

# 8 Conclusions

## Introduction

8.1. Elders IXL Ltd (Elders) acquired the United Kingdom brewer Courage from Hanson Trust PLC in November 1986. We have explained in Chapter 3 that, after talks with the management of Scottish & Newcastle Breweries PLC (S & N), which did not result in any form of agreed merger, Elders acquired a substantial shareholding in S & N, and made a full bid in October 1988.

## The merger situation

8.2. Under a reference (the first reference) made on 9 November 1988 under sections 69(2) and 75 of the Fair Trading Act of 1973 (the Act) we are required to investigate and report whether arrangements are in progress, or in contemplation, which, if carried into effect, would result in the creation of a merger situation qualifying for investigation as defined in section 64(8) of the Act, in that enterprises carried on by or under the control of S & N (being a body corporate incorporated in the United Kingdom) would cease to be distinct from enterprises carried on by or under the control of Elders and that the condition set out in section 64(1)(b) of the Act would be satisfied. (See Appendix 1.1 for terms of reference.)

8.3. It is clear from evidence given to us during the course of the inquiry that, if it is permitted to do so, Elders intends, either directly or through a subsidiary, to make a further offer for the shares of S & N which it does not already own.

8.4. The assets of S & N exceed £30 million (see Table 3, Appendix 4.1). The condition set out in section 64(1)(b) of the Act is therefore satisfied.

8.5. We conclude that arrangements are in contemplation by Elders for the acquisition of S & N which, if carried into effect, would result in the creation of a merger situation qualifying for investigation (the merger in contemplation).

8.6. Immediately after Elders had been informed on 10 November 1988, through its legal representatives, that the Secretary of State had referred the proposed acquisition to the Commission, Elders acquired, directly or through subsidiaries, a further substantial number of shares in S & N. It had thus raised its total shareholding of the ordinary capital from some 14 per cent on 9 November 1988 to 23.6 per cent on 10 November. At the time of the acquisition there was some controversy over Elders' acquisition of shares on 10 November. It is not necessary for us to comment on this action.

8.7. We are also required to investigate and report under a second reference made on 7 December 1988 under sections 64 and 69(2) of the Act. This second reference deals with the question whether a merger situation qualifying for investigation, as defined in section 64(8) of the Act, has been created in that enterprises carried on by or under the control of S & N (being a body corporate incorporated in the United Kingdom) had, within the six months preceding the date of the reference, ceased to be distinct from enterprises carried on by or under the control of Elders and that the condition set out in section 64(1)(b) of the Act is also satisfied (see Appendix 1.1 for terms of reference). For the reason given in paragraph 8.4, the condition is satisfied.

8.8. Under the second reference, therefore, we have to determine whether, in the six months preceding the date of the reference, a merger situation qualifying for investigation was created. In so doing, following sections 64 and 65 of the Act, we have to consider whether Elders' holding of 23.6 per

cent gave it the ability to control or materially to influence the policy of S & N. We are satisfied that the holding was built up to this figure during that period of six months. Elders' holding on 7 June 1988 was 2.89 per cent. For completeness, we would mention that, by virtue of the issue of further ordinary shares by S & N, the holding is now 23.58 per cent but we do not consider that this has any significance in the present context.

8.9. On 10 November 1988, the Secretary of State made an Order which, among other things, restricted Elders from exercising 15 per cent or more of the total voting rights of S & N. Elders has submitted that its holding in S & N does not give it the ability to control or materially to influence S & N's policy. We have considered carefully the position in this respect. Clearly, one consequence of the Order is that direct evidence of the extent to which the existence of the holding has given Elders the ability to control or materially to influence S & N's policy since the Order is lacking. But this does not in itself prevent conclusions being drawn from the situation as a whole including what we would expect to happen if the restriction on voting, arising from the Order, should cease to have effect after the Commission's report has been laid before Parliament (see section 74(4) of the Act). Nor do we consider that the existence of the restriction precludes us that it is the intention or effect of the Act that we should be precluded by a restriction of this nature from looking at the situation as a whole. In what follows, therefore, we have regarded it as correct to leave aside the temporary effect of the Order of 10 November.

8.10. Elders' holding is by far the largest single shareholding in S & N. Given the normal pattern of voting at general meetings of S & N, it seems to us most improbable that when special resolutions are concerned sufficient shareholders (not less than 75 per cent) would outvote Elders on any particular resolution. Special resolutions are necessary to provide the directors with increased borrowing powers and the authority to allot shares. Elders would, therefore, be in a position at general meetings to prevent the passing of such resolutions with a shareholding of over 23 per cent.

