

Completed acquisition by Sports Direct International plc of a number of stores from JJB Sports plc

ME/3986/08

The OFT's decision on reference under section 22 given on 01 May 2009. Full text of decision published 21 May 2009

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

## PARTIES

1. **Sports Direct International plc ('SDI')** is the UK's leading sports retailer by revenue and operating profit, and the owner of a significant number of internationally recognised sports and leisure brands, operating approximately 375 retail outlets in Great Britain. The majority of retail outlets trade under the Sports Direct or Sports World fascias. SDI has acquired a number of retail businesses over the last few years, and some retail outlets still trade under their previous names, such as Lillywhites, McGurk, Exsports, Gilesports, Sports Soccer, Field and Trek, and Hargreaves.
2. In addition, SDI currently holds a 29.4 per cent stake in Blacks and a 25 per cent holding in each of Sweatshop and SheRunsHeRuns. The OFT considers that, in accordance with the OFT's Guidance<sup>1</sup> and the established practice of the OFT and CC in relation to determining material influence for the purposes of section 26 of the Enterprise Act 2002 ('the Act'), absent any evidence to the contrary, it is or may be the case that SDI has material influence in relation to all three retailers (Blacks<sup>2</sup>, Sweatshop and SheRunsHeRuns), as the level of SDI's shareholding in each would be very likely to provide it with the ability to block special resolutions at shareholder meetings.<sup>3</sup>

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<sup>1</sup> Paragraph 2.10 of the OFT's Guidance 'Mergers – substantive assessment'.

<sup>2</sup> Blacks includes a number of retailer brands including Millets and the Outdoor Group.

<sup>3</sup> SDI did not contest this. Indeed, the OFT understands that SDI has already used its voting rights to block the sale by Blacks of its winter sports subsidiary, Free Spirit: <http://www.financeweek.co.uk/item/5265>.

3. **JJB Sports plc** ('JJB') is one of the UK's leading high street sports retailers. As of 27 January 2008, JJB operated approximately 400 retail outlets in the UK<sup>4</sup> – although the OFT is conscious that this reduced through 2008/09.<sup>5</sup> JJB also operates a chain of combined fitness clubs with attached retail store space. However, the OFT understand that arrangements are in place to dispose these to **Dave Whelan Sports Limited**.<sup>6</sup> JJB reported a pre-tax loss of £9.7 million for the first half of 2008.

## **TRANSACTION, PROCESS AND TIMING**

4. The transaction concerns the completed acquisition by SDI of 31 retail outlets from JJB which took place between 5 November 2007 and 1 December 2008 ('Acquired Stores' or, individually, 'Acquired Store').<sup>7</sup>
5. The OFT became aware of the transaction through an own-initiative investigation by the Mergers Intelligence Unit in December 2008. The extended statutory deadline under section 24 of the Act is Monday 4 May 2009.

## **JURISDICTION**

6. The OFT considers that the acquisition by SDI of 31 retail outlets from JJB constitutes enterprises ceasing to be distinct for the purposes of section 23(1) of the Act.
7. Section 27(5) of the Act provides that the OFT may treat successive events as having occurred simultaneously on the date in which the latest of them occurred. Section 27(6)(a) of the Act adds that a 'successive event' can occur within a two year period under consequence of the same arrangement or transaction, or successive arrangements or transactions between the same parties. In this case, the date of the latest retail outlet acquisition was 1 December 2008.
8. SDI submitted that the retail outlet transactions were entirely separate and should not be aggregated on the basis of section 27(5) of the Act.

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<sup>4</sup> JJB's 2008 Annual Report.

<sup>5</sup> See <http://www.jjbcorporate.co.uk/pdf/26%20March%202009.pdf>.

<sup>6</sup> See above.

<sup>7</sup> The retail outlets are located in the following locations: Barnsley, Basildon, Bedford, Bradford, Bristol, Cardiff, Ealing, Eltham, Farnborough, Harrogate, Huddersfield, Ilford, Isleworth, Inverness, Lancaster, Llanelli, Newcastle-under-Lyme, Newcastle-upon-Tyne, Newport, Orpington, Poole, Truro, Salisbury, Sutton, Uxbridge, Walthamstow, Washington, Wolverhampton, Wood Green, Worthing and York.

9. However, in this case, the OFT considers it appropriate to exercise its margin of appreciation under section 27(5) to treat as taken together all of the 31 Acquired Stores, notwithstanding that there have been other circumstances in which the factual context was such that the OFT considered that it would not be appropriate to do so.<sup>8</sup> Although there was no evidence to suggest that the acquisition of the Acquired Stores were structured so as to avoid scrutiny under the merger control provisions of the Act, the OFT believes that it should take into account in choosing whether to exercise its ability under section 27(5) that such a large number of retail outlet acquisitions may, on a cumulative basis, have a significant effect even if each one might not do so individually. Accordingly, the OFT considers that these transactions fall squarely within the scope of section 27(5) of the Act and are therefore appropriate to be subject to merger review scrutiny under the Act.
10. Given that the Acquired Stores had UK turnover in its last financial year of approximately £[ ], the turnover test in section 23(1)(b) of the Act is not met.
11. However, the OFT believes that it is or may be the case that the share of supply test in section 23(2)(b) of the Act is met and, therefore, that a relevant merger situation has been created. This is because SDI's share of supply of goods by national sports retailers ('Sports Multiples', that is, SDI, JJB and JD Sports) in the UK, by number of outlets, in 2007 was 33 per cent.<sup>9</sup> <sup>10</sup> In this case, the acquisition of 31 retail outlets from JJB represents an increment of approximately 2.5 per cent.
12. In addition, the OFT believes that the share of supply test may also be met through the combination of SDI and the Acquired Stores' share of supply in the UK of sports clothing retail, which is also estimated to be greater than 25 per cent. SDI alone has a share of supply of all sports clothing retail in the UK<sup>11</sup> of 24.9 per cent measured by sales<sup>12</sup> and the OFT estimates that

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<sup>8</sup> Completed acquisition by Tesco plc of the Co-operatives Group's stores in Uxbridge Road, Slough as well as Stapleford Lane, Toton, Nottingham and Towers Place, South Shields (*Tesco/Slough*), 2 February 2004.

