
Anticipated merger between Co-operative Group (CWS) Limited and United Co-operatives Limited

The OFT's decision on reference under section 33(1) given on 23 July 2007.
Full text of decision published 3 August 2007.

Please note that square brackets indicate figures or text which have been deleted or replaced with a range by the OFT or at the request of the parties for reasons of commercial confidentiality or public interest.

PARTIES

1. **Co-operative Group (CWS) Limited** (CGL) is the UK's largest co-operative society with approximately 3.9 million members. It is active in diverse sectors including banking, insurance, property investment, retailing of footwear, travel, pharmacy, funeral services and groceries. CGL's UK turnover for the year ending 13 January 2007 was £7,334 million.
2. **United Co-operatives Limited** (United) is a regional co-operative society, based primarily in the north of England and the Midlands. It is active in diverse sectors including motor dealerships, property investment, travel, pharmacy, funeral services and food retail. United's UK turnover for the year ending 27 January 2007 was £2,207 million.

TRANSACTION

3. The parties propose to amalgamate their respective societies by a transfer of engagements between the two co-operative societies under section 51(1) of the Industrial and Provident Societies Acts. The merger is expected to be completed by registration at the Financial Services Agency [Endnote 1] by the end of July 2007. The Office of Fair Trading (OFT)'s administrative deadline for this case was 16 July 2007.

JURISDICTION

4. As a result of this transaction CGL and United will cease to be distinct. The turnover of CGL and United both exceed £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. 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.

SUBSTANTIVE ASSESSMENT

5. The parties overlap in the following sectors, which will be considered below in turn:
 - a) property investment
 - b) financial services
 - c) travel agency services
 - d) pharmacy services
 - e) funeral services, and
 - f) grocery retail services.

PROPERTY INVESTMENT

6. CGL and United both operate activities designed to derive revenue from property within their estate. Both of the parties' UK turnovers from these activities in 2007 were relatively modest. Having regard to a number of factors, including the wide scope of property investment in the UK by a large number of competitors and a lack of third party concerns, the OFT does not believe that the merger raises competition concerns in this sector and will therefore not be considered further.

FINANCIAL SERVICES

7. CGL is active in the UK financial services sector through the Co-operative Insurance Society and The Co-operative Bank. United is involved in the provision of cash-in-transit services and ATM maintenance operations in the UK but holds low shares of supply for each and competitors will provide a sufficient constraint post-merger. The OFT received no concerns from third parties in relation to financial services generally and does not

believe that the merger raises competition concerns in this sector.
Therefore, no further consideration will be given to financial services.

TRAVEL AGENCY SERVICES

8. CGL's main travel business is its Travelcare Retail operation, which has 272 leisure travel agency branches across the UK.¹ United owns and operates 138 Co-op Travel branches, principally located in the north of England.

Market definition

9. The overlap in travel agency services includes 'high street' branches, call-centre based services and online services. Travel agents in general supply various services to consumers and business travellers such as flight bookings, hotel and other accommodation bookings, and other related services (such as car hire). They typically offer the products of a range of tour operators and other suppliers.
10. The parties submit that the internet and direct sales channels (telephone and teletext) utilised by tour operators operate as direct competitors to 'high street' travel agency branches. Third party respondents agreed with this analysis.²
11. The parties submit that the geographic frame of reference for travel agency services is national in scope. This is consistent with the MMC's 1997 report³ and the EC Commission recently confirmed that 'the market should be considered as national, although with some regional aspects taking into account that consumers are only prepared to travel a certain distance to reach a retail outlet...' ⁴ In that case, the EC Commission considered that the options for customers to compare local agents' prices with offers on the internet, and of booking online, were likely to provide sufficient constraint to consider the geographic frame of reference as national.

¹ Travelcare also has certain []. CGL also operates Travelcare Direct, Direct Flights, Magic Breaks [].

² This is consistent with the EC Commission's comments in both Case COMP/M.4600 *TUI/First Choice* and Case COMP/M.4601 *KarstadtQuelle/MyTravel*.

³ MMC report on *Foreign package holidays: A report on the supply in the UK of tour operators' services and travel agents' services in relation to foreign package holidays*, December 1997.

⁴ Case COMP/M.4601 *KarstadtQuelle/MyTravel*.

12. In this case, competitors also stated that the principal arena of competition is national.

Horizontal issues

13. National market shares held by the parties are low and there are a number of larger competitors in the sector.
14. A number of local 'high street' travel agency branch overlaps were identified where the parties face limited local competition from other 'high street' branches. However, the OFT is satisfied that this local concentration of 'high street' branches is not problematic due to wider constraints such as national level pricing and constraint from online services.⁵ Furthermore, based on evidence obtained from the parties and third parties, barriers to entry and expansion for travel agency services at a local level would appear to be relatively low.
15. The OFT received no third party complaints in relation to the travel agency sector.

