

SAFEWAY MERGER INQUIRIES: REMEDIES STATEMENT

The Competition Commission has sent remedies letters to the main parties in the Safeway merger inquiries. These inquiries concern the mergers in contemplation between each of Wal-Mart Stores Inc (Wal-Mart), the owner of Asda Group Ltd (Asda); J Sainsbury plc (Sainsbury); Wm Morrison Supermarkets plc (Morrison); Tesco plc (Tesco) (the “parties”); and Safeway plc (Safeway) (together the “main parties”).

On 8 May, the Commission set out in its Issues Statement a number of issues that it wished to consider which, together with any other issues identified as the inquiry proceeded, would help the Commission to reach conclusions on the question of whether any of the four potential mergers might be expected to operate against the public interest. The Commission has received further evidence from the parties, their competitors and other interested organisations and individuals since 8 May. It has as yet reached no conclusions on any matter, and further evidence is awaited, but in order to ensure that the parties are aware of all the issues that might affect its conclusions, the Commission is taking the opportunity to set out its current thinking on the issues, including potential areas of concern, in Part 1 of the following statement. In Part II, the Commission suggests certain remedies which might be appropriate in respect of one or more of the mergers in contemplation should it conclude that any of them might be expected to operate against the public interest.

The Commission is continuing to study the issues of competition and choice in local areas through its ongoing isochrone analysis. It is also considering the responses to two surveys it has carried out, of small and large suppliers respectively.

A Remedies Letter is always sent to main parties before the Commission has reached any conclusions, to give them the opportunity to comment, on a purely hypothetical basis, on possible ways in which any adverse effects of the merger might be prevented or removed. The purpose of making the statement of remedies public is to inform all interested parties and give them an opportunity to raise any further points with the Commission. The Commission would be grateful for any written views which interested parties may wish to present, on any aspect of the Statement, to reach the Commission by **no later than Friday 4 July**.

Parts I and II of the Remedies Statement are set out below.

PART 1 – CURRENT VIEWS ON THE ISSUES

We summarise below the Group's current thinking on each of the issues set out in the Issues Letter published on 8 May. These views are based on evidence received to date. However, further evidence is being sought, or analysis carried out, on a number of issues; the views expressed below must therefore be regarded as provisional. (The issues are reproduced in italics.)

A. THE MARKETS INVOLVED

1. In the CC monopoly report on supermarkets published in October 2000 (Cm 4842) (the 2000 report), the CC concluded that the relevant economic market was that for one-stop grocery¹ shopping carried out in stores of 1,400 square metres or above. The CC further concluded that shopping patterns were essentially local, most consumers travelling no more than 10 minutes to the supermarket in urban areas and no more than 15 minutes in non-urban areas. Bearing in mind that the 2000 report was a report on the monopoly situation as regards the supply of groceries from multiple stores and the possibility that different considerations might arise in the current merger inquiries, consideration needs to be given to the extent to which that definition of the economic market is still appropriate and, in addition, to what extent there may have been developments in the market since 2000. We therefore consider that the following issues arise in the case of each of the mergers in contemplation:

(a) Whether the product market or markets should be defined, for the purposes of the competition analysis, as “groceries” or whether it (or they) should include other product categories now frequently sold in large multiple retail outlets and, if so, what other categories; or whether it (or they) should be defined in some other way;

(i) On the basis of the evidence received to date, our current thinking is that the product markets affected by these mergers relate primarily to groceries, although we recognise that many supermarkets now sell a range of goods that go beyond the core grocery offer, and which could have an impact on competition.

(ii) Although petrol filling stations (PFS) may increase footfall in the grocery outlets with which they are associated, petrol should not be considered as being in the one-stop shopping market.

(b) Whether the market or markets should be defined, for the purposes of the competition analysis, as including only those stores where one-stop grocery shopping typically takes place and whether this includes only stores whose sales area is above 1,400 square metres or other sized stores as well and, if so, which other stores; and whether there is a relevant market that includes “convenience stores”, that is, stores under around 600 square metres in size;

(i) One relevant market is that for one-stop shopping in stores of 1,400 sq metres or above. However, in sparsely populated areas (for example, parts of Scotland), account needs to be taken of stores which, although somewhat smaller than 1,400 sq metres, nevertheless fulfil the role of one-stop shops.