8.11. We would also expect that, over a period of time, some at least of the other shareholders would be likely to vote with Elders on ordinary resolutions, which require a simple majority of votes. On some matters Elders might, in time, gain approval for its own ordinary resolutions. Elders could also be expected to be able to influence some of the shareholders in relation to the appointment of directors. We think it likely that in time Elders could block the appointment of directors whom it regarded as unfavourably disposed towards Elders or could even secure the appointment of its own representatives. We also think it likely that in the longer term, rather than face continuing disputes with a major shareholder, S & N would be forced to seek some form of accommodation with Elders.

8.12. We do not consider that, in the present circumstances, Elders has the ability to control the policy of S & N. We do consider, however, that Elders' potential ability to block special resolutions and the potential that it may have in the future to block ordinary resolutions, or put forward ordinary resolutions of its own with a reasonable prospect of these being passed, is such as to provide it with the ability materially to influence the policy of S & N.

8.13. We conclude therefore that, under section 65 of the Act, enterprises carried on by or under the control of Elders and S & N have, within the six months preceding the date of the second reference, ceased to be distinct from each other; and that therefore a merger situation (the merger in being) qualifying for investigation has been created.

### **The background to the merger**

8.14. There are at present in the United Kingdom some 70 or so companies which brew beer and sell it through their own retail estates (mainly public houses), to other retail outlets, sometimes described as the 'free' trade, and to the off-licensed trade. Many of these companies, however, are small and sell their beer only over a local area. In this reference we are concerned with two of the largest brewers in the United Kingdom. Courage supplies approximately 10 per cent and S & N approximately 11 per cent of total beer supply in the United Kingdom. Both companies have substantial estates of public houses, some 5,020 in the case of Courage and 2,270 in the case of S & N. If the merger were allowed both companies together would have approximately the same number of public houses (some 7,000) and volume of beer sales (22 per cent) as the largest United Kingdom brewer, Bass.

8.15. The recent history of the two companies is rather different. S & N was formed, as its name suggests, from brewers in Scotland and the North-East of England. It has recently acquired a brewer in the Midlands (Home Brewery) and another in the North-West of England (Matthew Brown). S & N has diversified into the hotel business, owns a maltster, and recently acquired a major interest in Pontin's Ltd which it has amalgamated with other leisure interests it acquired with Matthew Brown. Although S & N's tied estate is situated mainly in the North of England and the Midlands, it has established a significant free-trade wholesaling business in parts of the South of England and is one of the United Kingdom's major suppliers of beer to the off-licensed trade. In Scotland, where brewers own relatively few public houses, S & N is one of the two major suppliers (Bass being the other) to the free trade.

8.16. Courage was formed during the 1950s and 1960s from a number of breweries in the South and South-West of England and in Yorkshire. In 1972 Courage was acquired by the Imperial Group and remained part of Imperial until 1986 when that company was acquired by Hanson Trust PLC. In November 1986 it was acquired by Elders, an Australian company based in Melbourne.

8.17. The Elders group can be described as a conglomerate with four core businesses: brewing, an agribusiness, a financial services business and a partly-owned natural resources business. The brewing business now includes Courage in the United Kingdom, the Carlton and United Brewery Company in Australia and Carling O'Keefe Brewery<sup>1</sup> of Canada, which was purchased in 1987. Elders' brewing business is based predominantly on brand marketing, particularly of its major lager brand, Foster's, although certain of its United Kingdom ale brands have also been heavily promoted. Elders told us that it regards its core business of brewing predominantly as a brewing function and not (in the manner of many other United Kingdom brewing companies) as that of a property owner or retailer as well. Elders has transferred many of the Courage managed public houses to tenancies, with, it believes, satisfactory results in terms of increased throughput of beer. More recently Elders has transferred the freeholds of the Courage estate of public houses to an associated company, Pubco. Elders owns 50 per cent of Pubco and has a 24.3 per cent share in the property company which owns the other 50 per cent (see paragraph 4.49). Pubco remains a subsidiary of Elders for tax purposes and Courage leases and controls the operation of the houses.

8.18. We have thought it both sensible and proper to take into account the report of the Commission on the Supply of Beer in the United Kingdom. This was made under the monopoly provisions of the Act and was delivered to the Secretary of State while the present inquiry was in progress. We do not know when the monopoly report will be published. We have made use of a limited amount of factual material from the monopoly report in Chapter 2. The conclusions, recommendations and summary of the report have been available to us and, in the course of the inquiry, a number of possible matters relating to the recommendations were, on a hypothetical basis, put to Elders and S & N for comment. However, we have reached our conclusions on the basis of the evidence presented in the current inquiry.

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<sup>1</sup>During the course of the inquiry Elders announced an agreement between Carling O'Keefe and a second Canadian brewer, Molson Companies Ltd (see paragraph 4.80).

