standpoint, and pointed to results from blind taste tests as evidence of this. Cott also argued that retailers specify packaging for own-label CSDs that is nearly identical to that for the branded product and market the same flavours of branded and own-label CSDs adjacent to each other on their shelves.

4.51 We do not consider that this is sufficient to include own-label and branded CSDs in the same market. Consumers do not purchase CSDs 'blind' but are clearly influenced by a range of factors beyond taste, including advertising and branding. We do not consider that attempts at similar packaging compensates for these advertising and branding issues, particularly as we note that the packaging of own-label CSDs must be sufficiently differentiated from primary brands to avoid actions for passing off.

(c) Previous decisions by competition authorities

4.52 In its response to our market definition working paper, Cott submitted that there was a strong and consistent line of case law across the UK⁵³ and the EU⁵⁴ which established that own-label and branded CSDs should be included in the same market. We gave careful consideration to these previous cases but we consider that none of them directly addresses the question of whether there were separate

⁵³MMC Report on Carbonated drinks: Cm 1625, Princes/Wells: 2000.

⁵⁴Cases: IV/M.794, IV/M.90, IV/M98/327, COMP/M2276 and COMP/M2504.

markets for branded and own-label CSDs and indeed in one case⁵⁵ this issue was left open.

4.53 We note that the cases referred to by Cott dated between 1991 and 2001. We consider that the dynamics of the own-label CSD business in the UK have changed significantly over this time (see paragraphs 4.48 to 4.49). In recent years, the widening of the price gap between branded and own-label CSDs suggests that consumer switching is far less likely to take place.

4.54 We are required to reach our own conclusions in the light of the facts and circumstances of the particular case before us. The relevant facts and circumstances in this case in relation to market definition are set out in paragraphs 4.1 to 4.51.

Conclusions on product market definition for own-label CSDs

4.55 For own-label PET-bottled CSDs, we consider that the product market can be defined in terms of the production capacity that could be used to produce own-label PET-bottled CSDs at short notice (ie less than one year). The capacity that should be included in this market includes the production lines at suppliers of own-label CSDs currently capable of PET-bottled CSD production and perhaps, those production lines that could be converted to produce PET-bottled CSDs.⁵⁶

4.56 For own-label canned CSDs, we do not need to conclude on the definition of the relevant product market for the purposes of our inquiry because it would not change our conclusions regarding the competitive effects of the merger (see paragraphs 7.21 to 7.22).

⁵⁵Case IV/M.794.

⁵⁶This excludes CSD capable production capacity owned by own-label water suppliers that currently only produces sparkling flavoured water.

Own-label PET-bottled CSDs: geographic dimension

- 4.57 The geographic dimension of the market for own-label PET-bottled CSDs is at least as broad as Great Britain. We have seen no evidence of regional market segmentation. Silver Spring based in Folkestone competes for business in the North and Cott and Macaw with manufacturing capacity in the Midlands and North compete for business in the South. As a result, we consider whether the geographic market is wider than Great Britain.
- 4.58 Imports of own-label PET-bottled CSDs into Great Britain are limited. We estimate that total imports of CSDs from continental Europe represent 8 per cent of the market by value for water and CSDs,⁵⁷ and that the majority of these imports are higher value, branded products such as Evian, Volvic, Perrier, Vittel and Red Bull where the higher product values are sufficient to absorb the greater transport costs. There are, however, small volumes of imports of own-label CSDs.
- 4.59 Foreign suppliers of own-label CSDs in Great Britain include Roxane, Hansa, Glenpatrick, Shannon Minerals and Northern Beverages.
- 4.60 Roxane, based in France, and Hansa, based in Germany, supply own-label PET-bottled CSDs to Lidl in the UK. According to Lidl, these supply arrangements largely reflect Lidl's UK buyers taking advantage of deals negotiated in France and Germany, rather than representing Roxane and Hansa actively competing for the supply of own-label CSDs to retailers in Great Britain.⁵⁸ Roxane told us that it exported other soft drinks, such as bottled water, to the UK, but Lidl was its only customer for own-label CSDs.

⁵⁷This figure is based on HM Customs and Excise UK Trade Statistics and the UK retail market value. Cott noted that the import value should be compared with the wholesale market value instead of the retail value, in which case the percentages would be slightly higher.

⁵⁸Lidl did, however, tell us that subsequent to its initial supply agreement with Roxane being put in place (based on Roxane's supply agreement with Lidl in France), it invited Roxane to participate in a tender to supply own-label CSDs to two of its depots in the south-west, which Roxane was successful in winning.

- 4.61 Glenpatrick and Shannon Minerals, both based in the Republic of Ireland, export own-label PET-bottled CSDs to the UK. Glenpatrick supplies own-label PET bottled CSDs to M&S in Great Britain. Shannon Minerals supplies own-label water and PET-bottled CSDs to a number of retailers in Northern Ireland and Great Britain, including Tesco, ASDA, Lidl and Aldi.⁵⁹ Norbev, based in Northern Ireland, supplies own-label PET-bottled CSDs to [redacted] under contract to Cott and directly to [redacted]. There is no evidence of more than limited use of own-label CSD suppliers from Northern Ireland or the Republic of Ireland, such as Glenpatrick's supplying of M&S,, and no evidence of broad-based competition from these suppliers in retailer tenders.
- 4.62 Four retailers told us that they would consider sourcing own-label CSDs from outside the UK in the event of an increase in wholesale prices. However, these retailers did not tell us whether they considered it likely that this would actually lead them to source from foreign suppliers. Two retailers told us that they did not consider it possible for imports of low-value own-label CSDs to be competitive with locally supplied product.
- 4.63 CCE told us that due to logistical costs, bottling facilities outside the UK did not typically focus their distribution efforts on the UK. A major European supplier of soft drinks [redacted] told us that it considered that transport costs were prohibitive and it could not envisage circumstances where this would not be the case. Further, we note that there are separate franchises for Coca-Cola and Pepsi products in Great Britain and Northern Ireland even though these are primary branded products, where transport costs would form a smaller proportion of the total sales price.
- 4.64 We assessed the extent to which transport costs would inhibit foreign suppliers' capacity to compete effectively with domestic suppliers of own-label PET-bottled

⁵⁹We were unable to obtain precise details of the breakdown in Shannon's supplies of own-label water and CSDs to different retailers. Retailer data indicate that Shannon's supply of own-label CSDs may be predominantly to Northern Ireland.

CSDs. We received mixed evidence from third parties on this point. Glenpatrick told us that transport costs did not place it at a competitive disadvantage compared with other suppliers, while Shannon Minerals told us that transport costs placed it at a disadvantage to domestic suppliers.

- 4.65 We examined likely transport costs for domestic and foreign suppliers and estimate that transport costs for imported PET-bottled CSDs are at least three to four times higher than transport costs for locally produced own-label PET-bottled CSDs and represent a substantial proportion of total product costs. This includes transport costs for both Irish and continental European suppliers.
- 4.66 Cott considered our estimates of transport costs as too high and provided an alternative quote for importing CSDs from continental Europe from its own supplier of transport services. This quote taken together with other information provided by another European logistics company, and by Roxane, supports our conclusion of transport costs from continental Europe being at least three to four times those of transport costs for a producer located in Great Britain, representing around 30 per cent of the wholesale price of a typical 2 litre PET-bottle of own-label CSD. We therefore consider that transport costs for imported own-label PET-bottled CSDs from both continental Europe and Ireland would represent a substantial proportion of total product costs, and in effect, precludes effective broad-based competition from imported own-label PET-bottled CSDs.
- 4.67 Based on the evidence in paragraphs 4.57 to 4.66, we consider that the geographic market for the supply of own-label PET-bottled CSDs is Great Britain.
- 4.68 Cott and Macaw both supplied own-label PET-bottled CSDs to Northern Ireland prior to the merger. We consider that the market for supply of own-label PET-bottled

CSDs to Northern Ireland includes Republic of Ireland and may be wider. However, we do not need to conclude on this point because it would not change our conclusions regarding the competitive effects of the merger (see paragraph 7.16).