(ii) Shopping that takes place in stores below 1,400 sq metres is typically secondary shopping or, in very small grocery stores, convenience shopping. We recognise, however, that some secondary and convenience shopping takes place in stores above 1,400 sq metres. Given that Safeway owns grocery outlets below 1,400 sq metres, offering secondary and convenience shopping opportunities, the acquisition of Safeway may raise issues of local choice and competition in respect of these stores which also need to be considered in the context of these inquiries. In this connection, an isochrone exercise is being carried out in respect of the

smaller stores of Safeway and its competitors in local areas; this may give some indication of whether any problems of choice or restricted competition are likely to arise in local areas because of the subsequent ownership by any of the parties of Safeway's smaller stores.

(iii) In relation to supermarkets' purchases of groceries from suppliers, the main parties between them appear to have a large share of such purchases. We are considering whether a separate procurement market should formally be defined for the purposes of the competition analysis and if so, whether it should include supplies of groceries to non-retail outlets.

(c) Whether the geographical market should be defined, for the purposes of the competition analysis, as national, regional or local and, if any of these, how its scope should be characterised; or whether the geographical market should be defined as manifesting characteristics of all or more than one of these.

Applying the standard methodology for defining the geographical market by using the SSNIP (or "hypothetical monopolist") test (see the Competition Commission's Merger Guidelinesⁱⁱ), our current view is that the market for one-stop shopping is essentially local, because of the limited distance which most consumers are prepared to drive for their main regular shopping trip. However, key decisions by the main parties about how their stores operate are, for the most part, made centrally and are therefore national in scope for national players. These decisions include pricing strategy and price levels for individual products; strategic decisions on the overall type of offering to customers, associated marketing and reputation building; and within this, decisions on the overall range and quality of products offered and on the main factors which will determine the general in-store experience of customers. While there appears to be some local variation possible in relation to certain limited aspects (for example, variation in the shelf space devoted to particular products in the light of local demographic factors) the decisions listed above currently appear to be set predominantly with regard to a party's aggregate business position rather than varied across stores in the light of particular local conditions. As a result, competition in local markets will in part reflect factors that are present at the broader level; these factors will in principle include national scale (in terms of revenue, assets and financial position), the costs of groceries purchased from suppliers and costs of operation, as well as the overall strength of competition operating through local markets. The competition analysis underlying our public interest assessment will therefore need to address both local and national dimensions of competition, as set out more fully below. Any consideration of remedies (in the event that we were to make adverse public interest findings in respect of any of these mergers) would also need to address both dimensions of competition. This inter-relationship between local and national strategies implies that divestment at the local level would not necessarily solve all competition problems at national level.

(d) Whether Internet home shopping to any extent, if at all, affects the geographical market definition;

Our current view is that Internet home shopping is not sufficiently significant as to affect the definition of the geographical market.

(e) Whether, in considering market definition, chains of substitution extending across localities or regions should be taken into account; if so, how such chains of substitution operate and what effect they have on market definition.

Local markets for one-stop shopping broadly approximate to 10- and 15-minute catchment areas (represented by isochrones) but they may be somewhat wider, depending on the degree of overlap of such catchments (chain of substitution). In areas where there are large numbers of significantly overlapping isochrones, the market may be regarded as in some respects

regional. However, for one-stop shopping we intend to use 10- and 15-minute isochrones respectively for urban and rural areas in order to investigate choice for consumers and the possibility of supermarkets being able to price discriminate in local areas (see paragraph 2.32 of the Guidelines). For smaller stores, we are using 5- and 10-minute isochrones.

B. COMPETITION ISSUES

Local level

2. *In its 2000 monopoly report, the CC concluded that isochrone analysis based on one-stop shopping in stores of 1,400 square metres or above, with drive times of no more than 10 minutes in urban or 15 minutes in rural areas, was an appropriate framework in which to consider local competition between stores. Bearing in mind the possibility that different considerations might be relevant in the context of these merger inquiries, and in the light of possible developments since the 2000 report, the following issues arise in the case of each of the mergers in contemplation:*

(a) Whether isochrone analysis based on stores is a practical and appropriate approach to identifying the sources of local competition between stores; and, if so, what methodology should be adopted for such an analysis and what are the correct criteria for consideration;