Conclusion

16. Consequently, the OFT does not believe that the merger gives rise to competition concerns for travel agency services in the United Kingdom.

PHARMACY SERVICES

17. CGL has 473 retail pharmacy stores across the UK, operated by National Co-op Chemist Limited and a number of CGL subsidiaries. United's Co-op Health Care Limited has 229 [Endnote 2] retail pharmacy stores in the north of England and the Midlands.⁶

⁵ This is consistent with the EC's findings in Case COMP/M.4601 *KarstadtQuelle/MyTravel*.

⁶ United is also active in pharmaceutical wholesaling through three subsidiaries – Sants, Wardles and MCS.

Product market

18. The overlap in the provision of retail pharmacy services encompasses a range of professional and retail services. As set out in previous cases by the OFT,⁷ these include the retail supply of:
- a) Ethicals (prescription only medicines) - there is no price competition between pharmacies on ethicals since the price of the prescription is set by the NHS.
 - b) P medicines (which do not require a prescription but can only be dispensed by a pharmacist) - pharmacists can now set their own retail prices⁸ for P medicines therefore limited pricing competition occurs.
 - c) General sales list (GSL) medicines (found in pharmacies, supermarkets, convenience stores, petrol stations, etc) - there is some pricing constraint on P medicines from GSL alternatives.
 - d) Non-pharmaceutical products (such as toiletries and health food) - no competition concerns arise in relation to the retail supply of these products and so the OFT does not consider them further.
 - e) Other pharmacy services - such as screening and consultation on medicine use review, direct to home prescription delivery and repeat prescription services.
19. However, for the purposes of market definition, nothing is gained in this case by considering separate product frames of reference for the individual supply of products and/or services supplied at retail level by pharmacies. Although the constraints in relation to price and non-price parameters of competition may differ depending on the product or service in question (and in particular, whether that parameter is regulated), these issues are best dealt with in the competitive assessment.

⁷ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006 and *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007.

⁸ Following the ending of resale price maintenance on over-the-counter, that is, P and GSL medicines in 2001.

20. The product scope of the relevant frame of reference for the competition assessment is therefore the overall provision of retail pharmacy services.

Geographic market

Retail pharmacies

21. In keeping with the findings of the OFT report on the control of entry regulations,⁹ the OFT has previously used a one mile radius as the basic proxy for the scope of relevant local geographic markets. However, consideration has been given to narrower and larger areas in cases where significant geographic features affected local access or the closest competing pharmacy was more than one mile away.
22. The OFT has not obtained any convincing evidence to warrant deviation from using a one mile radius as the principal basis and starting point for the assessment of retail pharmacy competition in this case. However, the OFT acknowledges that identifiable local factors may warrant some scope for flexibility, including flexing of the 1-mile radius. Due to the small number of overlaps in this case, the OFT was able to consider each local area on an individual basis based on specially-prepared maps and other relevant evidence.

Supply of pharmacy services to the NHS

23. In addition to providing services to customers, pharmacies have contractual relationships with the NHS. This includes negotiating the national pharmacy contract with the Department of Health, which specifies the core services to be undertaken by the pharmacies and remuneration levels, and negotiating enhanced service level initiatives with individual Primary Care Trusts (PCT).
24. The candidate markets for national and regional (that is, Primary Care Trusts (PCT)-wide) supply of pharmacy services to the NHS has therefore also been considered. However, as the OFT believes that, on balance, no competition concerns arise at either the national or regional/PCT-level, it is

⁹ *The control of entry regulations and retail pharmacy services in the UK – A report of an OFT market investigation* (January 2003).

not necessary to reach a view on the appropriate geographic scope of the frame of reference.

Horizontal issues

National shares

25. The parties estimate their combined share of UK retail pharmacy services to be [zero to five] per cent (increment [zero to five] per cent). Given such modest shares, the OFT does not believe that competition concerns arise in relation to retail pharmacy services on a national basis.