## **PUBLIC INTEREST ISSUES**

### **The competition issues**

8.19. Elders told us that it considered the merger of Courage and S & N was not against the public interest on competition or other grounds. On the contrary, it suggested, the merger would create a new competitive force in the United Kingdom beer industry and a much-needed rival to Bass and the other major brewers.

8.20. On the other hand, S & N told us that it considered the consequences of the merger would be seriously detrimental to competition in the beer market, where S & N was predominantly a free-trader deriving the greater part of its sales volume from outlets that were not brewer-owned (Table 4.1). It was second only to Bass in the free trade with a higher volume of sales than Courage (which had twice as large a tied estate). The merger would also, according to S & N, be detrimental to the continued financial health of other businesses currently successfully run by S & N and to regional development and employment in the North of England and Scotland.

### **Competition in the beer market**

8.21. We have described the main features of the market in Chapter 2. The market for the sale of beer through on-licensed premises is dominated by the brewers, who own about 75 per cent of public houses. They supply, through these owned houses and through other on-licensed outlets, well over 90 per cent of the beer that is consumed in the United Kingdom.

### **The tied estates**

8.22. The present six large tied estate brewery groups are Allied, Bass, Courage, Grand Metropolitan (Watney), S & N and Whitbread. Together these brewers account for over three-quarters of the beer supplied in the United Kingdom.

8.23. These large brewers have all been involved in mergers and amalgamations, particularly in the 1960s and 1970s, and, as a result, their tied estates tend to be concentrated in different parts of the country according to the individual brewers that went to make up the present groups. As we have explained, Courage and S & N have most of their tied estates in the South and North of England respectively. In a limited number of areas, in particular some parts of Yorkshire, the merger would lead to further concentration of public houses controlled by Courage and S & N.

8.24. There is no doubt, however, that a merger between Courage and S & N would bring under unified control a very large national tied estate. Under the tied house system the individual managed and tenanted houses are restricted to offering only those drinks, particularly beers, which have been chosen by their brewer-owners, rather than freely chosen by the licensee in response to the preferences of his customers. Such a large extension of tied ownership by one brewer would be highly detrimental to consumer choice.

8.25. Elders suggested that there would be no real reduction of competition from the amalgamation of the tied estates, because the merged group would be able to interchange beers so that consumers would gain from the increased choice that would be available. It is in our view very unlikely that in the long run there would be any increase in the number and variety of beers offered by individual public houses. Further, where the consumer at present also has the choice between a Courage and an S & N house, some reduction of the present variety which is supplied seems to us to be inevitable if the merger goes ahead.

8.26. One further factor which leads us to conclude that there would be a reduction in choice stems from the strong branding policy of Elders, particularly in relation to its main brand of lager, Foster's. Prior to its acquisition of Courage, Elders had entered into an agreement with Watney to license that company to produce and sell Foster's draught and bottled lagers in the United Kingdom. Foster's lagers have become one of Watney's major lager brands and, despite some changes in the licence agreement, Foster's will continue to be sold as a major lager brand in Watney's public houses and other outlets supplied by Watney. There is also an agreement between Elders and the Mansfield Brewery and the

latter is introducing Foster's as one of its lagers. If the merger takes place, Elders would be certain to introduce Foster's into all S & N outlets, at the expense of other brands, so this one lager would then become the main or one of the main lagers in the tied estate of Courage, Watney, Mansfield and S & N and would also be on sale in many of the free houses, some of which are tied by loans to Courage/S & N, Mansfield and Watney.

8.27. Thus, the merger may be expected to be adverse to the public interest in that, by leading to a large increase in the scope of the control of a single brewer, consumer choice and competition between brands will be significantly reduced.

### **Competition for the free trade**

8.28. Much of the rest of the on-licensed market is made up of clubs, restaurants and non-brewer-owned public houses. Practically all this free-trade business is supplied by the brewers through their own wholesaling operations. The ability of the relatively few free public houses to compete with the brewer-owned outlets is very important to competition.

8.29. Some of the non-brewer outlets, particularly those that are owned by national chains, can expect to receive substantial discounts from the brewers' wholesale price lists, and even individual outlets can obtain discounts if they have a significant throughput of beer. But a substantial proportion of the free trade, in volume terms probably well over 50 per cent, is supplied under arrangements where, in return for a subsidised loan from the brewer, the owner or licensee will grant the brewer an exclusive arrangement for the supply of all or a substantial part of his supplies of beer and other drinks. This practice is often described as 'loan tying' and usually involves the outlet paying the full wholesale price.