For the purposes of these inquiries, isochrone analysis centred on stores is the best practical approach to identifying the sources of local competition between stores. However, such an approach may risk missing potential competition and choice problems. For this reason, we have incorporated population centring as one element of our analysis.ⁱⁱⁱ The detailed methodology for the first stage of the isochrone analysis adopted by the Group (including drive times and the definition of urban and rural areas) has been discussed with the parties. The outcome of the first stage will be a list of those localities in which the number of different fascias^{iv} capable of offering one-stop shopping would be reduced to four (or fewer) as the result of the acquisition of Safeway's one-stop shop portfolio by Asda, Morrison, Sainsbury or Tesco. The Group is considering the question of how many different fascias in any locality is sufficient to give consumers adequate choice and maintain effective competition (see also paragraph 10 (d) below). As set out earlier, this analysis covers both one-stop shopping and shopping in smaller stores. The second stage of the isochrone analysis involve a more detailed consideration of the localities identified in stage one, with a view to determining in each case whether adequate competition would exist following any of these mergers, taking into account particularly the number, size and type of competing stores in the locality concerned.

(b) Whether isochrone analysis based on a consumer-centric or some other population-based approach is a practical and appropriate way to determine local competition between stores; and, if so, what methodology should be adopted for such an analysis and what are the correct criteria for consideration;

It has not proved practicable in the context of these merger inquiries to rely only on a consumer-centric or other population-based approach. As already noted, we are taking account of population factors by using areas of population to re-centre isochrones.

(c) Whether there are any other practical and appropriate ways of assessing local competition between stores;

None has been identified.

(d) Whether it would be appropriate to use measures such as the number of fascias in a locality, the Herfindahl Hirschmann Index or market share data to examine the degree and adequacy of local competition and, if so, which of these measures; and what change in any such measure should be regarded as indicating a reduction in local competition;

(i) We currently consider that all three measures may be relevant.

(ii) Specifically with regard to HHIs, local HHIs for one-stop grocery shopping, measured in terms of sq metres and current sales, are already high in some cases – for instance, even if there were five equally-sized competitors in an isochrone, the HHI would be 2,000, which is usually regarded as indicative of a highly concentrated market. High HHIs are a relevant part of the evidence relating to the adequacy of competition in particular local areas.

(iii) Specifically with regard to the number of fascias, one factor in deciding how many fascias may be sufficient to ensure adequate choice and competition in any locality is the existing extent of concentration in that locality. A reduction from six to five fascias (or conceivably from seven to six) could in theory present a competition or choice problem locally. It appears, however, that there are very few instances where six fascias would be reduced to five and the main area of concern is therefore likely to be a reduction of five to four fascias or some lower number. We currently view a reduction from five to four (or any greater reduction) as posing a potential competition and choice problem, but it remains to be seen whether this is too stringent a criterion, taking all relevant matters into account.

(iv) Neither HHIs nor the number of fascias is likely to prove determinative. These are first stage indicators and all factors must be taken into account in the overall assessment of the competitive impact of any of these mergers.

(e) Whether there are any other measures that might be used to indicate a change in the degree of competition at the local level;

There appear to be no other relevant measures.

(f) Whether any of the mergers in contemplation might be expected to bring about such a degree of concentration at the local level as to result in any of the coordinated effects set out in the CC's guidelines for merger references;

(i) In considering the scope for coordinated effects in local areas, we note that competition can be affected by changes in local market concentration. In particular, a reduction in the number of players in a local area may reduce the intensity of competition if it leads to a mutual, albeit independent, recognition that, for example, price reductions are more likely to precipitate an equivalent and off-setting response. These effects are described more fully in paragraphs 3.32 to 3.36 of the Competition Commission's Merger Guidelines. The conditions under which such effects might be facilitated, set out in paragraphs 3.37 to 3.43, are also relevant, and include a high level of concentration, high barriers to entry, little opportunity for small firms significantly to increase their presence (at least in the short to medium term), market demand and costs being generally stable and not subject to unpredictable fluctuations, little scope for third parties (such as suppliers or consumers) to exert pressure on the parties, a high degree of homogeneity of products (in the shape of the "weekly one-stop shop") and market transparency, and finally, the ability of the parties to change prices very quickly.

(ii) In addition, where price and non-price decisions are taken locally and where players face each other in a range of local markets, there may be an impact on the scope for coordination even if, for example, divestments ensured no change in concentration in any particular area. Coordinated effects might still be easier to support because of the possible disciplining effects on parties' behaviour arising from interaction across a range of markets. The extent to which this could or does occur will in part depend on the specific circumstances of the case (see (i) above).