Regional/PCT-level overlaps

26. One PCT submitted that the parties would account for around 40 per cent of its pharmacies and speculated that this could cause problems commissioning enhanced services if the merged group decided not to provide any such service. However, there was no specific expectation that this basis for concern would materialise.
27. The scale of this merger does not appear sufficient to raise concerns in relation to the negotiation and provision of services to PCTs. In *Boots/Alliance UniChem*¹⁰ the OFT did not expect an SLC in relation to the provision of PCT services, even where those parties accounted for in excess of a 50 per cent share of pharmacy numbers in certain PCTs. The minimum number of pharmacies needed to support a typical new PCT initiative was found to be fairly low, and PCTs' negotiating position was considered to be strengthened by their ability to grant new pharmacy application licences. The OFT has obtained no evidence in this case to warrant a different view. Therefore, no competition concerns are considered to arise in relation to pharmacy services at a regional/PCT level.

Local overlaps – analytical framework

28. Local area analysis on the basis of a one mile radius indicates that the merger will give rise to overlaps between 12 CGL pharmacies and 10 United pharmacies.

¹⁰ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006.

29. Consistent with previous practice, the OFT has adopted a fascia count approach as a first screen.¹¹ However, it is recognised that in some circumstances fascia analysis is capable of under-reporting potential problem areas where the parties are particularly close competitors, since a fascia approach treats all (included) competitors as being of equal competitive discipline upon each other.
30. Other factors, such as restrictions in some NHS pharmacy contracts, may also limit the parameters of competition between retail pharmacies at a local level. However, previous relevant cases considered by the OFT have established that there is some scope for competitive interaction between pharmacies at a local level.¹² In this case the parties have confirmed that product range stocking and discretionary (promotional) pricing decisions are made independently by each party's central pharmacy teams, hence there is scope for their competitive strategies to differ. Within each party's pharmacy estate, the size of a particular branch may impact on the number of lines and variants stocked.

Assessment of local overlaps

31. Based on the OFT's analysis using a one mile radius the merger gives rise to a three-to-two fascia reduction in two local areas: Heckmondwike (West Yorkshire) and Orrell (Wigan). Two further local areas, in Bramley (Leeds) and Winsford (Cheshire), would result in a four-to-three fascia reduction.

Three-to-two fascia areas

32. The OFT concluded in its recent decision in *Lloyds/IPCC*¹³ that, on the facts of that case, in the absence of mitigating factors of local competition, the creation of a three-to-two fascia reduction gave rise to competition concerns in four out of five overlap areas. Based on an assessment of the local circumstances relevant in this case, no mitigating factors are apparent. Furthermore, in both instances the three-to-two areas have

¹¹ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006 and *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007.

¹² *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006 and *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007.

¹³ *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007, at paragraphs 31-34 and 42-44.

elements resembling a two-to-one fascia reduction when some radius flexing and/or re-centring is undertaken. In addition, both parties operate a traditional community pharmacy model, and thus this case (like the *Lloyds/IPPC* case) is distinguishable from *Boots/Alliance UniChem* in this respect. The OFT therefore believes that the merger may give rise to a substantial lessening of competition in each of Heckmondwike and Orrell.

Four-to-three fascia areas

33. In *Boots/Alliance Unichem*¹⁴ the OFT found that while a fascia reduction from four to three or higher in that particular merger case could give rise to a lessening of competition, it could not be expected to be substantial; in other words, it would not weaken rivalry to such an extent that pharmacy customers in such areas would be harmed. In part this was due to the different business models applied by the parties, with Alliance UniChem operating as a community pharmacy primarily dispensing prescriptions while Boots offered a much more broadly based High Street health and beauty proposition.
34. In this case, and in keeping with the approach taken by the OFT in *Lloyds/IPCC*,¹⁵ the OFT considered, on a cautious basis, whether any four-to-three area could give rise to concerns. There are two local overlap areas where the merger will leave three remaining fascias. On the basis of local factors of competition and in particular, the parties' and competitors' relative store locations, the OFT believes that the four-to-three fascia reduction in these two local overlap areas are, on balance, not problematic. Similarly, no competition concerns are considered to arise in those areas where four or more fascia are present post-merger.

Barriers to entry and expansion

35. The control of entry regulations remains the key barrier to entry in retail pharmacy. The parties submit that barriers to entry have been reduced following amendments to the regulations in 2005 which introduced certain exemptions to the control of entry test and that further emphasis may be placed on PCT decision-making in the future so as to allow a wider range

¹⁴ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006.

¹⁵ *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007, at paragraphs 35-37.

of new entrants. However, in previous cases¹⁶ entry possibilities were not considered sufficient to mitigate competition concerns arising from local fascia count reductions and the OFT has obtained no evidence in this case to alter that conclusion.

Buyer power

36. Individual pharmacy customers tend not to have any meaningful countervailing buyer power.

Vertical issues

37. United has a wholesaling arm but no significant merger-related issues arise given its small scale relative to major wholesalers such as AAH, Alliance UniChem, and others which will act as a sufficient constraint post-merger. No third parties identified any vertical issues.