<sup>9</sup> Verdict, UK Sports Retail 2008, pages 103, 117, and 133. SDI had 414 outlets out of a total of 1242 from the national generalist sports retailers (SDI, JJB and JD Sports – the Sports Multiples) in 2007. In 2008, SDI's share of outlets was 30.7 per cent.

<sup>10</sup> The Act is clear that the OFT, in determining whether the share of supply test is met, may apply such criterion (whether value, cost, price, quantity, capacity, number of workers employed or some other criterion, of whatever nature), or such combination of criteria, as it considers appropriate (section 23(5) of the Act).

<sup>11</sup> The OFT considers that it is reasonable for it to assert jurisdiction on the basis of the SDI and the Acquired Stores' share of supply of sports clothing retailing in the UK. As this segmentation has been used in specialist market reports (such as Verdict) such a description of goods or services supplied in the UK appears to the OFT to be reasonable, and an appropriate basis on which to apply its jurisdictional test.

<sup>12</sup> Verdict: UK Sports Retailing 2008, page 68.

the increment arising from this transaction is approximately 1 per cent on the same basis.<sup>13</sup> <sup>14</sup>

13. For all of these reasons, the OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## BACKGROUND

14. SDI and JJB are the two largest high street specialist retailers of sports clothing and fashion wear, sports footwear and sports equipment in the UK.
15. Total sales of sports retailing in the UK were worth £8,488 million in 2008.<sup>15</sup> Sports clothing and fashion wear represented the majority of sales with £2,791 million (32 per cent), followed by sports equipment with £2,487 million (29 per cent) and sports footwear with £1,744 million (21 per cent).<sup>16</sup> Sports retailing has increased by 12 per cent for the period 2003 to 2008. Sports clothing and fashion wear, sports equipment and sports footwear can be purchased from a variety of retail outlets including those belonging to Sports Multiples as well as other retailers such as independent local sports retailers, and catalogue showroom retailers (that is, Argos).

## MARKET DEFINITION

16. At the outset the OFT considers that it is worth noting that market definition is not an end in itself, rather it is a framework for analysing the direct competitive pressures faced by SDI. In the context of differentiated goods markets, as in the present case, the analytical discipline of market definition helps identify the extent of immediate competitive interaction between SDI and other sports retailers' value propositions to their

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<sup>13</sup> JJB operates 409 retail outlets and has a share of supply of 13.8 per cent on the basis of total sales. Apportioning this share equally across these retail outlets gives an average retail outlet level share of 0.03 per cent. Multiplying this by the number of retail outlets purchased (31) gives a total increment of the order of 1 per cent.

<sup>14</sup> Moreover, the OFT notes that if the share of supply attributable to those retailers over which SDI has material influence over (Blacks, Sweatshop and SheRunsHeRuns) were included in SDI's share of supply, then this figure would be well over 25 per cent. For example, the OFT understands from the Verdict report that the Blacks chain (in which SDI has over a 29.4 per cent stake) has a share of supply in the region of 3 to 4 per cent for sports clothing retail.

<sup>15</sup> Verdict, UK Sports Retail 2008. The 2008 figures are estimated figures. In 2007, total sales of sports retailing in the UK were worth £8,429 million. Sports clothing and fashion wear represented the majority of sales with £2,857 million (34 per cent), followed by sports equipment with £2,396 million (28 per cent) and sports footwear with £1,754 million (21 per cent).

<sup>16</sup> The remainder relates to cycling.

customers, which in this case are consumers.<sup>17</sup> However, in differentiated goods markets, market definition creates a risk of drawing bright lines that either overstate or understate the degree of competitive constraints posed by suppliers.

## Product scope

17. The OFT has not considered previously the product scope for sports retailing in the UK. However, the OFT has, in some previous retail mergers,<sup>18</sup> considered whether there are separate markets on the basis of store size or distribution channels, or whether it is appropriate to assess the degree of competitive constraint at the product level or on the basis of individual products or product areas.
18. In considering the latter of these issues, it is important for the OFT not only to consider the degree of competition within individual product categories (for example replica sports shirts, cleated sports footwear) but also to consider that retail outlets may compete to provide an overall retail proposition to consumers across these categories (for example, in the way that supermarkets compete to provide an overall grocery retailing proposition to shoppers (often referred to as a 'basket' of goods), in addition to competing within individual grocery product lines). The importance of a supplier's retail proposition as a whole will depend in part on consumers' perceptions and habits and will be greater in situations when the consumer sees the outlet as a 'retail destination' in itself, actively purchasing a basket of goods in the outlet across a range of categories. Conversely, in circumstances where customers travel to retail outlets in order to purchase a single specific product, it is less likely that the retail proposition as a whole will be as important.
19. With regard to sports retailers, the OFT's investigation did not indicate that all bricks and mortar providers will generally offer a full range of products to their customers, as some retailers concentrate on one particular sub category of products product (for example, in the case of Footlocker, sports footwear) or a specific sport (for example, cricket). Moreover, as stated by SDI, there was no evidence suggesting that a consumer would purchase a 'basket' of goods across the categories of products available in sports retailers. The OFT, therefore, considers that, in this case it is more appropriate to consider the market for sports retailing by product category.

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<sup>17</sup> OFT Guidance 'Mergers – Substantive Assessment Guidance', paragraphs 3.11 and 3.22.

<sup>18</sup> OFT decision of 6 December 2005 on the anticipated acquisition by HMV Group plc of Ottaker's plc; OFT decision of 23 March 2005 on the anticipated acquisition by Somerfield plc of 114 Safeway stores from WM Morrison Supermarkets plc; OFT decision of 15 April 2008 on the completed acquisition by Home Retail Group plc of 27 leasehold properties from Focus (DIY) Ltd ('Homebase/Focus'); OFT decision of 20 March 2009 on the completed acquisition by NBTY Europe Limited of Julian Graves Limited.

20. With respect to the exact segmentation of the market, SDI was unable to provide any conclusive evidence in this regard. It submitted that there was little to be gained from assessing competition at the individual product level, and that the OFT should instead focus on the total retail proposition, which it described as multi-category sports retailing (that is, the Sports Multiples). However, the OFT notes that industry market reports<sup>19</sup> tend to sub-divide sports retailing into three distinct categories, namely (1) sports clothing (including both sports specific clothing and sports fashion wear), (2) sports equipment, and (3) sports footwear.
21. In light of the above, and having reviewed the key product lines sold by sports retailers, the OFT considers the above categories to be a reasonable product frame of reference.