(iii) As the types of coordinated effects may differ according to whether there is national or local pricing, the Group is therefore considering whether the main parties could (or indeed might be expected to) decide to revert to local pricing.

(iv) If, as the result of any of the mergers in contemplation, competition were subdued in any of the ways set out above, we would expect the parties to pursue those policies that were most profitable for them, notwithstanding current levels of competition.

(g) Whether any of the mergers in contemplation might be expected to result in prices for groceries or other product categories being higher, in service levels or quality diminishing, or choice being less (whether in the one-stop shopping or any other grocery market) than would otherwise have been the case, as a result of the actions of one of the parties, or one of the parties in association with the actions of one or more other multiple grocery retailers;

Further concentration could alter the dynamics of price or non-price competition, even if pricing were set locally. For instance, a party may achieve large market shares in some local markets as a result of the merger. If the merged firm were to price locally, then high market shares could lead it to price independently of the anticipated actions of other local competitors. Such unilateral effects need not take the form of increased prices; they could, for instance, manifest themselves in lower service levels or quality. In addition, to the extent that a limited number of parties currently lead price competition, we shall need to consider whether any increase in concentration brought about by any of the mergers might lead to one or more of those parties changing their pricing strategies, with the result that prices levelled off or even increased. Non-price competition could also diminish.

(h) Whether any of the mergers in contemplation might be expected to result in prices being higher than they would otherwise be in petrol retailing, as a result either of the actions of one of the parties, or one of the parties in association with the actions of one or more other market participants;

It has been put to us that PFS owned by the main parties increase footfall in their outlets. To the extent that any of these mergers brought about increased concentration in the grocery markets, there may be less incentive for the main parties to use their PFS to increase footfall and they might raise their petrol prices. If so, it will be necessary for us to consider whether any resulting increase in petrol prices in the parties' PFS would be likely to bring about increases in the rest of the petrol retail market.

(i) Whether any of the mergers in contemplation might be expected to have any adverse effect on the ability of a new multiple grocery retailer to enter the local market, or the ability of an existing grocery retailer to grow in the local market.

(i) Entry barriers into the market at the scale of the main parties to the merger references appear high, both because of the current planning guidelines which restrict the building of new out-of-town stores and the existence of scale economies in the purchasing and distribution of groceries. The acquisition of Safeway by Asda, Morrison, Sainsbury or Tesco would, given these circumstances, effectively remove what appears to be the easiest entry route to the market on the scale of these companies. The same considerations apply to significant expansion by other grocery multiples. We recognise that barriers to entry may be lower for much smaller grocery retailers.

(ii) It is generally recognised that acquisition of sites is a key issue in entering or expanding within the multiple grocery sector. We are considering whether any of the mergers would lead to a disproportionate advantage for the acquiring party in terms of its ability to obtain sites or intensify its acquisition programme; or would be likely to reduce the prospect of other entry, for example, by smaller grocery multiples such as Waitrose, M&S or a foreign-owned grocery

retailer. We are also considering whether any of the mergers might result in more effective local competition for sites.

3. *Whether any of the mergers in contemplation might be expected to bring about benefits for consumers or others at the local level that would not have been realised in the absence of the merger, and if so, what form these might be expected to take; for example:*
(a) consumers having a better chance of being able to shop at their preferred supermarket;
(b) prices of products or services being lower;
(c) efficiencies (for example in distribution, IT, advertising or promotion) being increased and passed on to consumers in the shape of lower prices for products or services, higher quality products or services, a greater choice of products or services or a better quality of service.

(i) The benefits claimed by the main parties in respect of each of the four possible mergers (including those in (a) to (c) above) are still being assessed. Benefits associated with any of the mergers could be set against any adverse effects of that merger, but we would need to be satisfied that they could not be achieved without the merger. An assessment of these benefits has to take account also of their sustainability over the medium to longer term.

(ii) All four parties have argued that if they acquired Safeway, prices would fall. We also need to address the longer-term effects of each of these mergers on prices, viewed in the light of the competitive conditions that each could be expected to bring about.

