CASE OF RELAY B.V. (Diageo) AND UNITED SPIRITS LIMITED*
(Combination Regulation)

Forum:
Competition Commission of India[1]

Legislative Provisions Referred:
Competition Act, 2002: Acquisition of shares and control under Section 5 of the Act.
CCI (Procedure in regard to the transaction of business relating to combinations) Regulations, *2011*:[2]

- Regulation 5 –Form of notice for the proposed combination
- Regulation 14 – Scrutiny of notice
- Regulation 19 –Prima facie opinion on the combination.

Parties to the Combination:

1. Relay B.V.
2. United Spirits Limited

Facts of the Case:
In its notice to the CCI, Relay B.V., an indirect wholly-owned subsidiary of Diageo Plc. (hereinafter referred to as "*Diageo*"), proposed to acquire majority shares and control of United Spirits Limited (hereinafter referred to as "*USL*"). This acquisition was conditional on the successful execution of certain pre-acquisition agreements that captured the obligation of all parties to the transaction as well has laid out the mechanism for the acquisition/transfer/sale/allotment of voting rights, shares and majority and board control. These were:

1. Preferential Allotment Agreement executed between Relay B.V., USL and Diageo (hereinafter referred to as "*PAA*");
2. Share Purchase Agreement (hereinafter referred to as "*SPA*"); executed between-
   a. United Breweries (Holdings) Limited *('UBHL')*, Kingfisher Finvest India Limited*('KFinvest')*, SWEW Benefit Company*('SWEW')*, Trustees of the USL Benefit Trust*('UBT')*, Palmer Investment Group Limited*('Palmer')*, UB Sports Management Overseas Limited*('UB Sports')* (hereinafter all collectively referred to as *"Sellers"*); and
   b. Relay B.V. and Diageo (Relay B.V. and Diageo jointly referred to as the *"Acquirer"*)
3. Shareholder's Agreement (hereinafter referred to as *"SHA"*) executed between United Breweries (Holdings) Limited, Kingfisher Finvest, Relay B.V. and Diageo.

All the said agreements were executed on 9th November, 2012. (PAA, SPA and SHA are hereinafter collectively referred to as *"Agreements"*). In terms of the applicable Combination Regulations, the parties were required to remove certain defects and furnish required information/document(s) to the Commission which were carried out by the parties. USL had proposed to increase its share capital to accommodate the increased share allocation required to ensure this transaction.

Nature of the Proposed Combination:
PAA: Relay B.V. agreed to subscribe to 10% of new equity shares of USL's post-issue enlarged share capital, by way of preferential allotment.
SPA: Relay B.V. agreed to purchase 17.4% equity shares of USL from the Sellers of USL's enlarged share capital.
In certain circumstances where the preferential allotment is not completed and Relay B.V. holds less than 25.1% of the equity shares in USL, then UBHL and KFinvest would sell to Relay B.V. such number of additional equity shares in USL which would take Relay B.V.'s shareholding in USL to 25.1%. In other words, if the preferential shares representing 10% of USL's post-issue enlarged capital were subscribed to by Relay B.V., then no additional shares would be required to be sold to Relay B. V.
The execution of the SPA and the PAA triggered an obligation by Relay B.V. to make a mandatory offer to the public shareholders of USL under the SEBI

---

*This deal encompasses various national and international legal and regulatory framework and compliances (SEBI, RBI, OFT etc.) This study limits itself to analysis from a Competition Law perspective. Notice u/s 6(2) of the Competition Act, 2002, given by Relay B.V. and United Spirits Limited. Combination Registration No. C- 2012/12/97 Decided by CCI on 26TH February, 2013. Available on: www.cci.gov.in/May2011/OrderOfCommission/CombinationOrders/C-2012-12-97.pdf

[1] Hereinafter referred to as 'CCI'.

[2] http://cci.gov.in/images/media/Regulations/CCI Combination%20Regulations%20asat%20040413.pdf

Takeover Regulations, after which Relay B.V. would hold 53.4% of USL's enlarged equity share capital. But if after the acquisition of shares under the SPA and PAA including the shares acquired under the SEBI Takeover Regulations, the Acquirer is unable to hold a majority of the share capital of USL, then certain parties identified as 'UB Parties' in the SPA who hold shares in USL, will vote their shares to Relay B.V.

Non-Compete: As per this, the 'UB Parties' and no current promoter of UBHL could carry on any business directly or indirectly which manufactures, distils, bottles, distributes, purchases and/or sells alcoholic spirits (excluding beer, wine and bottled water) or disclose to any person or use any confidential information, during the term of the SHA and for a period of two years thereafter.

Issue Raised and Observation thereupon:

CCI while evaluating the proposed combination had to consider only one main issue whether or not such transaction between Diageo and United Spirits has an Appreciable Adverse Effect on Competition (AAEC) in India. The observation is as follows:

Issue: Whether the proposed combination will have AAEC in India?