### **Effective competitor set**

22. At the national level, 3 Sports Multiples currently operate in the UK. These include SDI, JJB and JD Sports. The OFT was able to confirm from multiple independent resources that the degree of competition between these three retailers is sufficient to conclude that they are effective competitors to each other.<sup>20</sup> The question therefore for the OFT has been to consider which other retailers should be considered within the relevant effective competitor set.
23. SDI suggested that the product ranges of specific Sports Multiples can vary<sup>21</sup> and that Sports Multiples are constrained in each product area by category specialists (such as Footlocker, Blacks, and Millets), independent sports specialists and, even, fashion retailers and supermarkets (such as, Asda), as consumers are willing to switch to these retailers for specific products.<sup>22</sup>
24. The OFT did not receive any compelling evidence from SDI that category specialists, independent sports specialists, fashion retailers and supermarkets are all in the same market as Sports Multiples. Such evidence can take many forms and in recent cases, parties have, for example, presented survey evidence or market research to the OFT detailing how and why consumers make their shopping decisions and who they see as credible alternatives. In other instances, the OFT has been provided with internal documentation (including reports and emails) showing how they

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<sup>19</sup> Sports Goods Retailing, Mintel (2008) and UK Sports Retail, Verdict (2008).

<sup>20</sup> For example, Sports Goods Retailing, Mintel (2008) and UK Sports Retail, Verdict (2008) both refer to the extent of competition between the 'big three' sports multiple retailers.

<sup>21</sup> For example, it would appear to be the case that JD Sports is more focussed on sports clothing and fashion wear, whilst JJB offers a wider range of sports equipment.

<sup>22</sup> For example, SDI stated that it views Argos as a competitor in the supply of sports equipment.

track and match the prices of key rivals, or how they have reacted more generally to new strategies by rivals and/or responded to new entry. Save for some limited information on local price monitoring, the OFT did not receive any such evidence from SDI during the course of its investigation.<sup>23</sup>

25. The OFT considers that category specialists,<sup>24</sup> local independent sport retailers and clothing retailers<sup>25</sup> may impose a competitive constraint (of varying strength) upon Sports Multiples and in those categories in which they overlap. The exact nature of any competitive constraint imposed on Sports Multiples by such other retailers will depend to a large extent on consumers' shopping habits and perceptions, on which the OFT received little information from the parties and third parties. In general, where the principal aspects of a retailer's offer—that is, price, quality, range and service ('PQRS')—are closely aligned with the Sports Multiples, the OFT considers that it is more likely that such category specialists will be able to exert a competitive constraint. Conversely, retailers whose PQRS differs quite significantly from that of Sports Multiples (such as Blacks, Millets, Brown Trout or Great Outdoors) are less likely to be considered to exert a competitive constraint on them. The OFT notes that this view was supported by an independent industry report.<sup>26</sup>

#### Local independent sports retailers

26. The exact nature of the competitive constraint placed on SDI and the Acquired Stores by local independent sports retailers may vary significantly between locations depending on the PQRS offering of the independent. Where the PQRS offering of the independent is closely aligned with that of SDI and the Acquired Stores, the OFT considered that the independent would be (subject to being geographically close enough) capable of exerting a significant competitive constraint.
27. As a general point, the OFT had some concerns regarding the inability of local independent retailers to achieve the same scale discounts on stock as national retailers which may limit their ability to offer a constraint on the

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<sup>23</sup> SDI gave limited examples of price monitoring; however, it did not clearly demonstrate when any price change was implemented as a result of that monitoring.

<sup>24</sup> Category specialist retailers include those who offer an extensive range of products in one sub segment of the Sports Multiples' retail sector or specialise in a single sport/activity. Category specialists can range in scope and scale dramatically from Footlocker, who specialise in footwear, to Argos with a stronger portfolio in sports equipment.

<sup>25</sup> Examples include TK Maxx and Debenhams.

<sup>26</sup> Verdict Report, UK Sports retailing 2008: 'Each of the players profiled in this section of the report is clearly differentiated from the larger specialists, with a keener service approach and a less price-driven offer. Many smaller players focus exclusively on branded product and add value through service. Indeed, there are no smaller players profiled in this report that aim to compete directly with the likes of SDI and JJB Sports. Only Foot Locker, part of the eponymous US giant, competes with the big players, though its offer is largely footwear focused with a bias towards American sports.'

Sports Multiples from a pricing perspective. Moreover, the OFT's previous experience of local retail mergers suggests that local generalists usually operate from smaller 'secondary' sites than those of larger national multiples, meaning the 'range' (R) in their PQRS may not be as wide. These are issues which the OFT has sought to take into account in the analysis that follows.

#### Category specialists

28. The OFT considers that it is plausible that category specialists may be able to constrain the Sports Multiples in those product categories in which they overlap. For example, Footlocker may constrain SDI in relation to sports footwear and Argos in relation to sports equipment by virtue of their significant product offerings in those categories relative to that of SDI.
29. However, where the retail proposition (even in the notionally overlap category) is significantly different from that offered by the Sports Multiples, the OFT considers that they should be excluded from the effective competitor set. For example, in the case of Blacks and Millets,<sup>27</sup> the OFT considers that they should be excluded on the basis that their retail proposition (that is, predominantly camping and outdoor wear) is significantly different from that of the Sports Multiples.<sup>28</sup>

#### Clothing retailers

30. With respect to broader clothing specialists such as TK Maxx and Debenhams, the OFT understands that the retail propositions are quite different from those of Sports Multiples. Debenhams, for example, sells a relatively limited range of sports clothing, in spite of being very active across the wider 'fashion' segment along with a wide range of other high street retailers. Overall, and given the lack of any consumer survey or other information in support of this contention, the OFT has taken the cautious view that these retail outlets, at best, provide a relatively weak constraint.

### Conclusion on product scope and effective competitor set

31. In relation to product scope, the OFT has assessed the transaction on the basis of supply of (1) sports clothing, (2) sports equipment, and (3) sports footwear in the UK.