8.30. The larger brewers, that is the six national brewers and a small number of regional brewers, are in a particularly strong position in relation to the loan-tied trade. The size and strength of their balance sheets makes it fairly easy for them to make or guarantee loans, and, equally importantly, they can offer a range of nationally-branded ales and lagers in a market where range is important. S & N suggested that in many parts of the country there might at present be no more than four or five national brewers competing for this loan trade. If two of these merge, and a free-trade outlet wishes to have two suppliers, its choice will be very restricted.

8.31. Elders and S & N are major competitors for the free trade. Indeed S & N considers that it is possibly the leading brewer in the supply of beer to the free trade. S & N competes not only in the areas where it has a substantial tied estate but also in other areas including the South of England where it owns very few outlets.

8.32. Courage told us that if the merger took place it would rationalise the wholesale operations of the merged company, closing depots where necessary so that the merged company would provide a single wholesaling operation in those parts of the country where it operates. Elders suggested that the bringing together of the range of beers now offered by the two companies into a single wholesale operation would provide very effective inter-brand competition because, for example, Foster's Lager would be offered alongside the Northern ale brands such as S & N's Newcastle Brown.

8.33. We agree that it is likely that, for some time, the merged group will continue to offer many of the products that are at present available from Elders and S & N. But in the longer term, to promote economies in brewing and in distribution, it seems to us inevitable that some products will receive less promotion: sales will therefore tend to fall away and brands will eventually be withdrawn. While we expect that Foster's and the major ale brands of S & N would be continued, there must in our view be some long-term doubt over whether the third-party lagers, and some other products, will continue to be sold by the merged group. Thus, the merger is likely to result in a loss of choice to the free-trade customer.

8.34. If the merger were to proceed, the number of competitors for the free trade, whether for loan-tied or other business, would be reduced, especially in those areas of Great Britain where at present Courage and S & N vie with each other as well as with other national brewers. This would be serious when only the major brewers are able to offer a full range of their own nationally-branded products. Our concern is reinforced by the absence in many parts of the country of a strong independent wholesaling sector.

8.35. We consider therefore that the loss of the independent wholesaling activities of S & N may be expected to reduce competition for the supply of beer to the free trade in a substantial part of Great Britain. This may be expected to be adverse to the public interest given the importance we attach to maintaining and promoting competition between the free-trade public houses and the brewers' owned estates.

### **The market in Scotland**

8.36. In Scotland the wholesale and retail markets for the sale of drinks on licensed premises have developed rather differently from those in the rest of Great Britain. Except in the major conurbations, most of the on-licensed trade is carried out from public houses, hotels and other outlets which are not brewer-owned. Much of this free trade is supplied under loan-tying arrangements which cover a very high proportion of the free trade over 50 per cent across Scotland as a whole and possibly as much as 80 per cent in the conurbations in Southern Scotland.

8.37. Two brewers, Bass and S & N, dominate the wholesaling of beer in Scotland, supplying up to 80 per cent of the trade. They also own a significant proportion of such outlets as are brewer-owned. Of the other national breweries only Allied, with about 13 per cent of the market by volume, is involved to any significant degree.

8.38. Courage, under a previous management, attempted in 1976 to enter the Scottish market by developing its own distribution and wholesale business. The attempt was not successful. According to Elders, Courage at that time had an unsuitable lager portfolio, and as it was unable to obtain sufficient business to justify its overheads, Courage withdrew from direct involvement in Scotland. Elders told us that it considered that the Scottish market continued to pose considerable problems for a potential new entrant attempting to enter without a distribution base. Elders also suggested that S & N was losing ground to Bass in Scotland, partly through a lack of a suitable lager portfolio. With the availability of Foster's to enhance the S & N lager portfolio, the proposed merger would, Elders suggested, enable the combined group to offer a much stronger degree of competition to Bass. For its part S & N denied that it did not or could not compete effectively with Bass, and suggested that its range of lagers, including the bought-in brands Carlsberg and Beck's, had enabled it in recent months to increase its sales in the Scottish market.

8.39. It is possible that the combination of S & N and Courage, under Elders, would be a stronger competitor for Bass in Scotland, although in the short term, as S & N has suggested, some adverse reaction from customers to the loss of S & N's independence might occur. It is certain, however, that the merger would result in the loss of an independent Courage as a potential competitor for the duopoly. Courage, it could be argued, with its ownership of a well-known lager brand, has a good potential in the increasingly lager-based Scottish market. On the other hand, a duopoly of Bass and S & N combined with Courage would be a powerful deterrent to any other brewer or wholesaler contemplating entry and would be certain to reduce the possibility of market entry.

8.40. In these circumstances we are unable to accept Elders' view that the proposed merger will be pro-competitive in Scotland. We consider that since it would reduce the number of potential large national brewers who could enter the market, and is likely to strengthen the position of the duopoly, it may be expected to operate to restrict competition in Scotland and thus be adverse to the public interest.