Third party views

38. No third parties who responded to the OFT raised significant concerns in relation to the retail pharmacy sector. One PCT raised a concern which has been addressed above at paragraph 26.

Conclusion

39. The OFT believes that competition concerns sufficient to give rise to the required belief that the merger will result in a substantial lessening of competition arise in relation to two local areas with three-to-two fascia reductions, located in Heckmondwike and Orrell.

FUNERAL SERVICES

40. CGL provides funeral services under the Funeralcare brand. [Endnote 3] Co-op Funeralcare is also active in the manufacture of coffins and the wholesaling of funeral accessories such as gowns and coffin liners. It

¹⁶ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006 and *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007.

operates 628 funeral branches across the UK and conducted 79,867 funerals in 2006.

41. United provides funeral services through Funeral Services Limited and Funeral Services Northern Ireland Limited. United's branded businesses trade under the name Co-operative Funeral Directors or Co-operative Funeral Services, usually followed by the name of the area. In addition a significant number of United branches trade under private names. United operate 189 funeral branches and conducted 25,974 funerals in 2006 in Northern England and Northern Ireland.
42. On 26 June 2007, the parties confirmed to the OFT that they had completed¹⁷ the sale of ten CGL branches within the overlap areas.¹⁸ These branches have therefore been excluded from the subsequent analysis.

Product market

Funeral services to individuals

43. The parties overlap in the provision of funeral directing services which include services provided directly by the funeral director (such as providing a coffin and managing the funeral) as well as arranging for the provision of services to others (such as cemetery or crematoria services) for which funerals directors are also responsible.¹⁹ The majority of funeral directing services are provided to individuals as a funeral package or, to a lesser extent, as a pre-paid funeral plan.²⁰ In both cases, the service provided is the same, so will therefore be considered together within the same product frame of reference.

Mortuary services

44. Funeral branches also provide organisations such as local councils and PCTs with mortuary services, where the funeral director removes the

¹⁷ Transactions are not contingent on the merger between CGL and United.

¹⁸ Three CGL branches in Greater Manchester (Blackley, Heywood and Rochdale) sold to Carriages Funeral Services Limited and seven CGL branches in Leeds and West Yorkshire (Headingley, Harehills, Halton, Moortown, Kippax, Middleton Park and Wakefield) sold to Funeral Services Partnership Limited. [Endnote 4]

¹⁹ This is consistent with the *Price Commission Funeral Charges, Report No 22, 1977*; the *MMC report on Co-operative Wholesale Society Limited and House of Fraser Plc 1987*; and the *MMC report on the acquisition by Service Corporation International and Plantsbrook Group plc 1995*.

²⁰ Pre-paid funeral plans account for approximately [five to 10] per cent of United's funerals and [five to 10] per cent of CGL's funerals in 2006.

deceased from the place of death and retaining the body pending collection by the family. These services are tendered for by NHS Trusts, Local Authorities or similar. Contracts appear to be variable in length, however a number of customers have indicated that their contracts were for two or three years.

45. These contracts account for [zero to five] per cent of CGL's turnover and [zero to five] per cent of United's. However, the OFT considered in the *CGL/Fairways*²¹ case that mortuary services are often offered at a very low price, as a means of gaining contact with the family in the hope of getting the individual funeral contract.
46. The OFT has previously found that the extent to which smaller funeral branches could compete for regional mortuary contracts is unclear and therefore there may be a case for treating these contracts separately from funeral services to individuals.²² In this case, one third party felt that smaller competitors were less able to compete for mortuary tenders. The OFT has therefore taken a cautious approach and considered the provision of mortuary services separately.

Geographic market

Funeral services to individuals

47. Consistent with past cases, information provided by the parties and third parties in this case supports the view that the market for funeral services to individuals is local in scope.²³
48. Previous investigations have identified several different methods for defining the scope of local catchment areas. Previously, the preferred methodology has been to consider catchment areas from which funeral branches derive 80 per cent of their business, measured by the number of

²¹ *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited*, 19 July 2006.

²² OFT investigation of the *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited*, 19 July 2006.