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<sup>27</sup> The OFT notes that the fact that SDI has the ability materially to influence the policy of these companies due to its shareholding in them raises doubt as to whether they should be considered to be independent competitors to SDI. SDI argued that any holding of material influence at a national level did not impact on competition at a local level. However, there was no need for the OFT to conclude on this point given that these companies were, in any event, excluded from the effective competitor set.

<sup>28</sup> There were 24 areas where there was an overlap between an Acquired Store and Blacks and/or Millets. However, due to their different retail propositions, they were not considered to be overlapping retail outlets, and accordingly excluded from the analysis.

32. In relation to the effective competitor set, the OFT considers it plausible that other Sports Multiples and certain category specialists (such as Footlocker and Argos) sufficiently constrain SDI and the Acquired Stores in some or all of the three identified product categories. However, the OFT has adopted a cautious approach and does not consider other retailers put forward by SDI (such as Debenhams, Blacks, Millets and smaller specialised retail outlets and market stalls) as providing an effective competitive constraint on any of the product categories due to their different retail propositions.

## **Geographic scope**

### **National and/or local competition**

33. SDI submitted that the geographic market is national. SDI submitted that it has a national pricing strategy, which means that [ ].<sup>29</sup> SDI also submitted to the OFT that its product range is determined completely at the national level, so that any differences to the range of products at any particular retail outlet are determined by the size of the retail outlet alone and not by local competition. SDI accepted that the 'depth of range' of a particular product (that is, the level of stock of an SKU) may vary locally, but that this is determined purely by local demand factors (so, for example, more stock of Newcastle United shirts will be held in Newcastle than in London). SDI also submitted that other key competitive variables such as retail outlet layout are determined at a national level, and provided examples of centrally distributed 'guidance' documents. In addition, SDI submitted that the OFT should place relatively low weight on local 'service' variables, given that SDI focused on a low price/low service product offering.

34. However, the OFT considers that such a national (or centralised) pricing, range and layout strategy need not necessarily preclude some elements of local competition. Indeed, although prices may be set at the national level to ensure that they are the lowest available, it may be the case that higher priced products may be re-stocked more frequently in areas where there is less competition. Other elements of the PQRS offering may also be 'flexed' at the local level to increase the margin achieved at retail outlets which face relatively less local competitive pressure. Accordingly, the mere fact that SDI prices aggressively, does not preclude it from wider (that is, QRS) competition concerns at a local level.

35. As discussed above, the OFT considers that although pricing decisions may be made nationally (or centrally), the geographic ambit of sports retailing from the demand-side is local as consumers carry out their shopping locally. Consequently, the OFT's starting assumption for geographic market

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<sup>29</sup> [ ].

definition in retail goods and services markets has therefore been—and continues to be, absent compelling evidence to the contrary—that there will be material local competition across each relevant local area to attract and retain customers, even if not on every parameter of PQRS.<sup>30</sup> Therefore, in practice, as in previous cases, our starting point is that retail mergers of this type will feature both national and local elements of competition.

36. As noted above, SDI submitted (together with some supporting evidence) that it employs a national pricing and national ranging policy, [ ]. However, it is worth noting that even if the OFT were to accept SDI's proposition that [ ], the OFT was presented with no evidence on which to base an assessment of the extent of JJB's local competitive activity. Prior to the acquisition, in those areas where retail outlets of both SDI and JJB were present, consumers would have the choice of, and access to, the combined range of products that they both offered. The OFT would therefore be unable to discount the possibility that, pre-merger, the acquired JJB retail outlets were providing some level of local competition and choice in response to SDI, which would be removed as a result of the acquisition. Accordingly, the OFT does not accept that pre-merger SDI and the JJB Acquired Stores did not compete to some extent in their retail offering at the local (and by implication, national) level.
37. In addition, SDI argued that a significant period of time had elapsed since the acquisition of the retail outlets and that during that time, no harm had actually materialised at the local level. Whilst the OFT acknowledges that this is a potentially powerful argument, the OFT notes that, save for this statement, SDI did not provide any evidence (for example, pre and post retail outlet gross margins or mystery shopper data) to support its assertion. Accordingly, the OFT was unable to consider this claim any further.
38. In examining any local unilateral effects from the acquisition of the Acquired Stores, the OFT will consider the competitive constraints imposed by the parties on each other. This may be 'symmetric' (two-way, that is each party constrains the other) or 'asymmetric' (one-way, one constrains the other but not vice versa). The basis for an asymmetric theory is that the competitive threat posed by one party on the other incentivises the threatened party to offer lower prices or a better overall non-price offer to attract and retain customers, and that the loss of asymmetric rivalry may be itself sufficient to constitute a realistic prospect of a substantial lessening of competition, because that rivalry will be internalised in respect of the proposition offered by one of the parties.

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<sup>30</sup> See *Homebase/Focus*.

## **Local dimension**

39. The OFT has not considered previously the geographic market for the supply of sports clothing, sport equipment and sports footwear in the UK.
40. SDI submitted that an initial 'filtering' methodology should be used to screen out local areas that appear competitively unproblematic, based on the filters employed in the DIY case, Homebase/Focus. In that case – and based upon the customer information provided by the parties in that case – the OFT applied three preliminary filters to assess whether the DIY shed acquisitions had led to any fascia reduction within radii of five miles and ten miles, or within a 20-minute drive time isochrone, all centred on the target store.
41. However, having considered the evidence, the OFT does not consider such an approach to be appropriate in this case. DIY sheds and Sports Multiples are different retail propositions from the perspective of consumers, in particular with respect to the location of retail outlets. Sports retailers operate in both 'town centre' and 'out of town' locations (which is not generally the case for DIY sheds). This means that customers may be more likely to purchase on impulse and may not see retail outlets in 'out of town' locations as a viable alternative. Consequently, in the absence of evidence to the contrary, in such circumstances a narrower geographic market definition (that is, taking account of the 'town centre' or 'high street' dimension) may be appropriate.<sup>31</sup>

## **Conclusion on geographic scope**

42. In view of the above, and the lack of any evidence provided by SDI (such as data on the distances travelled by customers to retail outlets), the OFT has analysed the geographic nature of competitive constraints on an overlap-by-overlap basis and has distinguished between 'town centre' and 'out of town' locations, where appropriate.

