

Anticipated acquisition by One Stop Stores Limited of 76 stores of the Mills Group of companies

ME/4810/10

The OFT's decision on reference under section 33(1) given on 14 March 2011. Full text of decision published 25 March 2011.

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**Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **One Stop Stores Limited (One Stop)**, a wholly owned subsidiary of Tesco plc (**Tesco**) is a retail convenience business, operating 521 convenience stores across England and Wales. Its core activities focus on grocery retailing (both food and non-food). One Stop also provides other services to customers including cash machines, Post Office services, National Lottery, Pay Point, mobile top-ups and home delivery of newspapers and magazines. One Stop's turnover for the financial year to February 2010 was £508 million. Tesco's UK turnover for the financial year to February 2010 was £42.3 billion.
2. **Mills Group (Mills)** is a group of privately-owned companies incorporated in England and Wales. Its principal activity is convenience retailing in the North East, Cumbria, Yorkshire, the East Midlands, the West Midlands and South Wales. It operates 85 stores in total but only 76 of them are the Acquisition Stores covered by this decision.<sup>1,2</sup> The turnover generated by the Acquisition Stores was approximately £61 million in the year to 31 January 2010.

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<sup>1</sup> Mills Stores also operate eight supermarkets but they are not subject to this transaction.

<sup>2</sup> See here for the list of acquisition stores:

[www.offt.gov.uk/shared\\_of/mergers\\_ea02/2010/MillsGroupstores](http://www.offt.gov.uk/shared_of/mergers_ea02/2010/MillsGroupstores). Mills' store in Filey is not subject to this transaction.

## **TRANSACTION**

3. Tesco/One Stop proposes to acquire the entire issued share capital of Mills, comprising of Mills Group Holdings plc, Mills Group Limited, Linebush Limited, Linebush III Holdings Limited, Linebush III Limited, Linebush IV Limited, Linebush V Limited, Mills (East Midlands) Limited, Mills (West Midlands) Limited, Careneed News Limited, Morgam Holdings Limited and Morgam News Limited. Together these companies own 72 of the 76 Acquisition Stores. The other four convenience stores being acquired by Tesco are presently owned, and will be acquired from, Linebush VI Limited.
4. The parties notified the transaction to the Office of Fair Trading (OFT) by means of a Merger Notice under section 96 of the Enterprise Act 2002 on 16 December 2010. The statutory deadline, as extended pursuant to sections 97(2) and 97(5) of the Act, for the OFT to decide whether to refer the merger to the Competition Commission (CC) expires on 14 March 2011.

## **JURISDICTION**

5. As a result of this transaction Tesco/One Stop and Mills will cease to be distinct. The parties overlap in the supply of groceries and Tesco's share of supply of grocery retailing in the UK is above 25 per cent and as a consequence, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **MARKET DEFINITION**

### **Product scope**

6. In past cases the CC and the OFT have considered that grocery retailing comprises three broad product markets:<sup>3</sup>

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<sup>3</sup> Anticipated acquisition by Co-operative Group Limited of Somerfield Limited, Case ME/3777/08, OFT decision of 20 October 2008 ('CGL/Somerfield') and in Somerfield/Morrisons.

- **One stop stores:** those with a net sales area of 1,400 square metres or above.<sup>4</sup> These stores form their own product market;
  - **Mid size stores:** those with a net sales area of less than 1,400 square metres but above 280 square metres. These stores are constrained by other mid size stores and by one-stop stores and so one-stop stores must be included in any market definition with mid size stores as its focus; and
  - **Convenience stores:** those with a net sales area of less than 280 square metres. These stores are constrained by all grocery stores and so the product market focused on convenience stores must also include mid size and one-stop stores.
7. The OFT has in previous decisions concluded that the effective competitor set in grocery retailing, for the purposes of fascia counting, consists of large national grocery retailers and regional grocers and symbol groups<sup>5</sup> For convenience stores, all national grocery retailers have been included in the fascia count apart from specialist retailers (for example, bakers or butchers),<sup>6</sup> Limited Assortment Discounters (LADs) and frozen food specialists.<sup>7</sup>
8. In their submission, the parties argued that LADs and frozen food specialists should be included in the fascia counting exercise. They submitted that the following provided evidence of the degree of constraint that LADs and frozen food retailers provided to other grocery retailers:
- a. Current economic conditions render consumers increasingly price-sensitive, meaning LADs and frozen food retailers compete vigorously with other grocery retailers, gaining market share.