²³ This is consistent with the MMC's conclusions in its reports on *Co-operative Wholesale Society Limited and House of Fraser Plc* 1987 and the acquisition by *Service Corporation International and Plantsbrook Group plc* 1995.

deaths in postcode areas.²⁴ In *CGL/Fairways*, the OFT departed from that approach to employ isodistance analysis due to a number of anomalies in the mapping work provided in that case which rendered the 80 per cent catchment area data unreliable.²⁵ In this case, the collation of the necessary data for a share of funerals analysis in relation to this merger would have been particularly cumbersome and generally unworkable at first phase. However, the OFT is satisfied that the data provided by the parties on the 80 per cent catchment areas measured by the proportion of deaths are sufficiently robust in this instance. Moreover, they provide the most reliable approach for considering the overlap branches in the North of England in this case as they are based solely on official ONS data on deaths by postcode and the number of funerals conducted by each of the parties' branches, rather than estimates of competitors' funeral numbers.

49. In Northern Ireland, data on deaths by postcode are not available. The OFT has therefore applied an isodistance analysis for the overlaps in Northern Ireland. Consistent with third party comments, the OFT considered a five mile radius around each overlap branch and calculated each parties' share of all funerals conducted by funeral branches located within that radius.²⁶

Mortuary services

50. Coroners' contracts are typically tendered at a local authority level. Third parties have suggested that contracts may also be split into more localised areas by the authority or district council.
51. The geographic scope for mortuary services therefore appears wider than the local catchment area for individual funeral services, potentially extending to local authority boundaries. However, as concerns do not arise on any geographic basis, it is not necessary to conclude on the precise scope of geographic frame of reference in this instance.

²⁴ See MMC report on the acquisition by *Service Corporation International and Plantsbrook Group plc*, 1995; Case No 1044/2/1/04, *ME Burgess, JJ Burgess and SJ Burgess v Office of Fair Trading and W Austin and Sons, the Harwood Park Crematorium and the Consumer's Association*, 2005 and OFT investigation of the *Anticipated Acquisition by Co-operative Group Limited of McIntosh Funeral Directors*, 4 April 2006.

²⁵ OFT investigation of the *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways group UK Limited*, 19 July 2006.

²⁶ Estimates of competitor funeral numbers in the Northern Ireland overlap areas were made by the parties and where possible, verified by the OFT directly with each competitor.

Competitive assessment

52. Previous inquiries have suggested that competition in the funerals sector is muted²⁷ and third party comments in the current case support this. Whilst a small number of competitors suggested that the number of people obtaining more than one quote is increasing, all third parties that responded to this question suggested that the proportion who do obtain quotes is still very low.²⁸ Customers are generally vulnerable and distressed due to the nature and infrequency of the purchase, lack of experience and time pressures involved. Third parties were broadly in agreement that the main factors influencing choice of funeral home are reputation and location.
53. National and/or regional branding by the parties does not appear to be a major competitive factor given the significant number of strong independent competitors across the country. Several third parties listed independent funeral branches as well as larger chains as their main competitors.

Assessment of local competition

54. Consistent with past cases²⁹ the OFT has adopted a 25 per cent threshold for share of deaths (or funerals in the case of Northern Ireland) as a first screen to identify areas which may give rise to prima facie concerns in each local area. On this basis, eight local areas were identified for further analysis, and are detailed below.
55. In addition, and in keeping with its approach in *CGL/Fairways*,³⁰ the OFT has also applied a second stage of analysis, which includes consideration of additional factors, including the number of other competitors present, share of branches within a five mile radius³¹ and geographic proximity (as a proxy for closeness of competition). The OFT also took into account where

²⁷ *The Price Commission Funeral Charges, Report No 22, 1977*; the MMC report on *Co-operative Wholesale Society Limited and House of Fraser Plc 1987*; the MMC report on the acquisition by *Service Corporation International and Plantsbrook Group plc 1995*; and the OFT investigation of the *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited, 19 July 2006*.

²⁸ Several third parties estimated that it was less than five per cent.

²⁹ See MMC report on the acquisition by *Service Corporation International and Plantsbrook Group plc 1995*; and OFT investigation of the *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited, 19 July 2006*.

³⁰ *Completed acquisition by the Cooperative Group (CWS) Limited of Fairways Group Limited, 19 July 2006*.

³¹ Five mile radius rather than 80 per cent catchment for share of homes based on availability of information.

the increment to the parties' share of deaths and share of branches was small. This, in combination with the factors listed above, suggested in some instances that the overall loss of competition would be limited. Each of the local catchment areas where the 25 per cent threshold was exceeded is considered below.

Bangor, Northern Ireland

56. Within Bangor there is one United and one CGL branch. The parties have a combined share of funerals of [30 to 40] per cent within five miles of the United branch and [60 to 70] per cent within five miles of the CGL branch.
57. In addition, the United and CGL branches in Bangor have a combined share of branches within their respective five mile radii of [30 to 40] per cent and [50 to 60] per cent and the parties are each other's closest competitors.
58. On this basis, the OFT believes that competition concerns arise within Bangor.