## **HORIZONTAL ISSUES**

### **Closeness of competition**

43. SDI and JJB are two of the only three national Sports Multiples in the UK. On the basis of the similarities between the pricing, product range, geographic scope and number of outlets of SDI and JJB, OFT considers that these two parties should be regarded, in general, to be each others'

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<sup>31</sup> This analysis is consistent with previous OFT decisions. For example, see the OFT's Ottakars/Waterstone's decision.

closest competitor. This view is also supported by independent market research reports.<sup>32</sup>

44. Therefore, the OFT notes that the constraint placed on JJB retail outlets by SDI, and vice versa, might be expected to be particularly strong.

### **National competition**

45. The OFT has concluded that the acquisition of the Acquired Stores does not give rise to any concerns at the national level given the relatively limited increment in market share and the fact that JJB continues to operate as a national retail competitor.

### **Local competition**

46. SDI stated that the retail outlet acquisitions formed part of a larger pattern within the sport retail industry of store openings and closures and that these relatively small number of retail outlet acquisitions would be unlikely to be of any material significance. However, the OFT is unable to dismiss competition concerns on the basis that store openings or closures are a feature of a particular industry.
47. SDI also stated that, by virtue of the fact that many of the transactions happened some time in the past, to the extent that there would be any anti-competitive effects, they should have become apparent. Accordingly, SDI argued that the lack of any visible anti-competitive effects should alleviate the OFT's concerns. However, in the absence of information from SDI on the competitive position, pre and post merger, of the relevant local markets discussed below, the OFT has been unable to confirm that no anti-competitive effects could arise (or have already arisen).

### **Initial filtering**

48. With regard to local competition, the OFT initially considered whether a substantial lessening of competition might be expected to occur on any plausible candidate local geographic market. The OFT initially filtered out those locations where the nearest remaining JJB was substantially closer to the Acquired Store than the nearest SDI, on the basis that competition would not be lessened substantially whatever the geographic market taken.<sup>33</sup> On this basis 11 locations were excluded from further analysis.<sup>34</sup>

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<sup>32</sup> 'The group's [JD Sport] primary focus is major sports brand and fashion brand clothing, in particular footwear, with a keen focus on designer labels such as Nike, Adidas and Converse. Its stores are more fashion focused compared to its high street rivals – SDI and JJB Sports – with collections extending beyond sports to fashionable casual wear. Stores reflect this positioning with prominent branding and contemporary store environments' (Verdict).

<sup>33</sup> Distances to closest remaining JJB retail outlet were taken from SDI's submissions. Distances to nearest SDI retail outlet were taken from SDI's submissions and SDI's online store-finder.

49. In a further eight instances, the OFT considered that, given the distance between the Acquired Store and existing SDI locations, and given the presence of other JJB retail outlets in the area, there would either be no loss of competition or any loss of competition was expected to be marginal. In these locations the OFT considered that any prospect of a substantial lessening of competition could be confidently ruled out under any plausible geographic market definition. On this basis these eight locations were excluded from further analysis.<sup>35</sup>
50. In a further six instances, the OFT considered that given the distance between the retail outlet locations (the Acquired Store and the nearest SDI), the retail outlets would not have exerted a significant constraint on each other and therefore the loss of competition, if any, arising in these cases would be small and so these could be excluded from further analysis.<sup>36</sup>
51. Accordingly, the OFT considered the competitive effect of the transaction on a case-by-case basis for the remaining six areas, namely Basildon, Llanelli, Newport, Harrogate, Isleworth and Newcastle-upon-Tyne.

#### **Unilateral effects (SDI and JJB overlap areas)**

52. The OFT examined whether there was a realistic prospect that, as a result of the acquisition, SDI would be able to raise prices, reduce service standards, reduce the range or quality of goods offered, reduce investment levels or otherwise harm consumers in the following local areas (unilateral effects theory of harm).
53. As mentioned above (paragraph 43) the OFT considers that the evidence suggests that SDI and JJB are each other's closest competitor. Accordingly, where the acquisition would result in the removal of that close competition within any local market for a particular product categorisation (sports clothing, sports equipment or sports footwear) and the remaining outside constraints are insufficient to prevent an internalisation of the lost competition between the parties, then the OFT considers that this would give rise to a realistic prospect of a substantial lessening of competition. Without specifically seeking to identify local concerns by reference to fascia reduction alone, in this case, competition concerns (as described further below) have tended to be found in those areas where the reduction in fascia was three to two or less. This is, perhaps, not surprising given the presence of three Sports Multiples (SDI, JJB and SD Sports) in relation to the broad category of sports retailing.

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<sup>34</sup> Barnsley, Bradford, Bristol, Cardiff, Huddersfield, Inverness, Lancaster, Newcastle-under-Lyme, Truro, Wolverhampton and York.

<sup>35</sup> Bedford, Farnborough, Ealing, Poole, Worthing, Salisbury, Sutton and Uxbridge.

<sup>36</sup> Eltham, Ilford, Orpington, Walthamstow, Washington and Wood Green.

### **Basildon (concern in sports clothing)**

54. In Basildon, in relation to sports clothing the acquisition has given rise to a reduction from three to two in Sports Multiples fascia (JD Sports is present) within the Basildon town centre. Although the OFT notes the presence of a small independent sports retailer (LAB sports) in view of limited supporting evidence from SDI and due to its small size, the OFT was not persuaded that it would offer a sufficient competitive constraint on SDI in Basildon.
55. The OFT considers that DA Sports, located 'out of town' is unlikely to provide a significant competitive constraint on SDI and has, in the absence of evidence to the contrary, therefore been excluded from the competitive analysis.
56. In terms of sports footwear, Footlocker is present in the town centre close by the Acquired Store and for sports equipment, there is an Argos present. Accordingly, the OFT accepts that they will both continue to be a sufficient constraint on SDI post merger.
57. Therefore, the closeness of the Acquired Store to SDI, both geographically and in terms of price and product range, together with the lack of compelling evidence showing that a sufficient number of other retailers will provide a sufficient competitive constraint on SDI, has led the OFT to believe that SDI's acquisition of the JJB retail outlet in Basildon gives rise to a realistic prospect of a substantial lessening of competition in relation to sports clothing.