## **The off-licensed market**

8.41. Over the last decade or so the entry of major supermarket chains into the off-licensed market and the willingness of licensing benches to grant new off-licences have resulted in a very competitive market, which has remained free of any form of brewery tie. Supermarkets have led the way in stocking a wide variety of brands, including 'own-label' products, at keen prices. Many brewers, including Courage and S & N, do not own retail off-licensed premises. Those who do are unable, because of the competition, to replicate the restrictions on stocking other companies' products which they place on their tied on-licensed estate.

8.42. All large brewers are involved in supplying significant quantities of canned and bottled ales and lagers to the take-home trade which is now the fastest-growing sector of the beer market. S & N derives a particularly large proportion of its beer sales (25 per cent) from the off-licensed trade, and has positioned Kestrel lager specifically for this market sector.

8.43. Elders has suggested that the importance of the off-licensed business to S & N is a weakness of that company. In the future, Elders suggests, there will be a move in the off-licensed market towards the national and international branded lagers. Those companies, including S & N, which do not have such lagers on offer, will, Elders suggested, be reduced to producing the lower-priced own-label or commodity lagers at very low margins.

8.44. It is possible that the off-licensed trade will be increasingly concerned with internationally-branded products and that attempts may be made to increase the importance of international lager brands. But, in our view, it is by no means certain that those who believe that the future of the beer market lies in international branding will prevail. We note that the British beer consumer has been tenacious in his demand for a wide variety of ales and lagers and we understand that the German beer consumer expects and sustains great diversity as well. What is certain is that at present S & N and Courage compete directly at the wholesale level in relation to a considerable number of ale and lager brands sold in off-licences. If the merger takes place this competition will be lost and this may be expected to be adverse to the public interest.

## **The efficiency of brewing**

8.45. Elders suggested that one of the main advantages of the merger would be that, since its own breweries were working at full capacity and those of S & N were working under capacity, the merger would be able to improve the overall efficiency of the breweries in the new group. This would then release capacity to enable Elders to export Foster's Lager to Europe.

8.46. There are many complications in attempting to assess the capacity of breweries. The seasonality of the business, the limited shelf life of the product, the range of beers produced, the variety of packaging, and constraints caused by the availability of plant or facilities at different stages of the process are all factors which have to be taken into account.

8.47. From the information available to us it appears that Courage's three breweries are probably approaching their full capacity and could be extended only with major expenditure. S & N has six breweries which include those recently acquired from Matthew Brown and Home Brewery. But as with Courage, and taking the same variables into account, we believe that S & N has very little spare capacity and that S & N's main brewery in Edinburgh, in particular, is fully extended. S & N is in the process of expanding its breweries, which tends to support the view that it has currently little spare capacity.

8.48. It is possible, as Elders has suggested, that a larger group of breweries would provide greater flexibility, making it practicable to rationalise production and, by reducing the range of different beers produced at certain breweries, allow for an overall increase in output with no additional plant. But there is a limit to the extent to which this can take place, particularly as consumer demand increasingly appears to make it necessary for certain 'heritage' ales associated with particular regions of the United Kingdom to be produced in particular breweries.

8.49. S & N is already exporting its ales successfully to Europe. Elders told us of its plans to produce packaged Foster's Lager in the United Kingdom and export it to parts of Europe where it believes it will be competitive with premium lager products. Foster's Lager has been successful in many markets in the world. There is no reason to doubt that it might meet with some success in Europe. But we do not consider that the capacity gains that might be obtained from reorganising the production of the breweries of a combined group are essential to the success of Foster's Lager in Europe.

### **Competition with Bass**

8.50. Elders suggested to us that the United Kingdom brewing industry is, in comparison with brewing elsewhere in the world, relatively unconcentrated and that, if the proposed merger went ahead, it would create a group which would be able to compete with Bass, the largest United Kingdom brewer. Elders considers that this may be the last opportunity to provide such a competitor for Bass which, it told us, is likely otherwise to increase its domination of United Kingdom brewing.

8.51. Elders also suggested that changes in the European Community would have important strategic implications for all European brewers together with the major non-European brewers for whom the community market was inherently attractive. The major European brewers were, according to Elders, striving to establish Community-wide brands and were aggressively cutting costs by rationalisation and investment in increasingly large breweries. Elders suggested that local European brewers, in which it included all the United Kingdom brewers except Bass, were facing a continued erosion of their market shares by major brewers and therefore had uncertain future prospects.