Other soft drinks

4.69 In addition to own-label, tertiary branded and contract packed CSDs, Cott and Macaw supply a number of other PET-bottled soft drink products, including aseptic drinks, still drinks, DTT drinks and bottled water. The following sets out our approach to defining the relevant market for each of these products.

Own-label PET-bottled aseptic drinks

4.70 Macaw was the sole supplier of own-label PET-bottled aseptic drinks prior to the merger, while Cott did not supply aseptic drinks. In terms of the market for own-label PET-bottled aseptic drinks, supply-side substitutability is unlikely due to the need for specialist bottling equipment and treatment facilities.⁶⁰

4.71 Demand-side substitutability between other soft drinks and own-label PET-bottled aseptic drinks also appears to be unlikely given the specific properties and premium pricing of own-label PET-bottled aseptic drinks. There may, however, be some demand-side substitutability between branded PET-bottled and own-label PET-bottled aseptic drinks as well as between own-label PET-bottled and own-label non-PET-bottled aseptic drinks.⁶¹ For the purposes of our inquiry, however, we do not need to reach a decision on the market definition for own-label PET-bottled aseptic drinks because it would not change our conclusions regarding the competitive effects of the merger (see paragraph 7.23).

⁶⁰As noted above, production lines for aseptic drinks and juices are so different from CSD production lines that conversion of these lines to CSD production cannot be readily carried out. We do not therefore consider that supply-side substitution would occur from aseptic and juice production lines to CSD production.

⁶¹Non-PET bottled aseptic drinks are, primarily, packaged in tetrapak cartons.

Own-label PET-bottled still drinks, DTT drinks, and bottled water

4.72 Prior to the merger, Cott produced own-label PET-bottled still drinks, DTT drinks and bottled water, while Macaw produced own-label PET-bottled DTT drinks and bottled water. The market for each of these products may be as narrow as the supply of the own-label version of each product type. However, it may be significantly broader than own-label once all supply- and demand-side substitution possibilities are taken into account. For the purposes of our inquiry, however, we do not need to reach a decision on the market definition for these drinks because it would not change our conclusions regarding the competitive effects of the merger (see paragraphs 7.24 to 7.25).

Conclusions on market definition

4.73 We consider that the relevant market for own-label PET-bottled CSDs can be defined in terms of the production capacity that could be used to produce own-label PET-bottled CSDs at short notice (ie less than one year). The capacity that should be included in this market includes the production lines that are currently producing own-label PET-bottled CSDs and all other production lines that are currently capable of producing CSDs at suppliers of own-label CSDs in Great Britain.⁶² It might also include production lines at these own-label CSD suppliers in Great Britain that could produce PET-bottled CSDs with some conversion costs. However, we did not consider it necessary to reach a decision on this point because it would not change our conclusions regarding the competitive effects of this merger (see paragraphs 7.7 to 7.8).

4.74 We do not find it necessary to reach a decision on the market definition for own-label canned CSDs, or own-label PET-bottled aseptic drinks, still drinks, DTT drinks or

⁶²This excludes CSD capable production capacity owned by own-label water suppliers that currently only produces sparkling flavoured water.

bottled water because it would not change our conclusions regarding the competitive effects of this merger (see paragraphs 7.21 to 7.25).

5. Pre-merger competition

5.1 This section considers competition in the markets served by Cott and Macaw prior to their merger as a guide to assessing how competition might develop following the merger. We first consider pre-merger competition in the market for own-label PET-bottled CSDs. We then consider pre-merger competition in the provision of other soft drinks provided by Cott and Macaw, including own-label canned CSDs, own-label PET-bottled aseptic drinks, still drinks, DTT drinks and bottled water.

Own-label PET-bottled CSDs

5.2 In examining pre-merger competition in the market for own-label PET-bottled CSDs, we first examine pre-merger market shares and indicators of pre-merger competitive outcomes and then consider other factors relevant to assessing pre-merger competition.

Market shares

5.3 On the basis of supply-side substitution, we have defined the relevant market for own-label PET-bottled CSDs in terms of capacity at suppliers of own-label PET-bottled CSDs that is currently capable of producing PET-bottled CSDs and, possibly, capacity that could do so with some conversion costs. For that reason, capacity-based market shares potentially better represent the potential for competition by taking into account each supplier's total capacity to provide own-label PET-bottled CSDs (ie including their capacity to supply-side substitute into CSD production). On the other hand, given that some of this capacity is currently committed to producing other soft drinks, this measure may overstate the share of capacity available in the short term to produce PET-bottled CSDs of those suppliers with large volumes of

other soft drink production. Market shares based on sales better reflect these suppliers' current shares of output but are likely to understate the potential capacity of these suppliers to produce own-label PET-bottled CSDs.

5.4 Table 4 therefore shows pre-merger market shares on two bases: first, share of production capacity currently capable of producing own-label PET-bottled CSDs (measured on a nameplate basis⁶³) at those suppliers of own-label PET-bottled CSDs⁶⁴ that we consider competitors for the supply of own-label PET-bottled CSDs to retailers and other customers (based on 2005-06 post-merger data); and second, share of total sales in 2004 of own-label PET-bottled CSDs. (The difference in timing between these two market share figures results in some loss of comparability between the two sets of market shares (see note 3 to Table 4). However, we do not consider that this fundamentally alters the overall picture in terms of the relative market share of the different suppliers of own-label PET-bottled CSDs.)

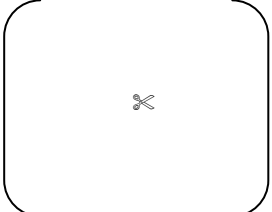
⁶³Nameplate capacity is a hypothetical figure defined as the production that would be achieved by a machine operating 24 hours a day, 365 days a year. While we have used nameplate capacity as the basis for measuring production capacity market shares, alternative bases for measuring capacity could also be employed, such as capacity based on existing work patterns. Market shares would not, however, vary greatly if alternative measures of capacity were used. We discuss different measures of capacity further in Appendix D.

⁶⁴This corresponds to the narrower of the definitions of the relevant market for own-label PET-bottled CSDs set out in paragraph 4.73.

TABLE 4 Market shares for own-label PET-bottled CSDs

per cent

Market shares

<i>Supplier</i>	<i>Share of nameplate production capacity capable of PET-bottled CSD production at suppliers of own-label CSDs</i>	<i>Share of own-label PET-bottled CSDs based sales volumes, 2004</i>
Cott		40
Macaw		25
Cott and Macaw		65
Princes		24
Silver Spring		9
Villa		1
AG Barr		1
Total		100
Pre-merger HHI		2,877

Source: Based on CC analysis of information provided by CSD producers and Zenith International, 2005.

Notes:

1. Sales volumes for own-label CSD by Glenpatrick, Norbev and Shannon Minerals as well as for producers of own-label sparkling flavoured water each represented less than 1 per cent of the market.
2. Capacity-based market shares will exceed sales-based market shares where CSD capable production lines are currently producing other soft drinks and/or where capacity is not fully utilised.
3. Production capacity market shares are based on post-merger production capacity data collected by the CC. Investment since the merger has changed some of these shares compared to the situation immediately prior to the merger. [X] We do not, however, consider that post-merger investment significantly alters the overall picture, and in particular, the relative position of Cott and Macaw. [X]
4. N/A = not applicable.

5.5 Regardless of the measure of market share, there was a high level of supplier concentration in the market prior to the merger. This is demonstrated by the pre-merger Herfindahl-Hirschman Index (HHI) for the industry of over 2,250 [X] based on shares of production capacity, or 2,877 based on shares of sales volumes, and a two firm concentration ratio of 65 per cent based on sales volumes.