Belfast, Northern Ireland

59. Within Belfast there are eight United branches and five CGL branches. The parties' share of funerals exceeds 25 per cent within a five mile radius of each of these branches, with the parties' combined share ranging from [30 to 80] per cent.
60. The United Mulholland branch is the closest competitor of the CGL Carrickfergus branch; and the United Brown, Houston & Williamson branch and the CGL Newtownabbey branch are each other's closest competitors. In addition, one third party raised concerns that the parties are (collectively) 'dominant' in Belfast.
61. On the basis of the local market assessment, the OFT believes that competition concerns arise within Belfast.

Greater Manchester

62. Within Greater Manchester there are 24 United branches but no CGL branches.³² However, the merger still gives rise to some small increments ([zero to five] per cent or less) due to a total of [zero to 10] funerals within Greater Manchester being conducted by CGL branches located outside

³² Following the sale of three branches to Carriages Funeral Services Limited on 26 June 2007 [Endnote 5].

Greater Manchester. Such anomalies would appear to arise due to the fact that the deaths data is collected on the basis of the postcode of the deceased, therefore, some funerals may be conducted by funeral branches outside of the local catchment areas.³³ Therefore, small increments of this nature, particularly where there is no geographical overlap between the parties, would not appear to be indicative of competitive interaction between the parties.

63. On the basis of the evidence provided the OFT believes that no competition concerns arise within Greater Manchester.

Liverpool

64. Within Liverpool there is one United Branch and 14 CGL branches. The parties' share of deaths exceeds 25 per cent in the catchment areas of four of the 14 CGL branches. However, in all of these cases the increment is below [zero to five] per cent ([zero to 10] or fewer funerals).³⁴ In addition, these four branches are located on the Wirral and are separated from the overlap United home by the River Mersey, therefore rendering the overlap even less problematic. For all of the remaining CGL branches in the Liverpool area their share of deaths is below 25 per cent and a number of other competitors are present.
65. Based on the local analysis, the OFT believes that no competition concerns arise within Liverpool.

³³ For example the deceased passed away in an area outside their home or relatives chose to hold the funeral in another area. For example, some funerals conducted for deceased who are recorded as being in the Greater Manchester area were held as far away as Canterbury and Glasgow.

³⁴ Furthermore, these funerals were conducted by United funeral homes outside Liverpool (in Greater Manchester).

Barnton

66. Within Barnton there is one CGL and one United branch. The parties have a combined share of deaths of [30 to 40] per cent (increment [10 to 20] per cent) and [30 to 40] per cent (increment [10 to 20] per cent) respectively. The parties have a combined share of branches within a five mile radius of each branch of [30 to 40] per cent, with four other competitor branches present. Furthermore, the parties are each other's closest competitors geographically.
67. Given the relatively high share of deaths, that the parties are each other's closest competitors and that they will own two of the six local branches, the OFT believes that competition concerns arise within Barnton.

Leeds

68. In Leeds there are 16 United branches but no CGL branches.³⁵ However, a small number of CGL branches located outside Leeds did conduct a handful of funerals within the area during 2006.³⁶
69. For 12 catchment areas, the parties combined shares of deaths exceeded 25 per cent, ranging from [25 to 35] per cent. However, the increments do not exceed [zero to five] per cent (or [zero to 10] funerals). In addition, there are no overlap branches within a five mile radius of any United. Therefore, small increments of this nature, particularly where there is no geographical overlap between the parties, would not appear to be indicative of competitive interaction between the parties.
70. Therefore, on the basis of the evidence provided the OFT believes that no competition concerns arise within Leeds.

West Yorkshire

71. In West Yorkshire there are eight United branches and six CGL branches. The parties' combined share of deaths exceeds 25 per cent in the catchment areas of four United branches and five CGL branches. The parties combined shares of deaths within these areas ranges from [25 to 60] per cent.

³⁵ Following the sale of six homes to Funeral Services Partnership Limited on 26 July 2007 [Endnote 6].

³⁶ The majority of which are by funeral homes located in West Yorkshire.