### **Llanelli (concern in sports clothing, sports equipment and sports footwear)**

58. In Llanelli, the acquisition has removed competition between the only Sports Multiples fascia in relation to sports clothing, sports equipment and sports footwear within the Llanelli town centre.
59. The OFT considers that the remaining JJB retail outlet (located in a retail park) and Picton Sports located 'out of town' are unlikely to provide a significant competitive constraint on SDI. Accordingly, in the absence of evidence to the contrary, both of these retail outlets have been excluded from the competitive analysis.
60. In terms of sports equipment, Argos is present within the town centre, but even if it were considered to be a constraint, there would still only be two competing fascia post merger.
61. The closeness of the Acquired Store to SDI, both geographically and in terms of price and product range, together with the lack of compelling

evidence showing that a sufficient number of other retailers will provide a sufficient competitive constraint on SDI, has led the OFT to believe that SDI's acquisition of the JJB retail outlet in Llanelli gives rise to a realistic prospect of a substantial lessening of competition in relation to sports clothing, sports equipment and sports footwear.

#### **Newport (concern in sports clothing and sports footwear)**

62. In Newport, in relation to sports clothing the acquisition has given rise to a reduction in Sports Multiples fascia from three to two (JD Sports present) within the Newport town centre.
63. Although the OFT also notes the presence of both Pure Rugby and Gwent Camping in close proximity to the Acquired Store in Newport town centre, both of these retail outlets are specialist sports retailers whose retail proposition differs significantly from the Sports Multiples. Accordingly, in the absence of evidence to the contrary, the OFT considers that they are unlikely to provide a competitive constraint on SDI and therefore both of these retail outlets have been excluded from the competitive analysis. There is another JJB outlet on an edge-of-town retail park and an independent (Macey Sports) present on the outskirts of the town. The OFT believes that both retail outlets may be too far from the town centre to act as effective constraints on SDI.
64. In terms of sports equipment, Argos is present within the town centre and the OFT accepts it will continue to be a sufficient constraint on SDI post merger.
65. The closeness of Acquired Store to SDI, both geographically and in terms of price and product range, together with the lack of compelling evidence showing that a sufficient number of other retailers will provide a sufficient competitive constraint on SDI, has led the OFT to believe that SDI's acquisition of the JJB retail outlet in Newport gives rise to a realistic prospect of a substantial lessening of competition in relation to sports clothing and sports footwear.

#### **Harrogate (concern in sports clothing and sports footwear)**

66. In Harrogate, SDI and the Acquired Store are the only two Sports Multiples fascia, although there is an independent sports retailer present in the town centre (Monkhouse Intersport) with a similar retail offering to the Sports Multiples. This suggests a three to two reduction in fascia in relation to sports clothing and sports footwear within the Harrogate town centre.
67. In terms of sports equipment, Argos is present within the town centre and the OFT accepts it will continue to be a sufficient constraint on SDI post merger.

68. The OFT also notes the presence of Cotswold Outdoors, Euro Golf, Brown Trout, The Ski Shop, Harrogate Hydro, Dive Time, Up and Running, Out and About, Linsley Brothers and Yeomans Outdoors in close proximity to the Acquired Store in Harrogate town centre. However, these retail outlets are specialist retailers whose retail proposition differs significantly from the Sports Multiples and, in the absence of evidence to the contrary, the OFT considers that they are unlikely to provide a competitive constraint on SDI. Accordingly, these retail outlets have been excluded from the competitive analysis.
69. The closeness of the Acquired Store to SDI, both geographically and in terms of price and product range, together with the lack of compelling evidence showing that a sufficient number of other retailers will provide a sufficient competitive constraint on SDI, has led the OFT to believe that SDI's acquisition of the JJB retail outlet in Harrogate gives rise to a realistic prospect of a substantial lessening of competition in relation to sports clothing and sports footwear.

#### **Isleworth/Hounslow (concern in sports clothing)**

70. SDI submitted that competition within the London area operates materially differently from other locations. The OFT considers that, in general, this argument is plausible. For example, where retail outlets are located near underground stations, it may be that locations on the same underground line are in fact closer substitutes than other retail outlets which may appear closer (as the crow flies), but which may take longer to travel to. Moreover, it may be the case that customers see central London to be a competing location to those areas of overlap, and may be willing to travel somewhat further or switch between competing shopping destinations relatively willingly.
71. In Isleworth, the Acquired Store, an out of town store, is 2.3 miles from a current SDI site, in Hounslow. The OFT considers it to be plausible that customers, particularly those living between the two locations, view these two centres as close alternatives to one another relative to central London given the relative travel distances.<sup>37</sup> Accordingly, the acquisition has reduced the Sports Multiples fascia from three to two (JD Sports present) in relation to sports clothing within the Isleworth area.
72. In terms of sports equipment, Argos is present within Hounslow town centre and the OFT accepts it will continue to be a sufficient constraint on SDI post merger.

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<sup>37</sup> TFL estimates the two centres are 3 minutes apart by train, but customers would have to travel for around 30 to 40 minutes to get into central London.

- 73. In relation to sports equipment and sports footwear, an independent sports retailer, Max Sport, is located in Twickenham. The OFT accepts it will continue to be a sufficient constraint on SDI post merger.
- 74. The OFT notes the presence of Len Smith (uniforms and sports team kits), Funky Leisure, The Rugby Store, Bike Hut, Moose Cycles, Duellist Int, Champmans Fishing and Isleworth Recreation centre in close proximity to the Acquired Store in Isleworth. However, these retail outlets are specialist retailers whose retail proposition differs significantly from the Sports Multiples and the OFT considers that, in the absence of evidence to the contrary, they are unlikely to provide a competitive constraint on SDI. Accordingly, these retail outlets have been excluded from the competitive analysis.
- 75. The closeness of the Acquired Store to SDI, both geographically and in terms of price and product range, together with the lack of compelling evidence showing that a sufficient number of other retailers will provide a sufficient competitive constraint on SDI, has led the OFT to believe that SDI's acquisition of the JJB retail outlet in Isleworth gives rise to a realistic prospect of a substantial lessening of competition in relation to sports clothing.