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<sup>4</sup> In 'The supply of groceries in the UK market investigation', 30 April 2008, ('CC groceries report'), the CC considered that the floor size threshold for larger grocery stores was larger than 1,000 to 2,000 square metres (paragraph 12) but used the threshold of 1,400 square metres for much of its analysis (paragraph 13). In *Tesco plc and the Co-operative Group (CWS) Limited: a report on the acquisition of the Co-operative Group (CWS) Limited's store at Uxbridge Road, Slough by Tesco plc (November 2007)* the CC also used 1,400 sq m as the threshold.

<sup>5</sup> CGL/Somerfield

<sup>6</sup> Since specialist stores will typically offer a limited range of products and operate during restricted hours. See Case ME/1271/04, *J Sainsbury plc/Jacksons Stores Ltd.*

<sup>7</sup> *Ibid.* See Annex 1 for full list of effective competitor set.

- b. The range of products sold by discount stores such as Aldi is broadly similar to the range sold by One Stop (around [REDACTED] for Aldi compared to around [REDACTED] for One Stop).
  - c. The size profile of a typical discount store is broadly equivalent to that of Co-op, Somerfield and M&S stores, all of which are considered by the OFT and the CC to constrain convenience store operators.
  - d. The discounters' price offer is considered to be better than that of many retailers.
  - e. The discounters have continued to win customers from certain grocery retailers.
9. The parties also cited the OFT's classification of LADs as mid-size stores for the purposes of the Stage One filtering exercise as part of its analysis in Asda/Netto. They suggested that since there is a one-way constraint from mid-size stores on convenience stores, this is further evidence of the need to include LADs and frozen food retailers in the effective competitor set for convenience retailing.
10. However, the CC<sup>8</sup> and the OFT<sup>9</sup> have in previous assessments of the grocery sector concluded that LADs and frozen food specialists are not part of the same product market as large grocery retailers. This is due to the fact that LADs and frozen food retailers typically carry a reduced number of SKUs<sup>10</sup> when compared to similarly sized stores operated by CGL, M&S, Sainsbury's, Somerfield and Tesco. Furthermore, entry analysis carried out by the CC as part of its Groceries Inquiry showed that stores owned by Aldi, Lidl and Netto were not close substitutes for the stores owned by the major retailers.<sup>11</sup> These results have been confirmed by findings of low customer diversion ratios to LADs from the major grocery retailers, in recent OFT merger analysis.<sup>12</sup> Where (as in Asda/Netto) the OFT was

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<sup>8</sup> CC groceries report.

<sup>9</sup> CGL/Somerfield

<sup>10</sup> Stock keeping units are used by retailers to identify product ranges (in terms of prices, current stock, manufacturer etc.). The granularity at which a particular SKU is assigned will depend on the specifics of the range (that is, differently sized products within the same line may entail separate SKU's), but are useful in providing an indicator of the ranges offered by different retailers.

<sup>11</sup> CGL/Somerfield

<sup>12</sup> CGL/Somerfield

considering the competitive constraint provided by LADs this was in respect of the constraint that other LADs (Aldi and Lidl) were able to exert on Netto.

11. In addition to convenience stores operated by the large national multiples and stores belonging to the symbol groups, the parties made representations to the OFT suggesting that the fascia counting and filtering exercises should also include petrol forecourt station (PFS) kiosks belonging to BP and Total, since these are likely to meet the IGD criteria for convenience stores.<sup>13</sup>
12. However the OFT has proceeded on a cautious basis and followed the methodology in previous merger analysis<sup>14</sup> involving convenience store acquisitions and considered the effective competitive set to include stores part of the groups operated by the large grocery retailers (Asda, CGL, M&S, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose), regional grocery retailers (for example, Booths and regional Co-ops) and symbol groups (for example, Budgens and Spar)- provided that the store in question meets the local store-size threshold for inclusion. Given the large number of stores which make up the proposed transaction, the OFT proceeds with the established approach and considers the constraint other convenience retailers may pose on the merging party fascia, in locations which fail the filtering methodology.

