I. The application and notification

1. On 12 June 1996 Bass Holdings Limited and The Bass Lease Company Limited, both wholly-owned subsidiaries of Bass plc (Bass), notified pursuant to Article 4 of Council Regulation No 17 (1) a standard form of lease (the standard lease), the subject of which is a fully fitted out on-licensed (2) public house in England and Wales with a tie for beer as described below. The parties have also notified certain related agreements. On 8 September 1997, the parties notified their standard lease agreements for Scotland. The parties requested negative clearance or confirmation that the agreements could benefit from the application of Regulation (EEC) No 1984/83 (3) or individual exemption pursuant to Article 85 (3) of the EC Treaty to take effect as from the date on which the agreements were entered into.

II. The parties

2. Bass is a public company listed on the London Stock Exchange. The Bass Group is an international drinks and leisure group operating in the hotel, leisure hospitality, brewery and drinks sectors in Europe, the USA and elsewhere in the world.

3. In June 1996 Bass owned approximately 4,182 pubs in the United Kingdom, of which 2,736 were managed (ie. the operator is an employee of the company) and 1,446 were leased to tenants.

4. As of March 1997, the Bass leased estate totalled 1,430 pubs, of which 106 are located in Scotland. Of this total number 1,430 pubs, 1,186 were let on standard leases, 178 were subject to tenancies at will, 42 were subject to a short-term tenancy agreement known as the Foundation Agreement, and the remaining 24 were either subject to other agreements or unoccupied. In the year ending 30 September 1996, Bass supplied approximately 422,000 barrels of beer to its leased estate, which represents 1.6% of the 1996 on-trade beer consumption (volume) in the UK.

5. On 16 December 1997, Bass agreed to sell the majority of its leased estate (1,190 leased pubs) and a number of its managed pubs to a management buy-in team led by Hugh Osmond and backed by BT Capital Partners Europe, the private equity arm of Bankers Trust. Approximately 50 leased pubs are being retained by Bass while a further approximately 170 leased pubs will be sold separately. Completion is due to take place by 11 April 1998.

6. Bass’ worldwide turnover in the year ending 30 September 1996 was £5,109 million of which £1,278 million arose from its pub operations (both leased and managed outlets). In that year Bass accounted for 23% of the UK beer market in volume production terms.

III. The market

7. Since 1991, the date of introduction of the Bass standard lease in England and Wales, significant changes have occurred in the structure and conduct of the UK brewing and pub retailing markets. These are for the most part the result of the Beer Orders made following the Monopolies and Mergers Commission’s (MMC) report on the supply of beer, together with a fall in both overall demand and particularly on-trade beer sales, shifts in consumer demand towards pubs offering a wider choice of drinks and food, the withdrawal of several companies from brewing and the redefinition of relationships between brewers and pub retail chains on the one hand and tenants on the other.

The 1989 MMC report and the subsequent Beer Orders

8. The MMC’s report of 1989 into the supply of beer led to a number of recommendations being made which were aimed at relaxing the traditional tie (exclusive purchasing obligation and non-competition obligation) between brewers and pubs. Most of the MMC’s recommendations were

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(1) OJ 13, 21.2.1962, p. 204/62.
(2) On-licensed premises are those which are licensed to sell alcoholic beverages for consumption on and off the premises as opposed to off-licensed premises, such as supermarkets, which are licensed for off premises consumption only.
implemented, mainly by the Supply of Beer (tied estate) Order 1989 and the Supply of Beer (loan ties, licensed premises and wholesale prices) Order 1989. The Tied Estate Order imposed the following changes on the national brewers (brewers with an estate of more than 2,000 on-licensed premises):

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

— their tenants would have the right to buy one cask-conditioned ale (a beer which undergoes fermentation in the cask (1) from a source other than the brewer/landlord (the so-called guest beer), and

— they were only allowed to tie a certain number of pubs. This forced them to sell or free of tie about 11,000 of the then estimated 60,000 UK pubs.

**Demand factors**

9. Beer can be sold through the on-trade, for example pubs, hotels and restaurants, or through the off-trade, for example supermarkets and off-licences. In addition, private duty-paid imports, mainly from Calais, are estimated to account for 4% of total beer consumption in the UK. Volume sales of all beer in the UK fell by 9.5% between 1989 and 1995 and volume sales of beer in the on-trade fell by 17.3% in the same period. The proportion of sales volume accounted for by the on-trade has thus fallen (from 79.3% in 1989 to around 69% in 1996) but, with the exception of Ireland, remains the highest proportion in the EC.