5.6 With approximately 20 retailers of own-label CSDs being identified during the inquiry, the number of firms buying in the market is considerably greater than the number of suppliers. However, there is a considerable degree of inequality in the distribution of buyer size, with the two largest buyers accounting for around half of the total volume of own-label CSDs purchased and the four largest buyers accounting for around three quarters (see Figure 4).

Indicators of competitive outcomes

5.7 Despite the high level of supplier concentration in the market prior to the merger, the indicators of competitive outcomes of this market show no evidence of any of the suppliers earning profits from their own-label PET-bottled CSD business in excess of their cost of capital. For example:

[REDACTED]^{65,66,67,68}

5.8 While alternative explanations can be advanced for each of these individual observations, we consider that, taken together, these indicate a pre-merger situation characterized by prices being set no higher than competitive levels and a lack of evidence of market power being exercised by suppliers.

5.9 As noted in paragraph 2.32, retailer sourcing practices for own-label CSDs show a general pattern of:

- retailers having an intense focus on prices with retailers regularly seeking price reductions;
- frequent re-tendering or threats to re-tender by retailers as a means of securing lower prices; and
- a shifting of costs and risks, where possible, by retailers on to suppliers.

5.10 Taken together, we consider that these indicators of competitive outcomes prior to the merger point to retailers having been in a strong bargaining position when resisting the pass through of cost increases, or alternatively, seeking price reductions or other improvements in conditions of supply from suppliers.

5.11 We now consider, in turn, a number of aspects of the market for own-label PET-bottled CSDs that are relevant to assessing pre-merger competition, namely the

⁶⁵Operating margin is gross contribution less sales, general and administrative overheads divided by net sales value.

⁶⁶[REDACTED]

⁶⁷Net sales value equates to customer turnover by SKU less customer specific discounts, for example, promotional expenditure.

⁶⁸[REDACTED]

extent of competition between alternative suppliers, the main factors affecting bargaining power in the retailer-supplier relationship, the presence of countervailing buyer power, the level of spare capacity and the threat of entry or expansion.

Pre-merger competition between suppliers of own-label PET-bottled CSDs for different customers

5.12 In this section, we assess whether there was any difference between suppliers of own-label PET-bottled CSDs in terms of the customers they sought to supply prior to the merger. We first consider pre-merger competition between Cott and Macaw, and then consider the extent to which Princes, Silver Spring and Villa had the ability to supply, and were considered potential suppliers by, the full range of retailers prior to the merger.⁶⁹

Pre-merger competition between Cott and Macaw

5.13 Immediately prior to the merger, Cott and Macaw were both supplying own-label PET-bottled CSDs to the four large retailers as well as a number of smaller retailers [REDACTED]. Tender data covering the past five years show that Cott and Macaw had competed against one another to supply own-label PET-bottled CSDs to two further retailers [REDACTED].

5.14 There are a number of retailers for which there is no direct tender-based evidence of Cott and Macaw competing to supply own-label PET-bottled CSDs. Nevertheless, Cott and Macaw should be regarded as competitors for the business of these retailers for at least two reasons.

(a) Although Macaw's top five customers accounted for [REDACTED] per cent of sales volumes and [REDACTED] per cent of revenues in 2005, it did have a number of smaller

⁶⁹We have previously ruled out other existing suppliers of own-label PET-bottled CSDs as competitors to supply retailers and other customers with own-label PET-bottled CSDs (see paragraph 4.16 in relation to AG Barr, paragraphs 4.26 to 4.28 in relation to own-label water suppliers that also supply own-label flavoured sparkling waters, and paragraphs 4.57 to 4.67 in relation to foreign suppliers of own-label PET-bottled CSDs).

customers. Indeed, Macaw had national account managers whose remit was to seek business with all types of retailers.

(b) [REDACTED]

5.15 We consider that Cott and Macaw were competitors for the supply of own-label PET-bottled CSDs across the full range of potential customers prior to the merger and that the impact of the merger should be considered in relation to all of these customers.

Competition for customers by Princes, Silver Spring and Villa

5.16 In response to a CC questionnaire, most retailers told us that Princes and Silver Spring were actual or potential suppliers of own-label CSDs.⁷⁰ [REDACTED]

5.17 Villa, however, was only considered an actual or potential supplier of own-label CSDs by six smaller retailers [REDACTED]. Further, Villa told us that it would not want to commit a large proportion of its production to a single customer. Given these factors, we consider Villa to have been a credible competitor for the supply of own-label PET-bottled CSDs to smaller retailers prior to the merger but we do not consider it to have been a competitor for the supply of own-label PET-bottled CSDs to the four large retailers. (We consider the implications of this finding in paragraph 5.52 where we discuss the level of spare capacity among alternative suppliers of own-label PET-bottled CSDs and the extent to which this was sufficient to facilitate retailer switching prior to the merger.)

Bargaining power in retailer-supplier relationships

5.18 The discussion of retailer sourcing arrangements for own-label CSDs in paragraphs 2.24 to 2.35 sets out the nature of the relationship between own-label CSD suppliers

⁷⁰While this questionnaire was administered following the merger of Cott and Macaw, our discussions with retailers do not indicate that their responses to this question would have been affected by the merger. In many cases, retailers separately identified Cott and Macaw as possible suppliers indicating that they were responding on a pre-merger basis.

and retailers, including retailers' intense focus on prices, frequent re-tendering or threats to re-tender, and a shifting of costs and risks, where possible, by retailers on to suppliers.

5.19 In this section, we discuss the underlying market conditions that contributed to the pre-merger situation where retailers had significant bargaining power in the negotiation of prices and other conditions of supply. These include:

- the ease with which retailers can switch suppliers;
- the competitive impact of suppliers' bidding for retailers' business;
- the flexibility of retailers' buying strategies;
- the importance to suppliers of sales volumes;
- the importance to suppliers of retailers' own-label brands; and
- the non-critical nature of own-label CSDs for the smallest retailers and wholesalers.

Ease of switching supplier

5.20 Switching between suppliers of own-label PET-bottled CSDs is easy for retailers provided that there is sufficient spare capacity at alternative suppliers. (The extent of spare capacity is discussed in paragraphs 5.47 to 5.54.) If customers are able to switch between suppliers quickly and with little cost, then this will facilitate movements between suppliers in order to secure lower prices.

5.21 Many retailers told us that switching suppliers was straightforward and inexpensive.⁷¹ Cott cites recent examples of Lidl, Tesco and Sainsbury's switching to Cott and being supplied in as little as two to 12 weeks. As set out in paragraphs 2.27 to 2.28, many supply agreements operate on a rolling basis or are not formally documented, which means that retailers are not locked in to using their incumbent supplier. Retailers

⁷¹Retailer responses to CC questionnaire.

own the brand name, packaging tends to be homogeneous, and it is relatively straightforward to replicate a recipe. The only costs that a customer seems to have to bear when switching are administrative and logistical. Cott suggested that these costs were limited to tendering costs, establishing new product and supplier codes, and approving product specifications. Retailers also expressed similar views.

5.22 The ease of customer switching, and the practice of retailers periodically re-tendering their supply of own-label PET-bottled CSDs, means that there is generally limited competitive advantage to being the incumbent supplier in terms of obtaining future business when it is re-tendered.

5.23 In contrast to retailers, it appears that agreements with contract packing customers are better defined in terms of their duration (which tends to be one year or longer), and during which period the customer is less able to switch suppliers. However, at the end of any contract, contract packing customers are also able to switch between suppliers with minimal difficulty and expense.⁷²

Competitive impact of suppliers bidding for retailers' business

5.24 Cott submitted that the supply of own-label PET-bottled CSDs fits the three criteria identified by Klemperer⁷³ as necessary to satisfy the 'typical definition of an ideal 'bidding market''. Cott argued that two firms may be enough for perfect competition in a market that satisfies this definition and that there should therefore be little concern about the relationship between market concentration and competition in the supply of own-label PET-bottled CSDs. The three criteria referred to by Cott are:

⁷²Third party brand owners (ie contract packing customers), though, do not appear to have the same aggressive buying behaviour as retailers.