### **Geographic scope**

13. The OFT has in previous cases concluded that the relevant geographic market for the supply of groceries by grocery retailers has both national and local aspects.<sup>15</sup>
14. At a national level, the OFT has found that the four largest national retailers (Tesco, Asda, Sainsbury's and Morrisons) constrain each other,

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<sup>13</sup> The necessary attributes include long store opening hours, selling space below 280 m<sup>2</sup> and the availability of certain core products for consumption off-premises. The IGD criteria is set out here: [www.igd.com/index.asp?id=1&fid=1&sid=7&tid=0&folid=0&cid=91](http://www.igd.com/index.asp?id=1&fid=1&sid=7&tid=0&folid=0&cid=91)

<sup>14</sup> CGL/Somerfield

<sup>15</sup>For example, Morrisons/30 CGL stores; CGL/Somerfield; Anticipated acquisition by Tesco plc of 45 outlets from Adminstore Ltd, OFT decision of 5 March 2004 (paragraph 11); Competition Commission, 'Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets plc; J Sainsbury plc; and Tesco plc: a report on the mergers in contemplation', September 2003 (paragraph 2.65).

with the merged CGL/Somerfield group providing a fifth national competitor.

15. At a local level, the precise delineation of the relevant geographic market is determined by the OFT on the basis of a variety of drive-time isochrones, ranging from five to 15 minutes, depending on the size of the store and whether a store is in an urban or rural area (10 or 15 minutes for one stop stores, five or 10 minutes for mid range stores and five minutes for convenience stores).

## **HORIZONTAL ISSUES**

### **Competition at a national level**

16. The OFT does not consider that competition concerns arise as a result of the proposed merger at the national level. Mills' share of grocery retailing at the national level is less than one per cent and other competitors, such as Asda, Sainsbury's, Morrisons and Co-operative Group, will remain post-merger and provide a competitive constraint on the merged entity at the national level. This reasoning – that the proposed merger does not remove an important constraint at the national level – applies for both unilateral effects concerns and coordinated effects concerns. Nor does the OFT consider that the proposed merger will create or strengthen coordination at the local level. The OFT has no evidence of pre-existing coordination at the local level nor does the OFT believe that the removal of Mills will make local level coordination more likely.
17. The OFT received representations from third parties suggesting that the merged entity would benefit from its considerable buying power in obtaining improved supply terms and ultimately lower prices. This would, it was suggested, mean that smaller businesses would not be able to compete effectively and ultimately result in exit from the local market and so reduced competition and choice for consumers. The OFT, in line with CC findings in its 2008 Groceries Inquiry,<sup>16</sup> considers the exercise of buyer power to ultimately benefit consumers in terms of reduced pricing. Effective competition in downstream grocery retailing ensures that a significant proportion of these cost savings are passed onto consumers.

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<sup>16</sup> Paragraph 9.4

18. In addition, one third party stated that increased buyer power on the part of the merged group would result in a 'waterbed effect' whereby suppliers would seek to repair overall business margins by forcing price increases on smaller retailers, as a way of recouping reduced profits from dealing with the merged business. The OFT however notes that the market share increment is relatively small (below one percent) and as such unlikely to alter supply conditions significantly. This was confirmed through supplier enquiries, who all suggested that the merger did not alter Tesco's share of business or bargaining power significantly.

### **Unilateral effects at the local level**

19. Following past cases, the OFT has considered whether the proposed merger is likely to result in deteriorating outcomes for consumers in terms of the Product, Quality, Range and/or Service (PQRS) offering in grocery retailing and more specifically convenience retailing at a local level.

20. In analysing competition at the local level the OFT employs the methodological approach in CGL/Somerfield.<sup>17</sup>

### **Preliminary filter**

21. The parties have submitted that a preliminary filter should be applied prior to the filtering methodology, such that areas where, post-merger, there would remain six or more competing fascia within the primary isochrone, could be identified as raising no competition concerns. The parties suggested that this approach was appropriate since:

- a. Convenience stores have a high degree of prevalence, with some 48,000 convenience stores operating in the UK.<sup>18</sup> This implies that in areas where at least five competing fascia are present in the primary isochrone, re-centring analysis is unlikely to flag such an area as potentially giving rise to a substantial lessening of competition.<sup>19</sup>

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<sup>17</sup> Ibid.

<sup>18</sup> [www.igd.com/index.asp?id=1&fid=1&sid=7&tid=0&folid=0&cid=91](http://www.igd.com/index.asp?id=1&fid=1&sid=7&tid=0&folid=0&cid=91)

<sup>19</sup> The OFT employs re-centring analysis in retail mergers, such that a fascia counting exercise is carried out in isochrones around relevant effective competitors, population centres (for one-stop and mid-range stores only) and census output areas (for one-stop and mid-range stores only). This methodology is employed to ensure that critical fascia reduction does not occur for a significant proportion of the population in the overlap local areas. For example see Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited.