72. In the case of one United branch (John Moores) the parties have a combined share of deaths of [50 to 60] per cent, however, the increment is just [zero to five] per cent which in this case equates to [zero to 10 funerals]. Furthermore, there are a number of other funeral branches present in the local area (the combined share of branches within a five mile radius is just [20 to 30] per cent) and the parties are not each other's closest competitors geographically. Therefore, competition concerns are not considered to arise in relation to the catchment area surrounding the John Moores United branch.
73. The eight remaining branches have combined shares of deaths of over 25 per cent, with increments ranging from [zero to five] per cent ([20 to 30] funerals) and [10 to 15] per cent ([90 to 100] funerals). In addition CGL Brighouse and Brighouse Co-op (United branch) are each other's closest competitors.
74. Based on the evidence available, the OFT believes that (with the exception of the catchment area surrounding John Moores) competition concerns arise in the remaining eight local catchment areas within West Yorkshire.³⁷

Sheffield

75. Within Sheffield there are four CGL branches and six United branches. The parties' combined share of deaths exceeds 25 per cent in the catchment area of all of the CGL branches and five of the United branches.
76. The parties combined shares of deaths within these areas ranges from [25 to 65] per cent. In addition the CGL Swallownest branch is the closest competitor of United's C A Powis & Sons branch.
77. There are four United branches where the share of deaths increment is [zero to five per cent] ([zero to 10] funerals). For three of these branches (B & C Funerals, Killamarsh and Beechwood) the parties also have a relatively low share of branches within a five mile catchment (25 [to 35] per cent) and at least 11 other local competitor branches present. Within a five mile radius of the other United branch with a low increment (Chapelton) the parties' have a combined share of branches of [40 to 50] per cent but five competitor branches within the five mile radius. Given these low increments, and the presence of other competitors locally, the OFT does

³⁷ United Arthur Houldsworth, United Joseph Sheards Funeral Services, United Brighouse Co-op Funeral Services, CGL Brighouse, CGL Dalton, CGL Huddersfield, CGL Halifax and CGL Elland.

not consider that competition concerns arise in relation to the local catchment areas surrounding B & C Funerals, Killamarsh, Beechwood and Chapeltown.

78. However, for the remaining five local areas the parties' share of deaths are high and the merger will result in material increments, and in some instances they are each other's closest competitor. Therefore, the OFT believes that competition concerns arise within the five remaining local catchment areas³⁸ within Sheffield.

Assessment of mortuary services

79. The parties have several mortuary services contracts in the overlap areas. CGL has contracts in Northern Ireland, Greater Manchester, Barnton, Sheffield and Liverpool, whereas United only has contracts in Greater Manchester and West Yorkshire.
80. No third parties raised any concerns in relation to mortuary services, stating that there were other funeral directors they could use and one stating that they preferred to use a range of smaller independent funeral directors as well as larger chains. In addition, the OFT believes that local authorities and NHS Trusts have some degree of buyer power given their ability to vary the number of contracts awarded. In *CGL/Fairways* the OFT considered that sufficient competitive constraints would remain post-merger to prevent the parties from raising price or reducing service quality to customers for mortuary services. The OFT has obtained no evidence in this case to depart from that conclusion.
81. The OFT therefore believes that the merger will not give rise to competition concerns in relation to mortuary services.

Barriers to entry

82. Third parties broadly supported the parties' view that the costs of entry and set up in the funeral business are relatively low. However, both third parties and the parties suggest that the importance of reputation and goodwill act as a barrier to successful entry. Entry by a funeral director previously employed at other funeral branches may overcome some of the reputation related entry barriers, but it is not necessarily the case that a suitable funeral director would exist in all areas where concerns arise. In

³⁸ CGL Rotherham, CGL Swallownest, CGL Greasbrough, CGL Hoyland and United C A Powis & Sons.

addition, a number of third parties have suggested in relation to this and previous cases that funeral directors employed by existing funeral chains often have clauses in their contract preventing them from setting up a competing home in the same area for a set period of time (usually one or two years).

83. The majority of third parties commented that they have a significant amount of available capacity. The parties confirmed that a basic configuration of one holding room, one chapel, one arranging room and one office/reception area can handle around 300 funerals per annum and if a second arranging room and chapel or holding room are added this can increase to over 1,000. However, spare capacity is not necessarily sufficient to imply a funeral home exerts a stronger constraint on the parties than the number of funerals they conduct would suggest, given the link between reputation and funerals conducted, which was mentioned by both the parties and third parties.
84. Based on the evidence available, the OFT does not believe that new entry or expansion would be sufficiently timely or likely to remedy any competition concerns identified.

Buyer power

85. Individuals purchasing funerals are not considered to have any countervailing buyer power and will rarely negotiate on price. Buyer power in relation to regional contracts is discussed briefly above in the assessment of mortuary services.