8.52. We have noted Elders' views about the European beer market but do not consider that the existence of large lager brewers in Europe will necessarily affect the ability of the United Kingdom brewers to compete in their own home market, in which regional variations of taste, particularly for ales, are important. We understand the arguments for exploiting the economies of scale in large breweries. We note that, rather than build major extensions to its own modern breweries, Elders is seeking to obtain additional capacity by acquiring a brewer with six breweries.

8.53. There is no doubt that the merger would produce a group of approximately the same size as Bass. Between them the two companies would account for well over 40 per cent of United Kingdom beer production and own over 30 per cent of the brewer-owned public houses.

8.54. It is evident that the merger, if it were allowed, would have very significant effects on the brewing industry and the supply of all kinds of drinks to on-licensed outlets. If we accepted the proposition that Bass will come to dominate the United Kingdom industry there might be advantage in permitting a merger to create a competitor of approximately equal size. But there is no guarantee that two such large companies would compete fiercely: instead they might seek to avoid direct competition and adopt practices which would increase the difficulties of others in competing. We are told by Elders that Courage finds it difficult to make headway in Scotland, which is already dominated by two brewers. Similar arguments apply to the whole United Kingdom market. And similar remedies are, in our view, appropriate. In both cases what is required is more competition, not less.

8.55. The merged company and Bass would both have very large tied estates. Elders strongly believes in creating powerful beer brands, and Bass also has a number of major, well-known brands. In the absence in the on-trade both of a strong countervailing force of independent retailers and an independent wholesale sector supplying them, we believe that the existence of two powerful vertically-integrated companies would severely restrict competition.

8.56. We do not therefore accept the view put forward by Elders that the merger would result in a grouping which would provide more competition to Bass and in the market as a whole. In our view the creation of a new group that together with Bass would control over 40 per cent of the supply of beer would, in present market conditions, be expected to be anti-competitive and adverse to the public interest.

### **The effect of the merger on Northern England and Scotland**

8.57. A number of governmental and other agencies have suggested to us that the merger would have adverse effects on the economies of the North of England and Scotland. S & N is Scotland's largest independent company and there is considerable concern that the loss of its independence would have an adverse effect on Scotland because it would reduce the requirement for high-quality jobs (for instance, in general management, marketing and R & D, and the requirement for professional and business services such as accounting or banking). Evidence given to us suggests that when take-overs are carried out by firms from outside any given region, there is a high risk that some of these functions and the accompanying quality of employment may be lost. The longer-term effect of this erosion of skills and the decision-making base, it is argued, is to reduce the capacity of a region to generate new or innovative economic activity because the people who would have acted as catalysts in this respect have been lost.

8.58. Elders recognised the probability that in seeking to take over S & N it would encounter objections related to the loss of an independent Scottish company. It therefore offered to locate the headquarters of the merged brewing company in Edinburgh and further offered that, if proposals it has in mind to float the brewing interests of Elders on the London Stock Exchange come to fruition, it would locate the international headquarters of that group in Edinburgh. In making this proposal Elders did, however, acknowledge, in the course of a meeting with the Secretary of State for Scotland, that the move of the headquarters to Scotland was intended as a concession to Scottish interests, and that if the bid were referred, it would reconsider its decision. This was taken to indicate that the choice of Scotland as the location was not driven by any underlying commercial logic.

8.59. Some of those who consider that the loss of S & N's independence will have adverse effects on Scotland and Northern England believe that Elders' undertaking is not to be relied upon and suggest that past history has indicated that such promises are not enforceable after a merger has taken place. We believe that Elders would honour its undertaking to move its headquarters to Edinburgh. As it has told us, not to do so would have serious adverse implications for its commercial prospects in Scotland and elsewhere.

8.60. But whilst we accept that if the merger took place the headquarters for the Elders European brewing group would be situated in Scotland, we are less confident about how meaningful an Edinburgh location would be for the headquarters of part of a world-wide group based in the Southern hemisphere. Although, therefore, it is possible that high-level posts will be brought to Edinburgh, we are not convinced that this will provide a satisfactory substitute for an independently-managed Scottish company.

### **The employment effects of the merger**

8.61. There is no doubt that the merger will result in a serious reduction of employment. Elders has estimated that savings will result from a rationalisation of the Courage and S & N distribution and wholesaling activities. In addition, there will be a loss of management functions when a proportion of S & N's estate is transferred to tenancy. Elders forecasts that there will be a loss of between 2,000 and 3,000 jobs. Many of these jobs will, however, be in the South of England, according to Elders, and it hopes to avoid job losses in Scotland.

8.62. The rationalisation and cost saving which follow mergers often result in a reduction of employment in the merged group. Elders has told us that it would seek to avoid compulsory redundancy although we doubt, in view of the numbers involved, whether this could be achieved. Where job losses are the result of increasing efficiency in a merged company, they may not be detrimental. In this proposal, we must bear in mind that the rationalisation which will result in many of the job reductions will, in our view, lead to a loss of competition and consumer choice.