- b. The fascia counting exercise could not falsely clear areas which should fail as a result of an asymmetric constraint,<sup>20</sup> since the target stores are all convenience stores and as such would be constrained by all grocery retail stores in the effective competitor set.
22. The OFT considered that the preliminary filter approach proposed by the parties was appropriate in this case to identify, at a preliminary stage, areas which will not give rise to any likelihood of anti-competitive effects as a result of the merger and proceeded in applying this approach.
23. There are 43 areas (centred on an Acquired Store) where either the parties do not overlap or would pass the preliminary filter.

#### First-stage filter

24. The methodological approach uses a competing fascia-count analysis, which considers that competition concerns at the local level do not arise if four or more fascias are present post-merger in any of the primary, target, competitors and census-output area re-centred isochrones.<sup>21</sup>
25. Following the application of this first-stage filter, an additional 27 areas were identified as having a sufficient number of competing fascia post-merger, such that they do not raise a realistic prospect of a substantial lessening of competition.
26. This left five areas<sup>22</sup> (six target stores) which failed the first-stage filter and the OFT considered it appropriate to assess the competitive conditions in these areas, in greater detail.
27. The parties submitted that the five areas which failed the preliminary and first-stage filter, should be subjected to ground-based assessment of competing convenience fascia within the primary isochrone and they proposed to conduct a ground based exercise to assess whether any of the

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<sup>20</sup> This would for example occur if the target store was a mid-sized store and, since mid-sized stores are not constrained by convenience stores, any convenience stores operated by the acquirer would not be counted. However the merger would serve to remove the one-way/asymmetric constraint that the mid-sized store offers to the convenience store.

<sup>21</sup> See Annex 2 in CGL/Somerfield for a detailed description of the methodology.

<sup>22</sup> Marston Green (two stores), Richmond, Horncastle, Ruskington, Birtley.



stores identified by the convenience store database, but excluded from the preliminary and first-stage filtering analysis, satisfied the IGD criteria for a convenience store and as such should be included in the effective competitor set.

28. While the OFT accepts that the approach adopted thus far is necessarily cautious, it does not consider the arguments provided by the parties to be sufficient in prompting a deviation from the OFT's established methodology in relation to the stores considered to be effective competitors.

Furthermore, the OFT considered the proposed approach to raise the following concerns:

a. Relying on the IGD criteria may be overly simplistic and could lead to over-estimating the constraint a store offers to the merging parties. For example, the IGD criteria states that for a store to be classified as a convenience store it has to (among other criteria) offer at least eight out of 15 product categories.<sup>23</sup> However, a better indicator (among others) of the product offering in grocery stores might be the number of SKUs on offer, which would allow for more granular comparison of the constraint the merging stores present to each other (in addition to other evidence such as customer diversion ratios between the target and acquiring stores).

b. Side-stepping the traditional consumer-survey approach the OFT typically applies at this stage may miss some of the nuances around local consumer preferences, as captured by diversion ratio analysis. These nuances may arise as a result of local topographical aspects, consumer shopping preferences or other important characteristics which affect the typical consumer's options set in relation to grocery stores.

29. Therefore the OFT proceeded by assessing local competition in the five areas which failed the first-stage filter, in terms of:

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<sup>23</sup> The categories are as follows: alcohol, bakery, chilled food, confectionery, fast food/food-to-go, frozen food, fruit/vegetables, health & beauty, household/non-food, national lottery, milk, newspapers/magazines, packaged groceries, snacks, soft drinks, tobacco.

- a. Local entry conditions such as the availability of appropriate sites for potential entry into convenience retailing and GOAD churn rates<sup>24</sup> for commercial property, including food retailing sites.
  - b. The closeness of competition between the acquirer and target store. This is assessed in terms of the geographical proximity, product offering, opening hours and the store size (net sales area) in the overlap stores.
  - c. The constraint offered by the competing fascia in these areas. The assessment of the constraint offered by competing fascia relies on the geographical proximity to the merging parties' stores, the product offering, the store size (net sales area), opening hours and whether the competitor is a multi-store operator.
30. Based on the evidence provided by the parties and the OFT's assessment of local competition in the five areas based on the above terms, the OFT does not consider that competition concerns arise as a result of the proposed merger in any of the five areas which failed the first-stage filter, and therefore it concludes that there is no realistic prospect of a substantial lessening of competition as a result of the proposed merger.