⁷³Klemperer P, *Bidding Markets*, Competition Commission, June 2005.

- Competition is ‘winner take all’ so each supplier either wins all or none of the order. There is therefore no smooth trade-off between the price offered and the quantity sold.
- Competition is ‘lumpy’. That is, each contest is large relative to a supplier’s total sales in a period, so that there is an element of ‘bet your company’ in any contest.
- Competition begins afresh for each contract, and for each customer. That is, if there is any repetition of a contest, there is no ‘lock-in’ by which the outcome of one contest determines another.

5.25 Cott argued that the supply of own-label PET-bottled CSDs fits a further criterion identified by Klemperer, which, if it is also satisfied, defines a market likely to be described as ‘contestable’, where even one supplier may be enough to deliver competitive outcomes. This further criterion is that entry of new suppliers into the market is easy.

5.26 We note that the market for own-label PET-bottled CSDs does not fully meet each of these criteria. Most importantly, individual supply agreements are not always so large that each contest is large relative to a supplier’s total sales. This criterion is only likely to be satisfied in relation to the supply of own-label PET-bottled CSDs to the four large retailers and then only when retailers conduct tenders of large proportions of their business for supply by a single supplier. The lumpiness of even these supply agreements is also limited in that retailers have a propensity to re-tender their supply agreements every 12 months and there appears to be an increasing ‘churn’ of supply agreements (see paragraph 2.32). Nevertheless, the loss of one of these supply agreements can have a substantial impact on a supplier’s financial performance for that year (see paragraph 5.30).

5.27 We also note that Klemperer considers that, once any of the extreme assumptions of an ‘idealised bidding market’ are relaxed, ‘we are quickly back into the familiar world of problems of dominance and unilateral and coordinated effects’.⁷⁴ While the market for own-label PET-bottled CSDs falls short of meeting the criteria for ideal bidding markets, those criteria do reflect structural features of the market that we consider to be relevant to the assessment of pre-merger competition. We discuss in paragraphs 5.28 to 5.33 the particular structural features of this market.

Flexibility of retailers’ buying strategies

5.28 When tendering for own-label CSDs, retailers have flexibility in their buying strategy based on their control over the price determination process. In particular, retailers are able to determine:

- when own-label PET-bottled CSD supply business is tendered;
- the mechanism by which any tender will be conducted (eg various types of e-auction, paper based tender, direct negotiation);
- the size and composition of a tender; and
- the length of any subsequent agreement.

5.29 Retailers are therefore capable of adjusting their buying strategy so as to achieve an outcome that best suits their needs. This flexibility in buying strategies is particularly important in our consideration of the competitive effects of this merger (see paragraph 7.20).

Importance to suppliers of sales volumes

5.30 CSD production is a volume-driven business whereby plant throughput is required to cover fixed costs and generate profits. The loss of an individual supply agreement with a retailer can have a significant impact on a supplier’s overall financial

⁷⁴Klemperer P, *Bidding Markets*, Competition Commission, June 2005, page 4.

performance. For example, in 2005 Macaw's CSD volumes decreased by just over 10 per cent as a result of losing a major supply agreement with [X], which led to a decrease in gross margins of approximately one fifth and operating margins⁷⁵ of nearly half. This means that suppliers have a strong incentive to bid competitively for large volume business. It is significant in this respect that we have seen evidence that suppliers have been willing to take on some large volume business for the sake of a financial contribution even where there is no operating profit once costs have been allocated.

- 5.31 Suppliers are also likely to have a strong incentive to bid competitively for smaller volume business with smaller retailers. It seems that when the business of a smaller retailer is contested suppliers look at this incremental revenue in terms of whether it makes a contribution to covering fixed costs rather than being concerned that it covers its fully allocated costs. [X] From this perspective, this incremental business can appear highly attractive. This may contribute to strong competition for the business of smaller retailers.

Importance to suppliers of retailers' own-label brands

- 5.32 Retailers' brands are the overwhelmingly preponderant route to market for own-label CSD suppliers. In general, own-label CSD suppliers lack the ability to develop markets outside their customer base as their tertiary brands cannot necessarily compete effectively with the heavily advertised primary CSD brands. This means that suppliers of own-label PET-bottled CSDs are heavily reliant on access to the own-label brands of a relatively small number of retailers.

⁷⁵Gross margin is gross contribution divided by net sales value, where gross contribution equates to net sales value less material costs, direct and indirect variable costs and fixed overheads. Operating margin is gross contribution less sales, general and administrative overheads divided by net sales value.

Own-label CSDs are non-critical for the smallest retailers and wholesalers

5.33 As set out in paragraph 4.44, the smallest retail chains and wholesalers may have the capacity to de-list own-label CSDs. The extent to which these customers may withdraw an own-label CSD offering will affect their price sensitivity. In the case of smallest retailers, having far more restricted display space than large retailers means that they have to be more selective about the products they stock. For these retailers, the main branded propositions such as Coca-Cola must be offered to customers. The decision to sell own-label CSDs, on the other hand, must be posited upon their being able to sell them at a reasonably competitive price, while also earning acceptable margins. If they are unable to procure own-label PET-bottled CSDs at reasonably competitive prices, stocking own-label PET-bottled CSDs will become unattractive. This gives these retailers some power to require that the price offered by their suppliers is the most competitive price available.

Countervailing buyer power

5.34 In assessing countervailing buyer power, the CC guidelines state that “buyers, either because of their size or commercial significance to their suppliers, may have the ability to prevent the exercise of market power by suppliers”.⁷⁶ Buyer power, as so defined, refers to the ability of large and commercially significant buyers to obtain from suppliers more favourable terms than those available to other buyers.

5.35 In reporting in 2000, on its investigation into the supply of groceries from multiple stores in the United Kingdom, the CC said that it believed that any multiple grocery retailer “with more than than an 8 per cent share of grocery purchases for resale from its stores, and accordingly all the major buyers (Asda, Safeway, Sainsbury, Somerfield and Tesco), are, for the most part, able to control their relationships with suppliers to their own advantage, whilst the smaller multiples are not able to do so to

⁷⁶CC, *Merger References: Competition Commission Guidelines*, CC2, paragraph 3.58.

anywhere near the same extent".⁷⁷ Given this starting point, we considered it likely that large retailers would, in principle, obtain lower prices for own-label PET-bottled CSDs than smaller retailers.

5.36 However, in relation to the factors discussed in paragraphs 5.19 to 5.33 that contribute to retailers' significant bargaining power over suppliers of own-label PET-bottled CSDs we consider that, with two possible exceptions, these factors apply equally to large and smaller retailers.

5.37 First, we have observed that sales volumes are important to suppliers and clearly large retailers can provide greater sales volumes overall than small retailers. The full impact of this may be partially offset by the tendency of large retailers to split the business they put out to tender into several parts, and smaller retailers concentrating their business into single tenders (see paragraph 2.26). We do not, however, have any reason to think that the large retailers divide their business in way that constrains the full impact of their buying power.

5.38 To the extent that large retailers have larger volumes of business to be won, this might indicate an advantage for large retailers in negotiating prices as suppliers' business models are predicated on achieving operating efficiencies by securing high levels of plant throughput. However, as discussed in paragraph 5.31, it seems likely that when the business of a smaller retailer is contested, the incremental revenues from this business are likely to be considered by suppliers in relation to its capacity to contribute to fixed costs rather than whether it covers fully allocated costs. In addition, we consider that smaller retailers have an additional supplier (Villa) available to them compared to large retailers. We were provided by Cott with many examples of the effectiveness of smaller retailers in negotiating cost reductions and

⁷⁷CC, *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*, Cm4842, 2000, paragraph 2.458.

we are satisfied that there is strong competition for the smaller volumes of business generated by smaller retailers.