10. Falling beer sales volume in the on-trade has been offset by:

(a) a rise, in real terms, in on-trade beer prices of 21% between 1989 and 1996, only a negligible proportion of which was accounted for by tax increases, and

(b) a rise in the proportion of non-beer sales in pubs to 37% of total revenues in 1996, largely as a result of the increase in catering sales.

11. Consumption of draught beer accounted in 1996 for 63% of total consumption. This is also, with the exception of Ireland, the highest figure in the EC. In contrast, the figure for Belgium, which has the third largest draught consumption in the EC, was 39%. UK pubs also offer a bigger choice of draught beers than elsewhere in the EC, with an average of 6.5 brands per pub.

**Supply factors**

**Brewing**

12. The main change since 1989 is that the brewing market has become more concentrated. The increased concentration has been caused by companies leaving the brewing market and/or selling their brewing operations to existing competitors. In 1996, the remaining four national brewers, Scottish & Newcastle, Bass, Carlsberg Tetley Brewing (CTB) and Whitbread, commanded 78% of the UK beer market in terms of supply. Four larger regional brewers also left the market between 1989 and 1991, reducing the number of large regional brewers from 11 to 7.

**Wholesaling**

13. One result of the Orders was the sale of some of the national brewers' tied estates. This was expected to lead to an increase in the free trade and to a greater role for independent wholesalers. However in 1995/1996 independent wholesalers still only accounted for some 6% of distribution, compared to 5% in 1985. The national brewers still dominate the wholesale sector, with a share of distribution similar to their share of production.

14. The pubs that were sold by the national brewers were purchased mainly by retail pub chains or by regional brewers. In general, pub chains either have their own wholesaling operations or are supplied directly by the brewers. Similarly, regional brewers do not require the services of independent wholesalers for distribution to their own retail estates. This, combined with the general decline in sales of beer and the increased efficiency of national brewer-wholesalers, has resulted in marginal growth in the independent wholesale sector.

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

15. In the UK, the retail sale of beer and other alcoholic drinks for consumption on the premises requires a justices' (local courts of law) licence. Three distinct classes of licence are currently in operation (\(^\)):

- full on-licences: where a person can buy an alcoholic drink, without being a resident or having a meal. There are approximately 83,100 full on-licences in issue, of which around 57,000 are pubs. The remainder include hotels and wine bars,

- restricted on-licences: where it is a condition of buying a drink that the customer is either a resident or having a meal. Covers some 32,300 private hotels and restaurants,

- clubs: a person has to be a member before buying a drink. Covers some 31,500 outlets, mainly jointly owned by their members.

16. By forcing changes in the ownership of pubs, the Orders have also had an effect on the proportion of beer sold through the different retail channels: (a) the tied estate of the brewers, (b) the managed estate of the brewers, (c) the tied estate of independent pub companies, (d) the managed estate of independent pub companies, (e) loan tied premises and (f) untied or free premises. This can be seen from the following overview on beer sales (volume). The 1985 data comes from the MMC report and can be considered as representative for the years 1985 to 1989; the 1995 data are from the Brewers and Licensed Retailers Association (BLRA), including estimates for non-members.

<table>
<thead>
<tr>
<th></th>
<th>(a)</th>
<th>(b)</th>
<th>(c)</th>
<th>(d)</th>
<th>(e)</th>
<th>(f)</th>
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<td>24,2</td>
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<td>12,4</td>
<td>20,2</td>
<td>9,1</td>
<td>3,5</td>
<td>21,1</td>
<td>33,6</td>
</tr>
</tbody>
</table>

17. The Orders also reduced the restrictive scope of loan ties, by allowing their termination at any moment in time by the borrower on three months' notice. The Orders also introduced the guest-beer right for publicans with trade loans from the national brewers and also required that such customers should not be restricted in purchases of non-alcohol and low-alcohol beers and non-beer drinks. From information supplied by the BLRA, it appears that approximately 20% of loans are terminated or advanced each year. An unestimated proportion of these terminations and new issues must be accounted for by publicans paying back an existing loan with money loaned to them by another brewer (in exchange for a new loan tie). It appears that the larger outlets such as clubs not only receive much larger loans, but they are usually non-exclusive as these operators want to have dual or multiple sourcing. However, the purchasing obligations are usually for a specific quantity of beer. No estimate was made by the BLRA as to the number of such non-exclusive loans, the total on-trade volume-percentage accounted for by such non-exclusive loans, or the percentage of total throughput of the relevant premises accounted for by the quantity of beer stipulated in such loan ties.