#### **Newcastle upon Tyne**

- 76. In Newcastle, in relation to sports clothing the acquisition has given rise to a reduction from three to two in Sports Multiples fascia (JD Sports is present) within the Newcastle town centre. The OFT however notes the presence of Start Fitness, who provide a range of sports clothing and sports footwear. The OFT accepts that this independent player will continue to be a sufficient constraint on SDI post merger.
- 77. In terms of sports footwear, Footlocker is present in the town centre close by the Acquired Store, and for sports equipment, there is an Argos present. Accordingly, the OFT accepts that they will both continue to be a sufficient constraint on SDI post merger.
- 78. Therefore, given the number of competitors in sports clothing, sports footwear and sports equipment, the OFT does not believe that SDI's acquisition of the JJB retail outlet in Newcastle gives rise to a realistic prospect of a substantial lessening of competition in relation to any product area.

#### **Barriers to entry and expansion**

- 79. In making its decision on the transaction in question the OFT must consider whether entry is likely to occur in a timely manner and be of a sufficient scale so as to remedy the substantial lessening of competition postulated.

In making a decision on these issues the OFT will necessarily be mindful of the nature of the substantial lessening of competition in question. In this instance therefore, the correct question for the OFT is whether timely, likely and sufficient entry or expansion will occur in all of the local overlaps of concern identified above in order to mitigate the competition concerns articulated.

80. SDI did not submit any evidence relating to potential entry in this case. At the national level, the OFT is not aware of any retailers that have entered the market in the last five years, although OFT does note the recent purchase of JJB's fitness centres (all but one of which have sports retail outlets linked to them) by Dave Whelan (the former owner of JJB). In fact, the market has been more characterised by exits from the market, most of which have been bought by SDI and JD Sports.<sup>38</sup>
81. With respect to entry of local competitors within the overlap areas, the OFT does not consider that barriers to entry are high per se but has some concerns that local independents may not benefit from the same economies of scale and scope as national chains, thereby limiting their ability to constrain SDI. Moreover the OFT has no evidence of the prevalence of entry among this category of supplier and considers that it may be the case that the presence of SDI may itself act as a disincentive to entry given its aggressive pricing policy. The OFT is aware of no instances of entry in any of the overlap areas on which competition concerns have been found, despite the fact that, in some instances, over a year has elapsed since the transactions took place.
82. More generally, the OFT is aware that the industry as a whole has been subject to significant difficulties as a result of the current prevailing economic conditions. The OFT understands that adverse trading conditions represent the primary rationale for the sale of the relevant retail outlets in this case. The OFT understands that, whilst sales have continued to rise for SDI, there has been considerable pressure on margins as a result of external factors such as the weakening of sterling.<sup>39</sup> The OFT is minded therefore to conclude that, in the short to medium term at least, entry is unlikely to occur in such a way as to mitigate the competition concerns raised by the OFT.

#### **Buyer power**

83. Given that SDI is a sports retailer and that its customers are individual consumers, no significant countervailing buyer power can realistically be attributed to the demand side.

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<sup>38</sup> See Mintel Sports Goods (2008), pages 83 to 86.

<sup>39</sup> <http://uk.biz.yahoo.com/18022009/399/sports-direct-sales-ahead-forecasts.html>.

## Coordinated effects

84. Coordination may arise when a market meets certain conditions.<sup>40</sup> The relevant question in a merger control context is not whether a market is susceptible to coordination in general, but whether the merger may be expected to increase the probability that post-merger, firms in the same market might tacitly or explicitly coordinate their behaviour to raise prices, reduce quality or curtail output.
85. In this case the OFT received a number of comments from third parties suggesting the presence of coordination between SDI and JJB. However, the OFT does not believe that the acquisition by SDI of 31 retail outlets from JJB would, in itself, increase the probability that they will collude (tacitly or explicitly) by reducing competition in the markets for the supply of sports clothing, sports equipment and sports footwear through Sports Multiples in the 31 locations.

## VERTICAL ISSUES

86. The OFT does not consider that vertical concerns arise in this case.

## COUNTERFACTUAL

87. Section 22 of the Act imposes a duty to refer upon the OFT if the OFT believes it is or may be the case that the completed acquisition by SDI of a number of retail outlets from JJB has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services.
88. In order to decide whether the duty to refer applies, the OFT considers the merger's impact relative to the situation expected to prevail absent the merger (that is, the counterfactual). Generally speaking, this will be the current (pre-merger) conditions of competition.
89. In this case, during discussions with the OFT, SDI has submitted that the retail outlets in question [ ].<sup>41</sup>
90. In order to treat this as the appropriate counterfactual for the assessment of the merger, the OFT considers that sufficient compelling evidence is required, [ ]. In effect, SDI is arguing that, to the extent competitive harm

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<sup>40</sup> See for example, the OFT's *Mergers Substantive Assessment Guidance*, paragraph 4.11 to 4.16, and the OFT decisions of 12 December 2007 regarding the anticipated mergers between First Milk Limited and Milk Link Limited, and 11 December 2006 regarding the anticipated acquisition by Wienerberger Finance Services BV of Baggeridge Brick plc).

<sup>41</sup> [ ].

may arise, the merger is not the cause of the harm as it would occur in any event. Where this type of absence of causation between the merger and the lessening of competition is argued, the OFT will as a matter of policy seek a high level of supporting evidence (within the parameters of its belief relevant to the reference test of the Act, which entails a comparison of the outcomes with and without the merger). This approach to evidentiary burden is appropriate given the asymmetry of information on such a key point: such claims are easily made but often difficult to verify independently, not least within the constraints of first-phase merger control. Accordingly, the following analysis is consistent with that adopted in previous OFT decisional practice under the Act.<sup>42</sup>