5.39 Second, for the smallest retail chains and wholesalers, where own-label PET-bottled CSDs are less critical, these retailers and wholesalers derive some additional strength in their bargaining position from their implicit ability to withdraw or to pare down their offering of own-label PET-bottled CSDs.

5.40 We undertook a quantitative analysis of Cott's and Macaw's margin data to see whether Cott and Macaw achieved higher margins on:

(a) lower volume SKUs compared with higher volume SKUs;

(b) sales to retailers with smaller purchase volumes from Cott and Macaw compared with sales to retailers with larger purchase volumes from Cott and Macaw; and

(c) sales to retailers that purchase smaller volumes of own-label PET-bottled CSDs from all suppliers compared with sales to retailers that purchase larger volumes of own-label PET-bottled CSDs from all suppliers.

5.41 Our analysis of the data (set out in Appendix C) shows no correlation between margins and either the size of a SKU or the retailer's purchase volumes from Cott and Macaw. However, we found a slightly negative relationship between margins and the size of a retailer's overall own-label PET-bottled CSD purchase volumes from all suppliers. This shows that large retailers of own-label PET-bottled CSDs seem to have been able to negotiate a price which has provided Cott and Macaw with fractionally lower margins than those earned from other retailers.

5.42 The lack of significant differentiation in bargaining power between large and smaller retailers might be explained through:

- (a) the effective dissemination to smaller retailers of favourable terms obtained by large retailers through the exercise of countervailing buyer power; and/or
- (b) the presence of other factors that also provide smaller retailers with effective bargaining power over suppliers (see paragraph 5.19).

5.43 Clearly price reductions achieved by large buyers through the exercise of buyer power would be disseminated to smaller buyers in markets in which there is a prevailing 'market rate' at which all transactions take place. However, the supply of own-label PET-bottled CSDs is characterized by individually negotiated prices with customers. Dissemination of the effects of countervailing buyer power of large retailers to smaller retailers under these circumstances might be facilitated by a degree of price transparency that would allow smaller retailers to negotiate more effectively so as to follow the price deals negotiated by large retailers. We consider that there is some price transparency between competing suppliers due to the frequency of tenders and the increasing use of e-auctions. Although there is relatively little evidence that retailers are systematically aware of the price paid by other retailers for own-label PET-bottled CSDs we would not exclude the possibility that the necessary pricing information, to some extent, comes into the knowledge of smaller retailers.

5.44 We consider that it is also possible that favourable terms achieved by large retailers are disseminated to smaller retailers because of the specific nature of the competition between different retailers' offerings of own-label PET-bottled CSDs. In other words, a smaller retailer will have little incentive to devote shelf space to an own-label CSD offering unless it can offer a price that is reasonably competitive with large retailers' own-label CSD offerings while also providing the smaller retailer with an acceptable margin. To do so, it therefore needs to obtain its own-label PET-bottled CSDs on terms similar to those on which large retailers are supplied.

- 5.45 Additionally, it was put to us that smaller retailers may experience less security of supply than large retailers in peak periods. This difference in service levels could, in principle, partly explain why suppliers of own-label PET-bottled CSDs are willing to supply smaller retailers at the same margin as large retailers (ie supply to smaller retailers is regarded as interruptible). However, we have no evidence that smaller retailers are treated any differently to large retailers in relation to quality of service.
- 5.46 In paragraph 5.19, we set out the factors that contribute to retailers having significant bargaining power over suppliers of own-label PET-bottled CSDs. We consider that the combination of (a) the dissemination of the effects of the buyer power of large retailers to smaller retailers, and (b) the presence of these other factors that provide smaller retailers with effective bargaining power, support the view that smaller retailers do not have a significantly weaker bargaining position than large retailers with respect to suppliers of own-label PET-bottled CSDs.

Level of spare capacity

- 5.47 This section considers the level of spare capacity among those suppliers of own-label PET-bottled CSDs that we consider to be pre-merger competitors for the supply of own-label PET-bottled CSDs to retailers and other customers (ie Cott, Macaw, Princes, Silver Spring and Villa). Given the ease of switching, set out in paragraphs 5.20 to 5.23, the presence and extent of spare capacity is important in determining retailers' actual ability to switch between suppliers. In this section, we consider the extent to which there was sufficient spare capacity to facilitate retailer switching between suppliers prior to the merger.
- 5.48 The extent of spare capacity at each supplier will be determined by the number of production lines currently capable of producing own-label PET-bottled CSDs

(consistent with our market definition), the maximum capacity of these production lines, and the extent to which these production lines are already being used.

- 5.49 In theory, the nameplate capacity of a production line measures its maximum output based on a 24-hour, 7-day-week work pattern. In practice, however, a number of factors will operate to reduce significantly the maximum level of output obtainable from a production line. These factors include downtime for job changes, planned downtime for maintenance, and unplanned breakdowns.
- 5.50 Seasonality of demand may also mean that while there is spare capacity on a production line for part of the year. This spare capacity cannot be allocated to new business as the supplier would not then have the capacity to meet peak demand from its existing business.⁷⁸ Finally, there may also be constraints, such as established working practices, on a supplier's ability to implement a 24-hour, 7-day-week shift pattern, which further limit the maximum output it can achieve.
- 5.51 Table 5 sets out our estimate of the current level of spare capacity on existing CSD capable production lines at each of Cott, Macaw, Princes, Silver Spring and Villa based on existing work patterns.⁷⁹ Further explanation of how these estimates have been developed is set out in Appendix E.⁸⁰

⁷⁸Stock build up and run down will also be used by suppliers to manage through peak or troughs in demand. Evidence from a number of suppliers, however, suggest that it is not possible to meet all the seasonal variation in this way.

⁷⁹[§].

⁸⁰While the estimates of spare capacity in Table 5 relate to the current post-merger period, changes in capacity since the time of the merger have not been significant, and as a result, we consider these estimates to be a reasonable proxy for the pre-merger period. [§]

TABLE 5 Estimated CSD production capacity and spare capacity on existing CSD capable production lines under existing work patterns

Supplier	Nameplate capacity (million litres)	Reduction in production capacity due to:				Usable capacity (million litres)	Sales 2006 est. (million litres).	Spare capacity (million litres)
		Work patterns %	Seasonality %	Product changes and maintenance %	Total %			
Cott	[]							
Macaw								
Princes								
Silver Spring								
Villa								

Source: CC analysis of supplier data.

Note:

1. []
2. []
3. Some figures in this table may not tally due to rounding.

5.52 Based on these estimates the total spare capacity that would have been available pre-merger is around one-sixth [] of total usable capacity, which is almost as large as the total demand of the retailer with the largest volume of own-label PET-bottled CSD sales. This would have been enough to allow sufficient switching by retailers to make a price rise by Cott uneconomic.⁸¹

5.53 Competitors could, in any event, achieve higher levels of usable capacity (and thus spare capacity) by, for example, adopting measures to address seasonality effects or time lost to maintenance. For example, it could rent temporary warehousing space so as to increase its stock-holding capacity and reduce the impact of seasonality, or employ additional resources to perform maintenance tasks more quickly (although this would be more expensive) and thus reduce downtime. Suppliers may also be able to increase usable capacity by increasing working hours, for example, by moving from existing work patterns to a 24-hour, 7-day-week shift pattern (subject to any workforce related constraints).

⁸¹Although we do not consider Villa as a competitor for the supply of own-label PET-bottled CSDs to the four large retailers (see paragraph 5.17), Villa's spare capacity can be given equal weight with Princes and Silver Spring and needs to be taken into consideration because any business that it wins from smaller customers releases capacity at competitors' plants.