Competition between brewers

18. At the wholesale level, the major brewers have some guaranteed sales through their tied and managed estates. The brewers have to compete to supply the remainder of the market, through individual agreements with free houses and supply agreements with pub chains and other brewers. This competition takes place mainly on price and brand strength, although the brewers also try to gain sales by offering other benefits such as promotional support.

Market entry at brewing level

19. The main barriers to entry at this level are the need to secure outlets for supplies and to have access to a distribution system. A new entrant has to secure supplies to free houses, pub chains, or to the brewer's estates as part of their portfolio of beers or (in the case of a national brewer) as a guest beer. Possession by competitors of well known brands is a further barrier to entry, or to expansion by existing brewers. This may be more important in lagers, which are normally marketed nationally, and where economies of scale in advertising may make small scale entry less viable.
20. The entry barrier of securing outlets has been reduced since the implementation of the Orders, owing to the reduction of the proportion of the market subject to ties and to the emergence of pub chains. It is easier for a new entrant to enter supply agreements with a chain rather than with individual pubs. The need for a distribution system remains a barrier to entry. However, brewing overcapacity has ceased to be a significant barrier to entry since brewing capacity utilization stood at 90% in 1996, up from 79% in 1991.

21. Most foreign producers of beer (mostly lager) have chosen to enter the UK market by entering into exclusive licensing agreements with existing national brewers whereby the beer is brewed in the UK and sold as part of the national brewer’s portfolio of brands. These foreign lagers have often been marketed as premium brands. Bass has formed a joint venture in the UK with the Dutch brewer Grolsch for the brewing and distribution of Grolsch products.

IV. The agreements

25. The tenancy agreements are contracts between Bass and the lessee, whereby Bass makes available a licensed public house together with fixtures and fittings to a lessee for the purpose of carrying on the business of the public house and under which the lessee pays a rent to Bass and agrees to purchase the beers detailed in the agreement from Bass or its nominee.

26. The basic standard lease agreement has been in existence in England and Wales since 1991, with slight modifications in the form used. The lease is generally of 10 years duration (some are of 15 or 20 years), with a fixed rent which is subject to review every five years and in certain other limited circumstances. The lessee may assign his obligations under the lease after two years, with Bass’ prior consent provided Bass is given first option to purchase the lessee’s interest. Under the terms of the Standard Lease the lessee has full responsibility for repairs and cannot install any amusement machines without Bass’ written consent, but may keep all the revenue from such machines. In 1992 a standard lease was introduced in Scotland. The main differences with the standard lease in operation in England and Wales are the following: first, the deed of leasing conditions, which contains the relevant trading conditions for the Scottish leases, entitles Bass to review the rent annually and increase it in accordance with the retail price index. However, Bass has never exercised this right. Second, Bass has the right to terminate the agreement five years after commencement. Third, Bass asks that ingoing lessees pay a certain sum of money into a ‘retention fund’. The maximum amount so required is £10,000. This sum is retained by Bass as security for losses or damages sustained to the premises or to Bass, or any other amounts owed to Bass by the lessee. Bass normally pays interest on the Fund at a rate of 2% per annum over the deposit rate of Barclays Bank plc on termination of the lease. Until recently, the deed

Market entry at retail level

22. Pubs compete only with others in their locality. Broadly speaking, each area has a local price for a certain type of package, which comprises the total pub ‘offer’ (facilities, ambience) and not just the price of beer.

23. Entry barriers in the retail market are relatively low. The only one of any significance is the presence of licensing laws, which can prevent new pubs from being opened unless there is a need for them. This law is not applied strictly throughout the UK, but where it is, it can result in entry within that locality being difficult. Also, in some areas of the UK, licences are now being refused mainly on public order grounds. However, a particular pub company has succeeded in opening over 100 pubs on greenfield sites in recent years.

Changes in arrangements between pub tenants and their landlords

24. Historically, pubs were let by means of ‘traditional’ short-term pub tenancies. Brewers retained responsibility for the fabric of the building and its fixtures and fittings, and tenants were responsible for selling beer supplied by the landlord plus other drink and food. Following the MMC report, pub tenants in England and Wales were provided with security of tenure by being brought within the Landlord and Tenant Act 1954. However, before the MMC’s recommendation, the first long full repair and maintenance leases, which provided some security of tenure and the ability to assign the lease, were offered.
of leasing conditions contained a covenant, which Bass has never enforced, restricting the lessee from competing within a radius of half a mile from the leased premises for one year post-termination of the lease. In March 1997 there were 1186 standard lease agreements in operation.