91. The OFT has recently published a 'Restatement of OFT's position regarding acquisitions of failing firms'.<sup>43</sup> This provides for two conditions that must be satisfied in order to benefit from the failing firm defence (summarised below):
  - inevitability of market exit of the firm in question absent the merger with no serious prospect of re-organisation, and
  - no less substantially anti-competitive alternative to the merger (that is no realistic acquisition by a substantially less anti-competitive purchaser and no substantially better competitive outcome following failure of the firm in question).
92. To date, other than referring to [ ], SDI has provided no substantiated evidence to support its claim regarding [ ]. Accordingly, the OFT contacted JJB, who provided a list of the operating profits of the Acquired Stores. According to that list, out of the five retail outlets concerned, [ ].
93. Moreover, the OFT did not receive any information regarding the realistic prospect of re-organisation of any of the retail outlets, [ ]. Nor did it receive any information regarding whether, [ ], there were other realistic buyers whose acquisition of the retail outlets would produce a better outcome for competition.
94. Accordingly, the OFT considers that the information and evidence provided by the SDI does not satisfy the required evidentiary standard for the purpose of the failing firm defence. In view of this, the OFT has taken as

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<sup>42</sup> To date, the OFT has applied the 'failing firm' defence five times under the Enterprise Act 2002: (i) *Anticipated acquisition by First West Yorkshire Limited of Black Prince Buses Limited* 26 May 2005; (ii) *Anticipated acquisition by Tesco Stores Limited of five former Kwik Save stores (Handforth, Coventry, Liverpool, Barrow-in-Furness and Nelson)* 11 December 2007; (iii) *Completed acquisition by the CdMG group of companies of Ferryways NV and Searoad Stevedores NV* 24 January 2008; (iv) *Homesbase/Focus*; and (v) *Anticipated acquisition by HMV of 15 Zavvi stores* 28 April 2009.

<sup>43</sup> Published on 18 December 2008.

the counterfactual the pre-acquisition status quo market position, where these JJB retail outlets were active as a competitor to SDI.

## **ASSESSMENT**

95. SDI and the 31 JJB Acquired Stores overlapped in the supply of sports clothing, sports equipment and sports footwear.
96. At the national level, the acquisition has not resulted in a reduction in the number of national sports retailers, or Sports Multiples. Based on the minimal increment of SDI's turnover (approximately 4 per cent) or the number of its retail outlets, the OFT does not believe that the acquisition by SDI of 31 JJB retail outlets raises any national competition issues.
97. The OFT considers that local competition could be lost by the acquisition. At the local level, in order to concentrate its assessment on areas raising potential competition issues, the OFT applied a filter to identify those areas where the acquisition would lead to fascia reduction. The application of that filter removed 11 non-overlap locations that did not raise any competition concerns. In addition, the OFT was able to remove an additional 14 areas on the basis of the distance between the Acquired Store and existing SDI locations (and therefore the limited constraint exerted by the retail outlets on each other).
98. In respect of the six locations where the acquisition did give rise to a reduction in the number of 'national' fascia at the local level, the OFT considers that the reference test is met in relation to five areas, namely, Basildon, Llanelli, Newport, Harrogate and Isleworth on the basis of a lack of geographically close alternative (non-national) retailers in each area.
99. New entry and threat of entry can also represent important competitive constraints on the behaviour of the SDI. However, entry must be timely, likely and sufficient in scale or character to replicate the competition lost in relation to the five local areas where the reference test is met. Based on the evidence before it, the OFT does not believe that entry in Basildon, Llanelli, Newport, Harrogate and Isleworth is timely, likely or sufficient.
100. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **UNDERTAKINGS IN LIEU OF A REFERENCE**

101. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such

a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

102. The OFT's Mergers Substantive Assessment Guidance states that, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.'<sup>44</sup>
103. SDI indicated that in order to remedy any competition concerns identified by the OFT, and to avoid a reference to the CC, it would be prepared to offer undertakings in lieu. SDI offered a divestment package covering each of the retail outlets where the OFT found that the merger gave rise to competition concerns.<sup>45</sup> The OFT considered that such divestments would be capable of addressing the competition concerns identified above in a clear cut manner, in accordance with the scheme of the Act as well as the OFT's Guidance and decisional practice.
104. The OFT considers that the undertakings offered in respect of the retail outlets are clearly capable of addressing the competition concerns arising in those local markets.

### **Up-front buyer**

105. The OFT considered whether it was appropriate in the circumstances of this case to require that the relevant divestments be made in whole or in part to an up-front buyer or buyers.
106. An up-front buyer requirement means that the proposed divestment purchasers will have committed contractually, subject to formal approval of the undertaking in lieu, to acquire the relevant divestment retail outlet(s) before the OFT accepts the undertakings in lieu and loses its duty to refer. This means that the OFT will consult publicly on the suitability of the proposed divestment purchasers, as well as any other aspects of the draft undertakings, during the public consultation period.
107. The OFT will seek an up-front buyer where the risk profile of the remedy requires it, for example where the OFT has reasonable doubts with regard

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<sup>44</sup> Paragraph 8.3.

<sup>45</sup> SDI offered (at the same time) two sets of undertakings, the second of which was only to be considered in the event that the first set was deemed insufficient. Given that SDI's first set of undertakings covered all the local areas in which the OFT had found concerns, the OFT did not need to consider the second set of undertakings offered by SDI.

to the ongoing viability of the divestment package and/or there exists only a small number of candidate purchasers.<sup>46</sup>

108. In this case, it is not clear to the OFT that [ ]. Furthermore, [ ] if there were purchasers that might be interested in acquiring some or all of the divestment retail outlets, it is not clear that they would be able to do so without giving rise to potential competition concerns (such that they would not be regarded as suitable purchasers).
109. In conclusion, the OFT has decided that, on a cautious basis, its decision to seek undertakings in lieu from SDI should be on the basis of an up-front buyer provision for the retail outlets to be divested. [ ]. Should SDI be unable to swiftly find a suitable purchaser, and therefore divest the retail outlets in an expeditious and timely manner, then the OFT would reactivate its duty to refer to the CC.

## **DECISION**

110. The OFT has therefore decided to refer the completed acquisition by SDI of a number of retail outlets from JJB to the Competition Commission pursuant to section 22 of the Act. However, the OFT's duty to refer is suspended because the OFT is considering whether to accept undertakings in lieu of reference from SDI pursuant to section 73 of the Act.

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<sup>46</sup> See *Homebase/Focus* and Anticipated acquisition by SRCL Limited of Cliniserve Holdings Limited, 21 November 2008.