5.54 To the extent that any of these or other measures to increase usable capacity in the short-term carries an associated cost, this may impact on the sustainability of the capacity increase. In some cases, a sustained increase in demand may lead a supplier to implement certain capacity enhancing measures as a short term solution prior to more permanent measures to expand capacity. We discuss expansion and new entry in paragraphs 5.55 to 5.69.

Threat of entry and expansion

5.55 In this section we assess the extent to which, prior to the merger, the threat of entry by a new competitor, or expansion by an existing competitor, in response to higher prices would have constrained the exercise of any supplier power that may have existed in the own-label PET bottled CSD market. We have evaluated the attractiveness of entry or expansion in the market both at current prices (which we consider to be a reasonable proxy for pre-merger prices) and in response to a 5 per cent price increase (see Appendix D).⁸² We consider four possible forms of entry or expansion:

- (a) expansion by an existing supplier of own-label CSDs;
- (b) entry by a supplier of other own-label soft drinks, such as still drinks, DTT drinks or bottled water;
- (c) entry by a supplier of primary branded CSDs; and
- (d) entry by foreign suppliers of own-label CSDs.

5.56 We then consider the likelihood of a retailer sponsoring entry or expansion prior to the merger.

⁸²Were prices to increase in the short term, then the exercise of market power by suppliers would be defeated if sufficient entry or expansion was attracted to return prices to the competitive levels which characterized the pre-merger situation.

Expansion by an existing supplier of own-label PET-bottled CSDs

- 5.57 Production capacity could be expanded by an existing supplier of own-label PET-bottled CSDs in two ways. First, it may be possible to undertake investments that allow it to increase the capacity of its existing production lines, and second, it can invest in additional production lines.
- 5.58 Cott provided us with an example of this first type of investment. It told us that it had been able to expand the production capacity of one of its lines by investing in a new blow moulder that allowed it to increase nameplate capacity on that line by [X] bottles an hour. Depending on the circumstances, this type of investment in additional capacity may be cheaper than converting existing spare capacity on another production line that is not currently capable of producing CSDs. [X]. Opportunities for this type of investment may, however, be limited. Any significant capacity expansion is likely to require an additional production line.
- 5.59 The likelihood of expansion by an existing competitor, and the constraint it represents to other competitors, depends on the cost of expansion and the likelihood that the supplier will be sufficiently confident of being able to sell enough output from the new capacity to earn an acceptable return on its investment.
- 5.60 In Appendix D, we set out the cost of an additional production line. For a current producer of own-label CSDs, the cost of this investment will vary according to whether it has sufficient space available in its existing buildings or whether it requires a completely new building to house the additional production line or additional warehousing space.
- 5.61 Assuming that sufficient space is available and the line could be constructed using refurbished rather than new equipment, we estimate that it would cost approximately

£1.5 million. The estimated payback period for this investment, based on current own-label PET-bottled CSD prices as well as certain assumptions regarding the level of sales from the new line,⁸³ is four years.⁸⁴ This is reduced to three years if the price of own-label PET-bottled CSDs is assumed to increase by 5 per cent. In the event that the line was established using both new and refurbished equipment, as might be likely given that we were told that suitable refurbished equipment is not always available, this payback period would be longer.

- 5.62 The estimated payback period for investment in an additional line indicates that a supplier would only undertake this investment if it had a reasonable expectation of sufficient new business for this line over the period required in its investment appraisal. This expectation is more likely to be satisfied if the new production line is capable of producing other soft drinks as well as CSDs. Recent investments in new production lines [✂] have generally (but not always) been in multi-purpose lines.

Entry by a supplier of other own-label PET-bottled soft drinks

- 5.63 In considering the market definition for own-label PET-bottled CSDs, we did not consider that suppliers of other own-label PET-bottled soft drinks would supply-side substitute into the production of own-label PET-bottled CSDs in response to a 5 per cent increase in the price of own-label PET-bottled CSDs (see paragraphs 4.26 to 4.28). The difference between entry and supply-side substitution is that entry is likely to occur over a longer period and may require more significant investment. Given our findings that suppliers of other own-label soft drinks are not considering competing generally in the supply of own-label PET-bottled CSDs, we have no reason to expect that prior to the merger these firms would have acted as a threat in

⁸³We assume that sales from the new line are 1.7 million cases in year one, 3.3 million cases in year two, and 5.0 million cases a year thereafter.

⁸⁴In the event that a soft drinks producer did not have sufficient space available and required a new building to install the new CSD production line as well as additional warehousing facilities (ie the same set of assumptions that we have also used for a completely new entrant to the own-label CSD business), then the net present value of the cash flows from this investment, under current own-label CSD prices, would be negative. If own-label CSD prices increased by 5 per cent, then the payback period would be approximately nine years.

terms of entering the market for own-label PET-bottled CSDs either at current price levels or in response to a 5 per cent price increase.⁸⁵

Entry by a supplier of primary branded CSDs

5.64 As with suppliers of other own-label soft drinks, we do not consider that suppliers of primary branded soft drinks would supply-side substitute into the production of own-label PET-bottled CSDs in response to a 5 per cent increase in the price of own-label PET-bottled CSDs (see paragraphs 4.15 to 4.19). Given our findings that the suppliers of primary branded CSDs have no interest in the supply of own-label CSDs, we have no reason to expect that, prior to the merger, suppliers of primary branded CSDs would have acted as a threat in terms of entering the market for own-label PET-bottled CSDs either at current price levels or in response to a 5 per cent price increase.

Entry by foreign suppliers of own-label CSDs

5.65 Entry into the market could come from a foreign supplier of own-label PET-bottled CSDs. In our discussion of the geographical extent of the market for own-label PET-bottled CSDs (see paragraphs 4.57 to 4.67), we note the limited use of own-label CSD suppliers from Northern Ireland and the Republic of Ireland by a number of retailers, and Lidl's use of own-label CSD suppliers in France (Roxane) and Germany (Hansa). We conclude, however, that for the generality of business for the supply of own-label PET-bottled CSDs, transport costs pose a significant barrier to competition from foreign suppliers. Given these findings, we have no reason to expect that foreign suppliers of own-label PET-bottled CSDs would have acted as a threat in terms of entering the market for the supply of own-label PET-bottled CSDs prior to the merger either at current price levels or in response to a 5 per cent price increase.

⁸⁵As noted in paragraph 4.28, we agree that flavoured sparkling water, as produced by many own-label water companies, may be classified as a CSD. However, the evidence provided by own-label water companies does not support the view that these firms would have acted as a threat in terms of entering the supply of own-label PET-bottled CSDs more generally.

Sponsored entry or expansion

- 5.66 To the extent there are risks or barriers associated with entry or expansion, a retailer could, in principle, facilitate any necessary new investment by giving assurances over prices or volumes of business and thereby provide sufficient security for this new investment to be undertaken. Our analysis in Appendix D shows the estimated payback periods for investment in new or additional production lines. These payback periods range from three to nine years, or longer, depending on the assumptions (detailed in Appendix D). As a result, sponsorship by a retailer could be an important element of ensuring that new investment takes place. The greater the likelihood of sponsored entry or expansion, the greater the competitive threat represented by entry or expansion.
- 5.67 Cott cites several examples of sponsored entry: Cott entered the UK market through collaboration with Sainsbury's; Macaw became established through relationships with Morrisons and Tesco; Shepley Spring commenced production of still and sparkling water through collaboration with Morrisons; and we were told that Montgomery Spring started supplying water through a relationship with Co-op.
- 5.68 In the case of Macaw, Mr Andrew Cawthray told us that [REDACTED] would source supplies from Macaw once production commenced.
- 5.69 A number of retailers told us that if the price of own-label CSDs were to increase they might consider sponsoring entry or expansion by providing some kind of reassurance, but without any commitment, about volumes. Moreover, the ease with which a retailer can switch supplier suggests that a prospective entrant (or competitor considering expansion) would find non-contractual assurances, in isolation, to be an insufficient basis for any large scale investment. To the extent that some kind of contractual commitment on the part of a retailer would have been necessary to

ensure entry or expansion prior to the merger, this would have required a major change in retailers' current procurement practices, which require short term and flexible agreements in own-label CSD supply.