National level

4. *The CC will wish to explore the precise nature of competition in the relevant economic market or markets at the national level, in order to establish the dimensions of such competition and the mechanisms by which it operates. In this context, the CC will wish to examine the effect that each of the mergers in contemplation might be expected to have on competition at the national level, including the effects on multiple grocery retailers without national coverage and on other (smaller) grocery retailers. In particular, the following issues arise in the case of each of the mergers in contemplation:*

(a) Whether it would be appropriate to use measures such as the number of fascias nationally, the Herfindahl Hirschmann Index or market share data to examine the degree and adequacy of competition at the national level and, if so, which measure or measures; and what change in any such measure should be regarded as indicating a reduction of competition at the national level;

(i) We currently consider that all three measures may be relevant. The number of fascias nationally, the prevailing levels of concentration (measured by the HHI) and the increase in those levels following any of the mergers and national market shares, may all be relevant in assessing competitive constraints on the behaviour of the parties following any of these mergers so far as the national dimensions of competition are concerned.

(ii) National HHIs are already high, indicating an existing high level of concentration.

(iii) In deciding how far concentration should be allowed to increase, if at all, account must be taken of what appear to be existing high barriers to entry and expansion at the existing scale of the main parties. This means that, so far as competition for new sites suitable for one-stop shopping following any of these mergers is concerned, the number of potential contestants for such sites would be reduced so far as the largest grocery retailers are concerned.

(iv) We are currently considering the extent to which market shares have changed over recent years. One measure of market share is that of new store openings. We are looking at the likely market shares of each of the main parties over the next three years on this and other measures, extrapolating from recent trends.

(b) Whether there are any other measures that might be used to indicate a reduction in competition at the national level;

There appear to be no others at present.

(c) Whether any of the mergers in contemplation might be expected to result in such a degree of concentration at the national level as to result in any of the coordinated effects set out in the CC's guidelines for merger references);

(i) There could be coordinated effects in pricing and non-pricing areas because of the large national share of supply of groceries to consumers which the main parties would have following any of these mergers. We have already drawn attention to these in the context of local markets.

(ii) Moreover, as with local competition considerations, we are considering to what extent the conditions (already outlined in paragraph 10(f)(i) above) under which coordinated effects might be facilitated appear to be present in the national context.

(iii) We are currently considering whether there may be a threat to the intensity of competition if the number of grocery retailers who operate on a national scale (currently four) were reduced to three (Asda, Sainsbury and Tesco) through the acquisition of Safeway by any one of these three. The short-term effects might be to intensify competition, but we shall need to consider whether, in the longer term, more dominant positions may be expected to establish a stable hierarchy within which competitive rivalry may begin to diminish.

(iv) An acquisition by Morrison might have different effects, because there would then still be four parties operating on a national scale. A Morrison/Safeway merger could be pro-competitive in creating a powerful fourth national player to offer competition to Asda, Sainsbury and Tesco. However, we shall need to consider the effects of further trends in concentration and whether a reduction from five to four competitors locally could be a threat to the intensity of competition at the national level. Moreover, it has been put to us that, if Morrison acquired Safeway, it would have to integrate two very different businesses and its success in achieving this while not sacrificing efficiency might be thought uncertain.

(d) Whether any of the mergers in contemplation might be expected to result in prices for groceries or other product categories being higher, in service levels or quality diminishing, or choice being less (whether in the one-stop shopping or any other grocery market) than would otherwise have been the case, as a result of the actions of one of the parties, or one of the parties in association with the actions of one or more other multiple grocery retailers;

Further concentration could alter the dynamics of price or non-price competition at the national level, leading to less intense price competition than at present, or to service levels or quality being lower than otherwise. We are considering whether any of these mergers would result in a reduction of the current diversity of grocery offer, since each of the main parties occupies, to a greater or lesser extent, a different position from its competitors in terms of its pricing strategy, product range, quality of service, store size and fit-out and other aspects of its offer. On the other hand, it has been put to us that Safeway does not currently offer a competitive alternative. We are considering the impact on diversity and innovation that might result from each of these mergers over the short and longer term.

(e) Whether any of the mergers in contemplation might be expected to result in prices being higher than they otherwise would be in the petrol retailing market, as a result of the actions of one of the parties or one of the parties in association with the actions of one or more other market participants;

See paragraph 2(h).

(f) Whether any of the mergers might be expected to have an adverse effect on the ability of a new multiple grocery retailer to enter the national market, or the ability of a smaller grocery retailer to grow nationally;

See paragraph 2(i).