27. In addition to the standard lease agreements, the parties have also notified certain related agreements. There are two further forms of tenancy agreement, the foundation agreement and tenancy at will (TAW) which is a temporary agreement. The foundation agreement is a three-year agreement used in circumstances where a 10-year lease may be inappropriate, such as unstable economic conditions or uncertain expense levels relative to trade. The agreement gives the occupier the opportunity to convert to a standard lease during the first two years. The tenant is not permitted to assign his interest, is not fully responsible for repairs and shares amusement machine income with Bass. The exclusive purchasing obligations in both the foundation agreement and the TAW are not materially different from those contained in the standard lease agreement. In March 1997 there were 42 pubs let under foundation agreements and 178 let under TAWs. These agreements are not used in Scotland.

28. Bass have also notified supplemental agreements relating to the division of the financing of alterations and improvements between Bass and its lessees, into which approximately 109 lessees had entered by June 1996.

29. In addition, Bass have notified an incentive package scheme available free of charge up to October 1996 to certain standard lease agreement lessees, the Premier Alliance Scheme. Under this scheme, which was first introduced in September 1994, lessees without any current debt are eligible for additional volume-based discounts and enhanced business support in terms of business planning, development and marketing. The only requirement is that the lessee attends regular business development meetings. A marketing fund is also available, which may be used, inter alia towards promotions offered by Bass or promotions run at the initiative of the lessee. By June 1996 approximately 654 Bass lessees had taken up the Premier Alliance Scheme.

The beer tie

30. The lessee agrees to buy all specified beers from Bass or its nominee with the exception of one brand of cask-conditioned draught beer and, by the end of March 1998, one brand of bottle-conditioned beer (guest-beer clause). Specified beers are the beers of the types set out in a schedule of the lease. These types are light, pale or bitter ale (known in Scotland as 70 shilling ale, heavy ale or Scotch ale), export or premium ale (also known in Scotland as 80 shilling ale), mild ale (known in Scotland as 60 shilling or light ale), brown ale, strong ale (including barley wine), bitter stout or porter, sweet stout, lager, export or premium lager (also known as 'malt lager' or 'malt liquor'), strong lager, 'diet pils' (or premium low-carbohydrate beer), low carbohydrate (or 'lite') beer. These types are represented by the brands or denominations of beer listed in Bass' current price list.

31. The lessee may sell any type of beer other than the specified types if it is packaged in bottles, cans or other small containers or if it is in draught form and the sale of that beer in draught form is customary or is necessary to satisfy a sufficient demand from the lessee's customers.

Rent

32. Under the standard lease agreements, rent is paid monthly in advance and the lessee will repay the premiums paid by the landlord for insuring the premises against loss or damage by fire, explosion and aircraft (including three year’s open-market rent of the premises and expert’s fees) and against other risks, and the cost of holding the justices’ licence.

33. The fixed rent is reviewed every five years. The reviewed rent is the higher of the existing rent or the market rental value of the premises at the relevant increase date. The market rental value is defined as an open-market rent but taking into account the terms, and in particular the exclusive purchasing obligations, contained in the lease. In the absence of an agreement as to the market rental level, any rent review is subject to determination by an independent surveyor or valuer.

Discounts and countervailing benefits

34. As individuals who are not tied for their beer purchases to another company (individual free-house operators) can obtain in the United Kingdom discounts for their beer purchases which are not available to the tied operators, the Commission has assessed (i) the net price differential for beer purchases from Bass between the price paid by individual free-house operators and Bass' tied lessees and (ii) the value of benefits which are granted by Bass to its lessees and which are not readily available
to the individual free-house operators. The starting point for this assessment was the report of the Office of Fair Trading on their enquiry into brewers’ wholesale pricing policy of May 1995 (the OFT report), which was supplemented by further investigations by the Commission.

35. The price differential is the difference between the average discounts in £/barrel granted by Bass to its individual free-house operator-clients across a typical product-mix including an equivalent discount per barrel by virtue of any loan and the discounts granted to the lessees which include the actual discounts on beer purchases and the value of the lower Bass list prices (for the leased estate) as compared to the standard Bass price lists. Discounts to Bass lessees also include the discounts offered to members of the premier alliance scheme via volume-related discounts and the marketing fund. All discounts offered have been averaged across the Bass leased estate, excluding tenancies at will.

36. The rent subsidy is calculated by subtracting the actual rental income from the tied estate from 15% of the estimated retail turnover of the estate (the assumed rent for a free of tie-outlet being 15% of turnover). For this purpose, tenancies at will were excluded from the calculation. This is because tenancies at will are characterized by significantly lower rent levels than other lease agreements.