Other soft drinks

5.70 In paragraph 4.69, we note that prior to the merger Cott and Macaw supplied a number of other soft drinks, including aseptic drinks, still drinks, DTT drinks and bottled water. Table 6 shows Cott and Macaw's share of sales by volume for own-label still drinks, DTT drinks and bottled water. It can be seen that the combined share for Cott and Macaw in these soft drink categories is relatively low.

5.71 Given that the product market for each of these drinks could be significantly wider than own-label once all demand- and supply-side substitution possibilities are taken into account, we consider that the combined share for Cott and Macaw represents the upper end of any estimate of their combined market share (expressed in terms of sales by volume) in these soft drink categories.

5.72 If market shares are expressed in terms of production capacity, Cott and Macaw's combined market share in each of these soft drink categories may be higher. The extent of this increase, however, is likely to be modest.⁸⁶ We discuss the competitive effects of the merger on these other soft drinks in paragraphs 7.24 to 7.26.

⁸⁶Supply-side substitution would allow Cott's and Macaw's production capacity for other soft drinks to be counted towards their market share, expressed on a production capacity basis, in each of these categories. The size of this increase, however, would be limited by the inclusion of other soft drink production capacity for their competitors in each category.

TABLE 6 **Cott and Macaw's share of sales by volume for own-label still drinks, DTT drinks and bottled waters**

<i>Product</i>	<i>Cott</i>	<i>Macaw</i>	<i>Combined Cott and Macaw</i>
Own-label still drinks	5%	0%	5%
Own-label DTT drinks	approx 15%	less than 5%	less than 20%
Own-label bottled water (still and sparkling)	less than 1%	less than 1%	less than 2%

Source: Based on Zenith International, 2005. Adjustments made for post-2004 events (eg the recent commissioning of Macaw's DTT line).

6. Counterfactual

6.1 In deciding whether the merger gives rise to an SLC, we must compare the competitive position following the merger with the competitive situation absent the merger (the counterfactual).

6.2 The evidence we received demonstrated that Macaw was a profitable, investment led business with a positive cashflow that, had the sale not taken place, would have been able to continue as an independent company. We do not consider that Macaw's loss of [redacted] as a customer for own-label CSDs in 2005 adversely affected its ability to continue as an independent company. By the time of Macaw's sale to Cott, sales volumes that had been lost to [redacted] had been largely replaced with new business.⁸⁷

6.3 It is not clear whether Macaw would have been sold to another bidder had the sale to Cott not taken place even though other offers were made for the business. Mr Andrew Cawthray, the principal shareholder in Macaw, told us that the sales process resulted from a number of approaches made by third parties in late 2004. The sales process was a targeted auction that sought primarily to assess the appetite of a limited number of potential acquirers and the value obtainable. It was not a

⁸⁷ Approximately half of this replacement business was in CSDs and the remainder in DTT drinks. Cott considers that as the new DTT drinks business related to a separate investment it should not be considered a replacement for lost CSD sales.

forced sale. Mr Cawthray told us that if he had not sold the business to Cott, it was likely that he would have retained ownership.

- 6.4 Our assessment of the counterfactual might be affected if we had an expectation that the alternative to Cott acquiring Macaw was another industry participant acquiring Macaw that would have also raised competition concerns. However, a review of the sales process showed that in the absence of the Cott offer, the next two most highly ranked offers for Macaw would not have raised any competition concerns. (Further, as noted in paragraph 6.3, we cannot be certain that Macaw would have been sold to another bidder in any event.)

7. Effects of the merger

- 7.1 In this section we examine the competitive effects of the acquisition and consider, as required under the Act,⁸⁸ whether the merger has resulted or may be expected to result in an SLC within any market or markets in the UK for goods or services. We first consider the impact of the merger on the market for own-label PET-bottled CSDs. We then consider the impact of the merger on the supply of other soft drinks.

Own-label PET-bottled CSDs

- 7.2 Cott's acquisition of Macaw has significantly increased its share of the market in Great Britain for the supply of own-label PET-bottled CSDs. Post-merger, Cott has a market share of around 50 per cent ([REDACTED] per cent) based on its share of production capacity, or 65 per cent based on its share of sales by volume (see Table 4 above). The industry as a whole has also become significantly more concentrated. The HHI index has increased from more than 2,250 [REDACTED] to more than 3,500 [REDACTED], based on capacity shares, or based on sales shares, from 2,877 to 4,890. Based on capacity shares, the two firm concentration ratio has increased from [REDACTED] per cent to [REDACTED] per

⁸⁸Section 36(1)(b).

cent, and from 65 per cent to 89 per cent based on sales volumes. The increase in Cott's market share as a result of the merger is, on the face of it, a significant cause for concern that the merger might lead to an SLC on either a unilateral or coordinated effects basis.

- 7.3 In the following paragraphs, we examine the possibility of the merged entity unilaterally increasing prices or otherwise exercising market power. We then examine the possibility of the merged entity being able to act in a coordinated manner with other suppliers of own-label PET-bottled CSDs to increase prices or otherwise exercise market power.

Unilateral effects

- 7.4 Cott's ability to increase prices unilaterally following the merger depends on the extent to which it is constrained by:

- (a) the bargaining power of retailers with respect to Cott;
- (b) the volume of spare capacity at competing suppliers of own-label PET-bottled CSDs; and
- (c) the threat of entry⁸⁹ by new competitors or expansion by existing competitors.

Retailers' bargaining power

- 7.5 Prior to the merger, retailers had significant bargaining power over suppliers of own-label PET-bottled CSDs in the negotiation of prices and other conditions of supply. This is due to some combination of the effective dissemination of the effects of buyer power from large retailers to smaller retailers and the presence of other factors that also provide large and smaller retailers with effective bargaining power over suppliers. These factors, identified in paragraph 5.19, are:

- the ease with which retailers can switch suppliers;

⁸⁹In considering the threat of entry preventing a price increase, we also consider the extent to which competitors would actually enter in response to price rise, thereby mitigating an increase in prices.

- the competitive impact of suppliers' bidding for retailers' business;
- the flexibility of retailers' buying strategies;
- the importance to suppliers of sales volumes;
- the importance to suppliers of retailers' own-label brands; and
- the non-critical nature of own-label CSDs for the smallest retailers and wholesalers.

7.6 We do not find that large retailers have differentiated bargaining power such that they are able to obtain more favourable terms than those available to smaller retailers. This is due to some combination of the effective dissemination of the effects of buyer power from large retailers to smaller retailers and the presence of factors that also provide large and smaller retailers with effective bargaining power over suppliers.

7.7 We do not consider that the merger of Cott and Macaw affects the factors set out above that contribute to retailers' bargaining power or any possible dissemination of the effects of buyer power from large retailers to smaller retailers. Retailers will continue to be able to switch easily between suppliers of own-label PET-bottled CSDs, subject to any capacity constraints (see paragraphs 7.7 and 7.8). Retailers will continue to have considerable control over the price determination process. Sales volumes of own-label brands of both large and smaller retailers will continue to be a key driver of suppliers' profitability and retailers will continue to own the brands that constitute the overwhelmingly dominant route to market for suppliers of own-label CSDs. Finally, own-label CSDs will continue to be subject to the possibility of delisting by the smallest retailers and wholesalers.