### **The financing of the merger**

8.63. When Elders' proposed acquisition of Allied-Lyons was referred to the Commission one of the major issues was the level of gearing that would be required to finance the merger.<sup>2</sup> We have again examined the level of gearing and set out the various ratios which, depending on the accounting conventions that are adopted and other factors, may be applied to the level of Elders' gearing after the merger (see Appendix 4.4). On this occasion the calculation of the gearing ratios has been complicated by the fact that Elders has arranged to sell and lease back the tied estate of Courage to a company, Pubco, in which it has a significant shareholding and an option, in certain circumstances, to acquire control. Pubco remains a subsidiary of Elders for tax purposes.

8.64. Depending upon the view that is taken on this and other matters, the Elders gearing ratio after the proposed merger would, calculated on the basis of the previous offer price of 400 pence per share, vary from 113 per cent to 277 per cent.

8.65. Elders submitted to us that we should not have too much regard to these gearing ratios. Elders, we were told, was a group of companies with certain core businesses, including brewing, but which possessed at all times other businesses, assets and investments which could, if necessary, be sold to reduce the level of borrowings. Elders supplied us with information on those businesses and assets which would be available for disposal if it became necessary, which it doubted, to reduce its level of borrowing.

8.66. S & N drew our attention to what it regarded as the potentially high level of Elders' gearing after the merger and also suggested that the Elders group had been relatively unsuccessful in increasing the profitability of its core businesses. Earnings and dividend growth, S & N suggested, had only been maintained by the sale of assets.

8.67. One view, therefore, is that, with a high gearing and a dividend supported partly by the sale of assets, the Elders group position may not appear in the longer term to be particularly financially secure.

8.68. On the other hand if, as we believe, it would be correct to consider Elders as a conglomerate which as part of its business activities buys and sells companies and other investments, it would be reasonable to expect it to have a variable level of gearing and to pay out a proportion of the profits from the sale of assets as dividends.

8.69. It follows from this second perception that Elders' long-term interest in S & N and its subsidiaries will be those core brewing activities of S & N which it wants to contribute to the Elders international brewing group. Elders told us that, except in the case of Pontin's which it would sell, it had reached no decisions on the subsidiary activities of S & N. But, given Elders' general policies, it is our view that the Waverley Vintners business, the Thistle Hotels chain, and Canongate, the S & N brewing technology subsidiary, might be sold. These actions would have little effect on competition within the brewing industry but they would affect the spread of interest which attaches to S & N's position as a large independent company directly managed in Scotland.

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<sup>2</sup>*Elders IXL Ltd and Allied-Lyons PLC: a report on the proposed merger*, Cmnd 9892, September 1986.

## **The Harlin and Petitio arrangements**

8.70. One feature of the Elders group (which it has in common with other Australian industrial groupings and many companies on the Continent of Europe) is the complex web of shareholdings in equity and convertible stocks which links Elders to other Australian groups and to private companies in which some of Elders' directors have significant shareholdings.

8.71. We have described in Chapter 4 (paragraphs 4.106 to 4.116) how certain cross- shareholdings with The Broken Hill Proprietary Company Ltd (BHP), which had been effected at the time of the Elders/Allied-Lyons inquiry to provide support for Elders' proposed acquisition, were subsequently unwound. A series of new arrangements has since been entered into that has resulted in a significant proportion of the existing equity shares in Elders being held by two private companies, Harlin and Petitio. Harlin, which is effectively controlled by a number of the directors and executives of Elders, owns 18.43 per cent of the ordinary share capital of Elders and has options to increase that proportion to 32.15 per cent. The majority of the finance for the purchase of these shares was made available by Australia's largest company, BHP, in the form of redeemable preference shares on which dividends are cumulative and payable at redemption date in 1993. A further loan subordinated to BHP's preference shares is also repayable to third parties, with accrued interest, in 1993. The Elders shares are the only material assets of Harlin, other than options to acquire Elders' shares, and it seems unlikely that the dividends that will be paid by Elders to Harlin will be sufficient to meet the cost of redemption of the redeemable preference shares, interest charges and dividends payable.

8.72. Petitio owns 17.23 per cent of the ordinary share capital of Elders, and this percentage would fall to 12.81 per cent following the exercise of Harlin's options. Petitio is owned 50:50 by Goodman Fielder Wattie Ltd (GFW) and AFP Group PLC (AFP). Elders owns 15.0 per cent and 20.6 per cent of the ordinary share capital of GFW and AFP respectively. Additionally, two non-executive directors of Elders own a proportion of AFP's fully-diluted ordinary share capital.