(g) Whether any of the mergers in contemplation might be expected to have particular effects in Northern Ireland or Scotland, with respect to the price, quality or choice of products or services on offer, the service levels associated with such products or services or in any other respect.

Because of our current view that the relevant markets are local and that key decisions are taken at the national level, we have not focused on possible regional dimensions of any of these mergers. However, because Northern Ireland is geographically separate from the rest of the UK, there may be some additional factors to be considered in assessing the particular effects of any of these mergers in Northern Ireland, for example, differences in distribution arrangements.

5. *Whether any of the mergers in contemplation might be expected to bring about benefits for consumers or others at the national level that would not have been realised in the absence of the merger, and if so, what form any such benefits might take; for example:*

(a) Whether the acquisition of Safeway by any one of the parties might be expected to bring about increased competition, and if so, in what ways this might manifest itself (for example, in price levels, the quality of goods or services or the diversity of the grocery offer);

(b) Whether any of the mergers in contemplation might be expected to bring about efficiencies that would not have been realised in the absence of the merger, and what form these might take (for example, in distribution, head office, IT or logistics) and whether such efficiencies might be expected to benefit consumers by being passed on in lower prices for products or services, higher quality products or services, a greater choice of products or services or a better quality of service.

(i) The benefits claimed by the main parties in respect of each of the four possible mergers are still being assessed. Possible benefits associated with any of the mergers – for example, better buying terms, greater efficiency, increased densities – must be set against any possible knock-on or off-setting effects elsewhere. (See also paragraph 11 above.)

(ii) It has been argued by some of the parties that the main benefit of the acquisition of Safeway would be the price cuts that could be instituted. Among the matters we shall have to consider in this connection are the size of any such price cuts, how sustainable they would be and whether they would be sufficient to compensate for the reduction in choice or non-price factors (such as range of products) that might be brought about by the merger. Moreover, as already noted, the parties' pricing strategies could change.

6. *Whether, if Safeway were not to be acquired by one of the parties or by another bidder, it might be expected to offer effective competition to the parties and to other multiple grocery retailers, and what role it might be expected to play in the market for multiple grocery retailing in the future.*

(i) Safeway cannot be considered a failing firm on the definition adopted by the Competition Commission in its Merger Guidelines: that is, that the firm is unable to meet its financial obligations in the near future and is unable to restructure itself to a position where it can meet those obligations.

(ii) The question is rather one of the competitive role that Safeway is likely to be able to play in the absence of the merger. It has been put to us that the current position of Safeway is attributable to structural problems such as the nature of its store portfolio, and in particular to

the size and location of its stores. We shall need to consider whether Safeway's relative lack of success is predominantly attributable to such problems, or to matters which a different management team and/or different strategies might be capable of remedying. In this connection, we shall be looking at indicators such as sales growth and financial performance and how these appear likely to develop in the short to medium term. Although past evidence is by no means conclusive, we note that there have been examples in recent years of other multiple grocery retailers recovering from comparatively weak positions.

C. BUYER POWER AND SUPPLIER ISSUES

7. *The following issues are for consideration:*

(a) Whether any of the mergers in contemplation might be expected to result in an increase in the merged entity's buyer power in relation to its suppliers and if so, how this might be brought about – for example, by virtue of suppliers having one fewer multiple grocery retail outlet for their products; and how any such increased buyer power might be expected to manifest itself – for example, in increased costs for suppliers (including as the result of situations where products they supply are sold by one or more of the parties at below cost on a persistent basis), a reduction in the quality or diversity of products or services supplied by them, or in the levels of innovation they can attain in relation to those products or services;

(i) The 2000 report found that, for leading suppliers' branded goods, the larger the scale of the grocery retailer concerned, the lower its buying costs. Work is in hand to find out whether the increased scale of the merged party following any of these mergers would bring about lower buying costs which were attributable to the costs saved by suppliers in supplying the merged entity; and/or lower buying costs which were attributable to the increased scale of the merged entity.

(ii) All the parties expect substantial savings from own-brand goods as a result of the mergers. We are considering the concern put to us that any of these mergers is likely to have the effect of reducing the proportion of branded goods available to consumers.

(iii) In the 2000 report, we found that below cost selling was a practice that operated against the public interest. This practice has been raised with us again in the current inquiries. There is some evidence that it still occurs. We are considering whether any of the mergers would be likely to encourage or facilitate this practice.