Spare capacity

7.8 For Cott to be able to increase prices unilaterally and profitably following the merger, it would need its competitors to be at or close to full capacity such that they would not

be able to attract significant volumes of business by undercutting Cott's increased prices before running out of spare capacity.⁹⁰ Once competitors' capacity is fully utilised, Cott would then be in a position to increase prices unilaterally without losing further volumes to them. Given the volumes of spare capacity available, under existing work patterns, at Cott's post-merger competitors (ie Princes, Silver Spring and Villa), see Table 5, and assuming that this could, and would, all be used to take volumes from Cott,⁹¹ Cott would need to increase prices by more than 10 per cent so as to compensate it for the volumes of business lost to its competitors.⁹²

7.9 However, we consider that such a price increase would not be sustainable as competitors would have an incentive to achieve higher levels of usable capacity, and thus spare capacity, through increasing working hours, or adopting other measures to reduce the impact of seasonality or planned downtime. As a result, any increase in price by Cott would be likely to result in its competitors not only using existing spare capacity but also taking measures to increase the volume of spare capacity available to them and thus undercut any price increase that Cott sought to impose.

Entry and expansion

7.10 We estimate that the likely payback period for investment in a new CSD production facility, including building and warehousing, is nine years or longer, depending on the assumptions employed (see Appendix D). Sponsorship of new entry by a retailer might assist in addressing the risks associated with this investment. However, we are unable to form an expectation that retailers would sponsor new entry in response to increased prices.

⁹⁰Our analysis of pre-merger competition shows the importance to suppliers of sales volumes. As a result, we expect that any post-merger price increase by Cott would result in its competitors responding, to the extent they have spare capacity, by offering lower prices than Cott in order to increase their own sales volumes.

⁹¹We discuss in paragraphs 5.16 to 5.17 the extent to which each of these competitors can be regarded as potential suppliers for the full range of customers. In the footnote to paragraph 5.52, we explain why Villa's spare capacity can be given equal weight to that of Princes and Silver Spring even though, unlike these two other suppliers, is not regarded as a competitor for the supply of own-label PET-bottled CSDs to the four large retailers.

⁹²This 10 per cent price increase is the increase that would be required to ensure that the merged entity would retain profitability (in terms of variable contribution) if competitors used all available spare capacity (based on existing work patterns) to take volumes from the merged entity.

- 7.11 In paragraphs 5.63 to 5.65, we consider the threat of entry by suppliers of other own-label PET-bottled soft drinks, primary branded CSDs and also foreign suppliers. In each case we conclude that entry into the supply of own-label PET-bottled CSDs is unlikely. We do not consider that this situation has changed post-merger.
- 7.12 Expansion by an existing competitor in own-label PET-bottled CSDs, however, may be more likely than entry. Existing suppliers may be able to undertake relatively small investments to expand production capacity on existing lines, and in some cases, this may be cheaper than converting spare capacity on production lines that are not currently capable of producing PET-bottled CSDs. Opportunities for this type of small investment may, however, be limited.
- 7.13 Investment in a new line by an existing supplier, assuming that there are orders to fill the additional capacity (on the basis of existing work patterns) and access to refurbished equipment, would have a payback period of less than four years. Existing suppliers of own-label PET-bottled CSDs have undertaken investments in recent years, and are planning further investments in production capacity. While existing suppliers will be well informed about current market conditions, we consider that they are likely to have difficulty in forecasting capacity utilization due to the short-term nature of supply agreements and the ease with which retailers can switch suppliers. We consider that this would limit any expansion by existing competitors.
- 7.14 We consider that expansion by existing competitors is more likely to occur than entry by new competitors. However, it may only have a limited impact in terms of increasing total production capacity and thus in constraining Cott's ability to increase prices unilaterally.

Conclusion on unilateral effects

- 7.15 Following the merger, there has been a significant increase in concentration among suppliers of own-label PET-bottled CSDs. This has been a source of concern. However, we conclude that retailers' bargaining power together with the degree of spare capacity available for the production of own-label PET-bottled CSDs and, to a lesser extent, the possibility of expansion by existing competitors will, therefore, on balance constrain Cott's ability to increase prices unilaterally or otherwise exercise market power.
- 7.16 We provisionally find that the merger of Cott and Macaw has not and may not be expected to result in an SLC in the market for own-label PET-bottled CSDs in Great Britain as a result of the unilateral exercise of market power.
- 7.17 In relation to the supply of own-label PET-bottled CSDs in Northern Ireland, we consider that retailer-supplier relationships are unlikely to be significantly different from those in Great Britain. Given this, and the smaller market presence of Cott and Macaw in the market for own-label PET-bottled CSDs that includes Northern Ireland and the Republic of Ireland, we provisionally find that the merger of Cott and Macaw has not and may not be expected to result in an SLC in this market as a result of the unilateral exercise of market power.

Coordinated effects

- 7.18 In the absence of a finding that unilateral effects are likely to follow from the merger, we consider whether coordinated effects might arise.
- 7.19 We recognize that a higher concentration of suppliers may result in a greater risk of coordinated behaviour. However, we heard no evidence to suggest that there had

been any history of coordination in this market in recent years nor any suggestion that the merger would be likely to lead to coordination.

7.20 We consider that retailers' bargaining power, which contributes to our expectation that Cott would not be able to increase prices unilaterally following the merger is also a key reason for considering that coordinated effects would not arise following the merger. In particular, retailers' could take advantage of the flexibility of their buying strategies through, for example, offering greater volumes of business in a single tender, offering longer supply periods, or altering tender processes, to create sufficient incentive for a supplier to deviate from any coordinated behaviour.

7.21 As a result, we provisionally find that the merger of Cott and Macaw has not and may not be expected to result in an SLC as a result of the coordinated exercise of market power.

Own-label canned CSDs and other soft drinks

7.22 Prior to the merger, Cott and Princes were the only two suppliers of canned own-label CSDs in Great Britain. We could only expect the merger to give rise to an SLC if Macaw could have been regarded as a potential supplier of own-label canned CSDs that imposed a competitive constraint on Cott and Princes in relation to this product.

7.23 Mr Jonathan Foster, former Finance Director of Macaw, told us that prior to its acquisition by Cott, Macaw had had no plans to invest in a production line for canned CSDs although it had not ruled out the possibility of such an investment in the future. We saw no other evidence of plans by Macaw to commence production of own-label canned CSDs. As a result, we provisionally find that the merger has not and may not be expected to result in an SLC in the market for own-label canned CSDs.

- 7.24 Prior to the merger, Macaw was the sole supplier of own-label PET-bottled aseptic drinks in Great Britain. We would only expect the merger to give rise to an SLC in this market if Cott could have been regarded as a potential supplier of own-label PET-bottled aseptic drinks that imposed a competitive constraint on Macaw in relation to this product. Cott told us that prior to the merger it had no plans to invest in an aseptic production line; its investment plans prior to the merger were focused on other opportunities. We saw no evidence that it planned to invest in an aseptic drinks production line. As a result, we provisionally find that the merger has not and may not be expected to result in an SLC in the market for own-label PET-bottled aseptic drinks.
- 7.25 In paragraphs 5.70 to 5.72, we discuss Cott and Macaw's combined share of sales by volume in own-label PET-bottled still drinks, DTT drinks, and bottled water. Even on a narrow own-label product market definition, the merged entity has a small market share in each of still drinks and bottled water (5 per cent and 2 per cent respectively, based on sales volumes). Given these small market shares, and the similarities of the market structure to own-label PET-bottled CSDs in terms of retailer-supplier relationships, we provisionally find that the merger has not and may not be expected to result in an SLC in the markets for own-label still drinks or bottled water.
- 7.26 For own-label PET-bottled DTT drinks, Cott and Macaw have a combined share of sales volumes that is somewhat greater at approximately 20 per cent. However, given that Princes has a sales share of approximately 80 per cent, and the similarities of the market structure to own-label PET-bottled CSDs in terms of retailer-supplier relationships, we provisionally find that the merger has not and may not be expected to result in an SLC in the market for own-label PET-bottled DTT drinks.

Provisional findings

7.27 We provisionally find that the acquisition of Macaw by Cott constitutes a relevant merger situation. We also provisionally find that the acquisition of Macaw by Cott has not resulted and may not be expected to result in an SLC within any market or markets in the UK.