#### Acquisition of multiple stores within five minute isochrone

31. During the course of its investigation, the OFT received third party representations, suggesting that the merger was likely to affect local competitive conditions most significantly in areas where multiple Mills stores were being acquired. In particular, these suggested that the acquisition of multiple overlapping stores warrants further consideration, since the merger may serve to remove a more significant constraint than the fascia-counting filtering methodology would highlight.
32. The parties argued that the existence of multiple target stores within the primary isochrone should not raise any additional competition concerns, since:
- The filtering methodology is itself cautious and the existence of other competing fascia is the key variable to consider in merger analysis.

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<sup>24</sup> [www.experian.co.uk/www/pages/what\\_we\\_offer/products/goad\\_retail\\_database.html](http://www.experian.co.uk/www/pages/what_we_offer/products/goad_retail_database.html)

- Barriers to entry in convenience retailing are lower than for larger stores, which would serve as a constraint on the merged entity's stores.
33. The parties also conducted a re-centring exercise, around the mid-way point between the target stores, in order to test whether consumers' most likely to be affected by the acquisition, would experience a significant reduction in competing fascia.
  34. Having considered the evidence, the OFT concludes that based on the re-centring exercise, a significant number of competing fascias would remain post-merger, including within a narrow geographic market (that is, five minute isochrone). In addition, in several of these areas that topographical and/or geographic features may reduce the potential for the multiple target stores to be considered as alternatives for consumers (for example in one area, target stores located on the outskirts of two adjacent towns, and separated by uninhabited areas, are unlikely to be seen as alternatives by a significant proportion of local consumers).
  35. Therefore the OFT concludes that the merger is unlikely to raise a significant prospect of an SLC, due to multiple acquisitions of stores within the same geographic market.

### **THIRD PARTY VIEWS**

36. The OFT received a number of comments from third parties. These have been dealt with above where relevant.
37. The majority of third parties did not raise any competition concerns as a result of the merger. In particular, several third parties stated that the convenience store sector in the UK is highly fragmented and competitive.
38. Two third parties raised some competition concerns in relation to the loss of a significant independent convenience store operator in the UK as a result of the merger. In particular, one third party argued that the conversion of Mills stores to One Stop stores would be detrimental to consumers. These concerns have been dealt with above.
39. Finally another third party suggested that the lost Mills business post-merger would result in higher distribution costs to its remaining

convenience-store members. However the OFT ascertained that any potential effect is likely to be limited.

## **ASSESSMENT**

40. Tesco/One Stop and Mills overlap in the supply of groceries to consumers. One Stop is a retail convenience business, operating 521 convenience stores across England and Wales. In addition, Mills' principal activity is convenience retailing in the North East, Cumbria, Yorkshire, the East Midlands, the West Midlands and South Wales. It operates 85 stores in total but only 76 of them are the Acquisition Stores.
41. In this case the OFT has used, for the purpose of filtering by fascia, the candidate product market which it has used in some previous cases. That is, convenience stores are constrained by - and so the product market must also include - other convenience stores, mid size and one-stop stores.
42. The OFT concluded that the relevant geographic market in this case has both national and local aspects. At a local level the precise delineation of the relevant geographic market is determined by the OFT on the basis of a variety of drive-time isochrones, ranging from five to 15 minutes, depending on the size of the store and whether a store is in an urban or rural area.
43. At a national level, the OFT does not consider that competition concerns arise as a result of the proposed merger. Mills' share of grocery retailing at the national level is less than one per cent and other competitors, such as Asda, Sainsbury's, Morrisons and Co-operative Group, will remain post-merger and provide a competitive constraint on the merged entity at the national level. This reasoning - that the proposed merger does not remove an important constraint at the national level - applies for both unilateral effects concerns and coordinated effects concerns.
44. At a local level, after a comprehensive investigation the OFT found no competition concerns as a result of the merger and the removal of the competitive constraint on Tesco/One Stop by Mills, which, on a realistic prospect standard, could lead to Tesco/One Stop increasing prices or lowering non-price aspects of competition in some local areas.

45. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom

## **DECISION**

46. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.