CCI while examining this issue first considered the 'relevant market' in the instant case, then whether such proposed combination will have AAEC on the relevant market.

Competitive Assessment of the Proposed Combination:

Alcoholic beverages can be broadly categorized into three main categories i.e., Beer, Wine and Spirits. Spirits include both country liquor as well as branded spirits and are distinguished on the basis of ingredients, alcoholic content and the manufacturing process involved. The alcoholic content in spirits is highest. USL and Diageo deal only with branded spirits which are categorised into five main segments i.e. Whisky, Rum, Vodka, Brandy and Gin.

Relevant Product Market: It was found that the market for alcoholic beverages comprises of different types of spirits, across various price segments, and is considerably differentiated and driven by the consumer's preference for different products and brands in each product category. Thus in a market characteristic of product differentiation the propensity of the consumer to switch to a different product depends upon the closeness of the available substitute products and these close product substitutes compete vigorously. To differentiate products and brands between Diageo and USL, the differentiated products for each type of branded spirits were further segmented on the basis of close price bands, to assess the degree of substitutability among the brands and the alcohol segment they operate in i.e. Whisky, Rum, Vodka, Brandy and Gin.

Relevant Geographic Market: While the production, manufacture, transport, sale etc. of alcoholic beverages falls within the regulatory purview of the respective State Governments it was found that the conditions of supply translate into the same competitive situation for all the enterprises. Marketing, branding and pricing decisions of Diageo and USL are broadly determined at a national level for the country as a whole. Further, as both USL and Diageo were stated to operate on a pan-India basis, the relevant geographic market for the purpose of the assessment of the proposed combination was considered to be the whole of India.

Evaluation of Effect on Competition

An analysis of the market shares of the parties determined that the market share combined entity would not change much except in the Vodka market. The DG report revealed that the consumer had options of various quality of a particular spirit in various price ranges which implied that for firms in highly segmented markets, their strategic choice is the positioning of the new products within a given price range. Agreeing with the investigation findings the CCI observed:

Whisky Segment: It was observed across Whisky brands that the segment had the presence of many other brands including those of Diageo and USL and was seen that the consumers have reasonable choice available at various price points minimising any concern of elimination of competitive constraint. Considering the current trend of premiumisation, it is anticipated that the players at various price points in this segment and as well as in other segments may introduce new and innovative premium brands and products, thereby providing more choice to the consumers.

Vodka Segment: It was observed that the Vodka brands of both USL and Diageo would also continue to face stiff competition at different price segments from many other brands and their variants and in the past two years, 27 new brands have entered the local as well as the flavoured Vodka segments, indicating that this market is rapidly growing and evolving in India.

Rum, Gin and Wine: It was observed that Diageo had an insignificant share in volume terms of the total segment and a marginal presence in this segment in India.

Decision:

Even in the narrow price sub-segments in the overall Whisky segment, where even if the brands of USL and Diageo were considered to be positioned as close competitors, it was found that there were brands of other players present and effectively competing with the brands of USL and Diageo in those segments. The volume in these price segments was also miniscule in comparison to the overall volume of the Whisky segment. Further USL and Diageo were mostly present in different price spectrums in the branded spirits market with negligible overlap between their products in each of the branded spirits segment. The CCI found that the proposed combination could bring new products and more variants of the existing brands at different price points which would ultimately enable the consumer to expand his choice set. Moreover, since the manufacture, distribution and sale of alcoholic beverages in India falls within the regulatory purview of the State Governments the introduction of new brands in the market as well the pricing of existing or newly introduced brands is not entirely at the choice of the enterprises and even if free from state control, it is determined by the market within the overall regulatory framework provided by the respective states.

The CCI further opined that the proposed combination may allow for increasing product differentiation as a consequence of both brand proliferation and brand extension and give a boost to the premiumisation strategy. Also, the degree of product differentiation across price segments is likely to increase in the post combination scenario. The combination may increase and improve consumer choice and since the combining parties produce distant substitutes, the synergy of the firms will not detract competition. Therefore the CCI held that the proposed combination is not likely to have an appreciable adverse effect on competition in India.