(b) Whether any increase in buyer power by the merged entity might be expected to have adverse effects on consumers, by bringing about a reduction in the number of suppliers, increases in product prices, or a reduction in the quality, diversity or levels of innovation in relation to those products

Some concern has been expressed to us that any of these mergers, to the extent that it led to the rationalisation of the total number of suppliers or to an increased emphasis on non-food lines in supermarkets, might bring about a reduction of product lines, and of product diversity and innovation.

(c) Whether any increase in buyer power by the merged entity might be expected to have adverse effects on smaller multiple grocery retailers or convenience stores, because suppliers to the merged entity might be expected to seek to recoup any loss of margin through raised prices to those other grocery retailers;

Preliminary evidence from analyses still being carried out has found limited evidence of this "waterbed" effect taking place over the short term. Some submissions have suggested that there may however be longer-term effects.

(d) Whether any of the mergers in contemplation might be expected to have any impact (positive or negative) on the effectiveness of the Code of Practice^v governing relations between some supermarkets and their suppliers in protecting suppliers;

As a result of recommendations in the 2000 report, the Office of Fair Trading put in place a Code of Practice, designed to regulate the relations between large supermarkets and their suppliers. Evidence received to date suggests that for the vast majority of suppliers, the Code of Practice has made no difference to their negotiating position with the large supermarkets. For those who thought that it had made a difference, more thought that it had made the position worse than thought it had made it better. A key issue is whether any of the mergers would significantly alter this picture. If buyer power were to increase as the result of any of these mergers, then the situation might worsen. An OFT review of the Code is currently being conducted and might be expected to identify any inherent weaknesses in it. In the context of these inquiries, the question is whether the Code is adequate to address an increase in the problem resulting from any of the mergers.

(e) Whether any of the mergers in contemplation might be expected to have any impact on the size, efficiency or diversity of the grocery supply chain in the UK or any part of the UK;

Concerns have been expressed about the impact of any of these mergers on the size, efficiency or diversity of the grocery supply chain in the UK and on the environmental impact of the food supply chain. We are still awaiting evidence on this matter.

(f) Whether any increase in buyer power might be expected to reduce competition at the local or national levels.

Increased buyer power resulting from any of these mergers might be a contributory factor in reducing competition at either the local or national level. It has been put to us that there would be no problem if the downstream market were competitive. However, it has also been suggested that if the merged entity achieved significant purchasing benefits, the competitive effects in the grocery retail market might accentuate the trend towards increased concentration in that market, possibly leading to one or two dominant players in the grocery retail market and followed by diminished competitive rivalry, as indicated above (see the points on unilateral and coordinated effects above in paragraphs 2 and 3).

PART II – POSSIBLE REMEDIES

In the following section, we consider possible remedies, at this stage purely on a hypothetical basis. If the Competition Commission were to conclude that one or more of these mergers might be expected to operate against the public interest, it may make recommendations designed to prevent or reduce the adverse effects. Possible remedies that we are currently considering are set out below.

Prohibition

8. A key issue is whether outright prohibition of any of these mergers should preclude the prohibited party or parties from acquiring any Safeway stores in any circumstances.

One or more mergers are allowed but subject to conditions as to divestment

9. The Commission might decide that one or more of the four mergers should be allowed, but only on condition that where competition would be reduced in particular local markets, because of the reduction in the number of fascias in those markets as a result of the merger, the acquiring store should divest the Safeway store. The following considerations arise:

Acquisition of divested stores

- a. Should there be any restriction on who should be allowed to buy any divested stores? Should it be a requirement that stores should only be divested to a party to be approved by the Office of Fair Trading (OFT)? Might approval be conditional upon there being no breach of the divestment rules? The dual purposes of this provision would be to prevent another large player from acquiring the store, and raising corresponding competition concerns; and to improve the prospects of one of the smaller grocery retailers acquiring it and providing stronger competition to the main parties.
- b. Should the OFT decline to approve divestment to any person who indicates an intention to operate the stores other than as grocery outlets, on the ground that this would result in a greater loss of choice and competition than any other outcome?
- c. Should there be any limitation on the acquirer divesting its own store rather than the Safeway store?
- d. If some of the bids were prohibited, but others allowed, should any constraints be placed on the extent to which the permitted bidders could acquire divested stores, for example, in terms of total national market share? If so, should that national share be of sales, purchases, stores or store areas of one-stop shopping (or a combination of one-stop and some other types of shopping)?
- e. Should the restrictions in (d) above be applied only to stores that are ordered to be divested by the OFT or also to stores divested voluntarily? Might voluntary divestment of stores offer parties a way of circumventing the restrictions?
- f. Are there likely to be sufficient buyers for large divested Safeway stores, should the other main parties be unable or unwilling to acquire them? What steps could be taken in the event that there were no bidders other than the other main parties? Should there be a requirement that the parties do not complete the acquisition of Safeway before having entered into a binding agreement with a purchaser for each of the divested stores?
- g. The suggestions outlined above might not benefit consumers if, in the interests of ensuring local competition, they were deprived of their preferred supermarket; how could we ensure that qualitative as well as quantitative elements of any local offer were taken into account in setting any rules on local divestments?
- h. The situation might arise in which the divesting party was unable to agree a price with a bidder.