8.73. S & N suggested, supported by advice from Australian lawyers, that aspects of the Harlin transactions resulted in serious potential conflicts of interest, in relation to their duties to Elders, for those directors of Elders who had interests in Harlin. Again with the support of advice from Australian lawyers, the allegations were rejected on behalf of those Elders directors.

8.74. In our judgment, if these allegations justified further consideration, something on which we express no view, this would be a matter for authorities in Australia and not for ourselves. It is our understanding that the arrangements described in paragraph 8.71 received publicity in Australia and that no action was taken by any public authority. We have disregarded the allegations in reaching our conclusions in this inquiry.

8.75. We note that one effect of the shares in Elders held by Harlin and Petitio is to give Elders a degree of 'bid-proofing'. Elders told us that this was desirable because partial bids for public companies were allowed in Australia. We have not taken this circumstance into account in reaching our conclusions. If, however, we had not found the proposed merger gave rise to serious public interest detriments on competition grounds, we would have considered further whether these arrangements, which could affect the future control and management of Elders, gave rise to public interest issues.

## **Conclusions and recommendations**

8.76. We have found that the merger may be expected to have the following adverse effects in the brewing industry:

- (a) a reduction of consumer choice and competition between brands by leading to a large increase in the scope of the control of a single brewer (paragraph 8.27);
- (b) a reduction in competition for the supply of beer to the free trade (paragraph 8.35);
- (c) a restriction of competition by the strengthening of the present duopoly of suppliers in Scotland (paragraph 8.40);
- (d) a reduction of competition in the market to supply beer to off-licences (paragraph 8.44); and

(e) the creation of a second major beer group which, together with Bass, would control over 40 per cent of the supply of beer (paragraph 8.56).

8.77. We have found no significant advantages to the public interest arising from the merger to offset these detriments. We have therefore concluded that the creation of the merger in contemplation may be expected to operate against the public interest with the particular effects adverse to the public interest specified in paragraph 8.76.

8.78. We are therefore required to consider what action (if any) should be taken for the purpose of remedying or preventing these adverse effects. Having done so and after considering the representations we have received, we have been unable to identify any effective remedy other than to prohibit the merger, and we so recommend.

8.79. Turning next to the merger in being, we have found a situation qualifying for investigation (paragraph 8.13). We have therefore to consider whether the existence of a holding of 23.58 per cent of the shares in S & N by Elders may be expected to operate against the public interest. Elders suggested to us that if it were not allowed to proceed with the full acquisition of S & N, it would not wish to retain the shareholding. It argued that we should find that the holding was not against the public interest. It seems to us reasonable to assume that, for some time at any rate, Elders may retain the holding. During that period, if it wished, Elders could make use of the ability it possesses, the nature of which we have considered in paragraphs 8.10 and 8.11, materially to influence the management of S & N.

8.80. We consider that it would be detrimental to the public interest on competition grounds alone that a major brewing company should need to pay close attention to the wishes of one of its major competitors, especially when the declared strategies of the two parties are so different. We have therefore concluded that the creation of this merger situation may be expected to operate against the public interest with the particular effects adverse to the public interest specified in this paragraph.

8.81. We have carefully considered the representations of Elders and S & N in relation to possible remedies to the adverse effects identified in relation to the merger in being. It was put to us by Elders that it would be sufficient if it were restricted, or gave an undertaking, to limit the amount of voting rights on its shares in S & N. We consider, however, that the mere existence of a substantial block of shares could exert influence over the management of S & N.

8.82. We have therefore decided that the only effective remedy is for the shareholding to be reduced to a level at which it could be expected not to exert any appreciable effect on the management of S & N, ie to just below the 10 per cent level at which a shareholder can requisition company meetings or call for a poll. We therefore recommend that Elders should be required to divest its holding of S & N shares to 9.9 per cent of the issued ordinary share capital of S & N. The divestment should be supervised by the Director General of Fair Trading to ensure that it is made to persons or companies who are not associates or subsidiaries of Elders.

8.83. The convertible preference shares which are held by Elders (Chapter 3) can be converted to ordinary stock from September 1989 and we therefore further recommend that these shares should be taken into account in relation to our recommendation in paragraph 8.82.

8.84. We recommend further that the divestment of the shares should be carried out over a period of 12 months, which should be subject to some flexibility in the light of market conditions. In the meantime Elders should be restricted in relation to voting rights to 9.9 per cent of the issued share capital of S & N.

R G SMETHURST (Chairman)

K S CARMICHAEL

A M HEAD

C A UNWIN

S WAINWRIGHT

R YOUNG

S N BURBRIDGE (Secretary)

8 March 1989