Post Script:

While the Acquirer and Sellers were involved in obtaining Competition approvals, the deal saw significant developments across legal and geographical jurisdictions that raised regulatory concerns and setback the process of complete operational takeover. These instances were:

I. UK's OFFICE OF FAIR TRADE

In November 2013 UK's fair trade watchdog – the Office of Fair Trade (OFT) found Diageo's deal to take over United Spirits to be anti-competitive, forcing the company to offer selling bulk of Whyte & Mackay whiskey business. The OFT had stated that the merger may lead to a substantial lessening of competition in the supply of blended whisky to retailers. OFT came to the conclusion after analysing evidence including data on consumer switching between brands, economic modelling and internal documents. Chris Walters, OFT's Chief Economist and Decision Maker in this case, said the two companies are leading suppliers of blended bottled whisky in the UK, especially to supermarkets and other large retailers. The OFT investigation found that the deal would lead to a substantial lessening in the competition and that other manufacturers could not offset the losses. Most importantly, it would lead to higher prices for retailers and ultimately the consumers which is what led the OFT to take this decision. A natural next step of this process would have been a referral to the Competition Commission but in the meantime, Diageo and USL presented the regulator with a revised deal structure that involved selling off the Whyte & Mackay whiskey business as part of the overall obligations under the acquisition. This revised proposal is under consideration by the OFT.

II. KARNATAKA HIGH COURT – WINDING UP PETITION STAY ORDER & APPEAL IN SUPREME COURT

Diageos' purchase of USL contained the transaction obligation by *inter alia*, the promoters to step in and offload shares in the event Diago is unable to acquire equity through the open offer for USL shares. Due to a muted response to the open offer, Diageo could only buy 0.04 % in United Spirits with the remainder being made up by amongst other, UBHL. Kingfisher lenders, including BNP Paribas, Rolls-Royce and others, initiated a claim in the Karnataka High Court against the sale of the 6.98 % stake by UB Holdings given that UBHL (UB Group investment/holding company) was also the guarantor for unsecured loans for another sister concern i.e. Kingfisher Airlines. In April 2013, 10 unsecured creditors of UB Holdings filed a winding up petition against the company. While this petition and 4 similar others were pending, UB Holdings approached the Karnataka HC seeking permission to sell the shares it held in United Spirits to Diageo. The single judge allowed the sale and told the company to pay its secured creditors from the proceeds and also deposit 250 crore rupees with the court. The unsecured creditors of UBHL appealed the single judge order before a division bench which overturned the earlier decision. The Division Bench of the Karnataka High Court disallowed the sale of USL shares by UB Holding given that winding up petitions had been filed against UB Holdings by some of its unsecured creditors. It held that the share sale of USL to Diageo by UBHL is null and void. Diageo and USL have preferred an appeal before the Supreme Court where they demonstrated the existence of all other intrusive and scrutinized approvals from RBI, SEBI and CCI, yet were unable to go ahead with the deal. The matter was heard at the Supreme Court and is listed for 31st January 2014, at the time of going to press.

ANALYSIS:

The deal valued at about INR 52 Billion is one of the largest transactions for acquisition, especially in the food and beverages industry, not just in India but across the world. The deal gave the Diageo Group a much anticipated entry into one of the world's fastest growing liquor market in India and also saw the leading premium alcohol maker extend its footprint to the lower segment of the market that drives scale. India now becomes Diageo's second-biggest market by sales revenue. For the UB Group, the deal offers a new partnership with an experienced global player and reduction of their respective debt while for USL it represents the best of both worlds as an established local presence meets international governance and operational standards and also deleverages itself. The deal integrates the well positioned USL range of brands across categories and price points to capitalise on the very strong growth trends that are predicted in the alcohol segment in India with Diageo bringing its skills and capabilities to this market. It brings Diageo's strengths in marketing and innovation together with USL's scale, leading local spirits brands, strong routes to market, and an exceptional supply base.

Expansion will be slow now given the regulatory challenges in Indian courts and the UK competition regulator's intervention, yet the sale of Whyte & McKay is very much on track. Only a 6.9 % stake will be affected by the Indian High Court verdict and this has already been cushioned by the initial agreement between the two players that had taken the winding up petition into consideration. United Spirits has given assurance to Diageo that the latter will be able to retain operational and management control even if they are not a majority shareholder. USL has a contractual obligation to go out of its way to ensure that Diageo gradually becomes a majority shareholder over time. For now, Diageo will continue to vote side by side on the board with USL per its deal contractual commitments. In addition there may be other contractual provision which gives them ability to purchase additional shares from the Indian promoter but that will depend on what the exact terms of the definitive agreements are. If UB Holdings is not able to return the cash, Diageo can initiate recovery proceedings against the company. Subsequently, Diageo can increase its shareholding either through open market purchases or through another open offer. It could also bid for the UB Holdings' shareholding as and when a liquidator organizes sale of assets of the company. At the time when the transaction in question was entered into, Diageo was fully alive to the fact that there were at that point in time winding up petitions pending in the Karnataka high court and deal structures were created to mitigate these outcomes. Further, while this deal is being touted as one of the biggest investments in the F&B space, an analysis of the various compliance touch-points across jurisdictions raises a pertinent complexity. The sheer volume of regulatory compliance mechanisms in place globally and the increased scrutiny regulators are undertaking demonstrates the difficulty in doing business.

Prepared by: Vibhor Juyal, CIRC