Form of divestment

10. Consideration should be given to the form in which any divestment might be achieved. The following points are relevant:

- a. Should divestments be in large blocks of stores, smaller packages or of individual stores? Considerations include the opportunity for a smaller grocery retailer to acquire a block of stores, perhaps with distribution assets included, and hence an increase in scale quite quickly; and the ease with which small retailers with limited assets could participate in the acquisition by picking up only one or two stores. Evidence received to date from smaller grocery retailers suggests that potential buyers would prefer to be offered stores in small blocks or individually.
- b. Assuming that one or more of Asda, Morrison, Sainsbury and Tesco (subject to some limit on the market shares of those parties) were permitted to acquire divested stores, what practical difficulties would arise in managing the divestment process? Would smaller stores have any opportunity of securing the stores they wanted?

Other forms of divestment

11. Other possibilities include:

- a. Distribution assets might form part of the divestment process. If they did, would this make it easier for acquiring parties to purchase a larger number of stores? What practical difficulties would there be in including distribution assets with divestment of stores – for example, in terms of the location of such assets?
- b. Would divestment of part of any of the main parties' land banks be feasible, either in addition or instead of store divestment? What problems would be likely to arise in implementing such a remedy?

Other forms of remedy

12. Certain remedies were put to us the purpose of which was to improve the position of suppliers following one or more of these mergers. We are currently minded to rule them out, on the grounds of impracticability; for example, with regard to suggestion (a), we could only require the successful bidder to agree to adhere to behavioural undertakings. However, comments on these suggestions are invited.

- a. Approval of any bid for Safeway should be conditional upon a strengthening of the OFT's Code of Practice governing relations between the successful bidder and its suppliers.
- b. There should be a requirement for a "level playing field" regarding suppliers' terms. Several variations on this theme have been proposed, but the essential point is that price differences between the supermarkets should reflect cost differences.

ⁱ Groceries include food, drinks (alcoholic and non-alcoholic), cleaning products, toiletries and household goods, but exclude petrol, clothing, DIY products and financial services.

ⁱⁱ Merger References: Competition Commission (CC) Guidelines, March 2003 (available on the CC web site).

ⁱⁱⁱ An isochrone is a line joining points at equal drive times from a central point. Where the central point is a store, this is known as a store-centric isochrone, and where it is an area of population, it is a population-centred isochrone.

^{iv} Fascia is defined for our purposes as a multiple grocery retailer – thus, "Asda" is a fascia. In analysing the effects of the mergers in local areas, one of the changes in which we are interested is the change in the number of different fascias. For example, in these inquiries, a local area in which Morrison had one store, Tesco, Asda and Sainsbury each had two stores and Safeway one store would have five fascias (and eight stores), and the merger would reduce the number of fascias from five to four.

^v The OFT Code of Practice followed the 2000 CC report, which recommended a code of practice to put relations between supermarkets and their suppliers on a clearer and more predictable basis. The OFT is currently reviewing the Code of Practice. The Code covers Asda, Safeway, Sainsbury and Tesco, all of which have a market share of purchases above 8 per cent. The Code does not apply to non-grocery items.

Notes to editors

1. The references concerning the four potential mergers were made under the Fair Trading Act 1973 on 19 March 2003 (see DTI Press Notice P/2003/173).
2. Further information is provided on the Commission's website at <http://www.competition-commission.org.uk/>
3. Enquiries should be directed to: Francis Royle, Press Officer, Tel: 020 7 271 0242.