— The estimate of the total retail turnover for the estate (that is, the aggregate turnover of the pubs let under standard lease or foundation agreements in the estate) was calculated on the basis of the aggregate rent paid being equal to 11,36% of turnover. The figure of 11,36% stems from internal Bass documents compiled for the most part in preparation for rent or rent review negotiations, for a random sample of 30 pubs chosen by Commission officials. These documents included individual estimates of turnover for the pubs, from which the average rent to turnover ratio was calculated,

— to arrive at the rent subsidy per barrel, the overall rent subsidy was divided by the total number of barrels sold to the estate (excluding TAWs) in each year.

37. In addition to the rent subsidy, Bass has supplied details of seven other quantifiable benefits to the Commission.

**Value-added services**

38. Since the date of introduction of the standard lease agreements Bass has offered its lessees bulk buying and procurement services, the value of which has increased over time. These value-added services currently include discounts on glassware, gas supply, rating, banking, insurance and paint. Bass has calculated the annual benefit of these services by estimating the potential value per outlet of the discounts and offers available across the range of goods and services, on the assumption that, where lessees have not taken advantage of the services on offer, they have used the fact that discounts are available to Bass lessees to obtain equivalent or better prices on the open market. This potential value per outlet, which has been estimated at £3,054,9 for the years 1994/1995 and 1995/1996, is then multiplied by the number of outlets, excluding TAWs, in the estate.

**Investment**

39. In 1994 Bass introduced a joint investment programme whereby the company undertook investment in the tied estate in cooperation with lessees. The value per barrel of this investment programme to existing lessees, excluding TAWs, has been calculated by taking the total cost, including outside consultancy and project supervision funded by Bass, and subtracting attributable rent increases over five years.

**Repairs**

40. This is the value to existing lessees, excluding TAWs, of non-rentalized repairs funded by Bass. These repairs are either to support investment or to fund statutory requirements, licensing demands and other such unavoidable expenses.

**Support franchise**

41. Since 1994 Bass has provided certain business planning, performance review and development initiative services for lessees wishing to take up, free of charge up to October 1996, an additional scheme know as the support franchise. By the end of the 1995/1996 financial year the lessees of an average of 669 pubs in the estate had joined the support franchise and for those pubs, there was an average increase of 0,93% in barrelage turnover, compared to a decline of 2,33% for non-participating pubs.
Bass have estimated that the average increase in net profit to a typical lessee receiving the support franchise was £2,585 in 1995/1996. The total estimated increase in net profit generated by the support franchise is therefore £1,7 million, which produces a figure of £4,50 per barrel if divided by the total barrelage to the leased estate.

**Direct operational support**

42. Bass has estimated the value and benefit of direct operational support per lessee for each of the relevant years by taking 75% of the total remuneration costs (salaries plus benefits and expenses) of the Bass Lease Company employees who are directly involved in supporting and developing the business of the lessee. These employees include business directors and business managers, business development managers, property managers and surveyors and employees dealing with catering, training of lessees, assisting with assignments, promotions and public relations.

**Set-up and development costs**

43. Bass provides support to new lessees in the form of literature and assessment schedules, including development, administration and printing costs associated with new initiatives as well as training costs, and to existing lessees in the form of annual recognition awards.

**Promotions**

44. Since the date at which the standard lease agreement came into operation Bass has made certain promotions and marketing offers exclusively available to its lessees on a national, regional or local basis. These promotions are intended to increase the turnover of the individual lessee.

45. The results of this assessment of the price differential and the countervailing benefits are shown in the following table:

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<td>24,41</td>
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<td>19,18</td>
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<td>22,18</td>
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<td></td>
<td>4,08</td>
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<td>1,14</td>
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</table>

**Other benefits**

46. Bass offers additional support and benefits to tenants in the form of fixtures and fittings funding for tenants in difficulty, one-off PR promotions, a charitable support fund and, until late 1994, a legal advice scheme for tenants and prospective tenants. Finally, Bass lessees also have reduced beer-derived profit volatility as a result of a reduced profit margin on beer relative to free house operators which, combined with lower fixed costs (rent), reduces the risk of an investment in a Bass tenancy.
V. Conclusion

The Commission intends to take a favourable position in respect of the agreements, a summary of which is published here, by granting a retroactive exemption pursuant to Article 85 (3). Before doing so, the Commission invites all interested third parties to submit their observations within one month from the date of this notice, quoting reference IV/36.281/F3 to:

European Commission,
Directorate-General for Competition,
Directorate F,
Rue de la Loi/Wetstraat 200,
B-1049 Brussels.