Vertical issues

86. CGL manufactures and sells coffins, memorials and funeral accessories. United are not active in the provision of these products. CGL supplies its own branches and occasionally competitors, including United.
87. However, there is no evidence that the merger raises any vertical concerns and no third parties voiced concerns in relation to the supply of coffins etc. The OFT therefore considers that the vertical links arising as a result of merger do not raise competition concerns.

Third party views

88. Third party comments have been discussed above where relevant.

89. Several larger funeral chains were contacted, all of which agreed that markets were local. Two competitors raised a general concern that CGL was getting larger, but did not raise concerns in any specific local markets.
90. Between 25 and 30 local competitors were contacted, again all considered the market for funeral services to be local. Four local competitors raised concerns. One stated that the merger may improve CGL's service levels making it harder for them to compete. One raised specific concerns that the parties were dominant in Belfast. Two respondents from Liverpool raised concerns that the parties were increasing their 'dominance' both in Liverpool and nationally, although in Liverpool the parties' share of deaths is relatively low and three other competitors in the area were not concerned.
91. Several local third party responses raised concerns that the Co-op branches (either CGL or United) do not always trade openly as the Co-op and often retain the previous independent's name which is misleading to customers and makes them think they have more choice than they actually do. However, this concern does not appear to be merger specific, particularly as the vast majority of CGL branches in the overlap areas are in fact branded as Co-op Funeralcare.

Conclusion

92. The OFT believes that competition concerns sufficient to give rise to the required belief that the merger will result in a substantial lessening of competition arise in relation to local catchment areas within Bangor, Belfast, Barnton, West Yorkshire and Sheffield.

GROCERY RETAILING

93. CGL operates 1,600 grocery stores across Great Britain. United has 559 grocery stores, primarily in the north of England and the Midlands.
94. CGL also acts as the manager and representative member of a co-operative sector wide buying group, the Co-operative Retail Trading Group (CRTG). Current CRTG members are all consumer co-operatives with a food retail interest. CGL supplies both branded and own label products under the Co-op brand at cost to other CRTG members. In addition to its procurement role, CGL also provides logistics services for a number of retail stores, both

its own and those of independent societies.

95. United also operates two food retail warehouses, which service its own estate as well as certain stores belonging to independent societies.

Product market

96. The OFT and CC have drawn distinctions in previous cases between different types of grocery shopping trips and the abilities of different sized stores to cater for customers requirements.³⁹ The types of shopping trips identified include one-stop shopping, top-up shopping and convenience shopping.⁴⁰
97. In the context of its ongoing market investigation into the supply of groceries, the CC has recently published an 'Emerging Thinking' document⁴¹ and a working paper⁴² setting out its initial thinking in relation to issues of market definition for the groceries sector. The OFT shares the CC's current view contained in these papers that competitive constraints in relation to the supply of groceries are asymmetric - as larger stores place a greater constraint on smaller stores than vice versa.
98. In *Somerfield/Morrisons*⁴³ the CC noted that there had been a gradual trend towards more use of secondary shopping and also that some of the major grocery retailers had expanded into the convenience sector. However, the CC did not consider that these changes should affect the product frame of reference. Nor did increasing use of the Internet and home delivery of shopping affect their market analysis, given that it still accounted for only a few per cent of grocery sales.
99. In this case, the parties overlap in grocery retailing for one-stop shopping (stores above 1,400 square metres), top-up shopping (in stores above 280

³⁹ OFT's decision on the *Completed acquisition by Somerfield plc of 114 Safeway stores from Wm Morrison Supermarkets plc*, 23 March 2005; CC's report on the *acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, September 2005 (hereafter referred to as *Somerfield/Morrisons*); CC's report on *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets plc, J Sainsbury plc and Tesco plc*, 18 August 2003 (hereafter referred to as *The Safeway Report*); CC's Groceries market investigation (ongoing).

⁴⁰ The CC used 'secondary shopping' to describe other shopping trips designed to top-up or to complement the main shopping trip (*The Safeway Report*, paragraph 5.4).

⁴¹ *CC Groceries Market Investigation: Emerging Thinking*, 23 January 2007, paragraph 12.

⁴² *CC Working paper on market definition*, May 2007.

⁴³ Para 6.22

square metres⁴⁴) and convenience shopping (in stores of any size). The OFT has considered the competitive constraint that each of these stores provides. The OFT has also identified those fascia that might significantly constrain the merging parties' stores in terms of both price and non-price parameters of competition, which the CC abbreviates to price, quality, range and service (PQRS) to capture the complex competitive proposition that rival grocery stores offer to local shoppers.

100. The parties in this case argued that Marks & Spencer and the limited assortment discounters Aldi, Lidl and Netto (LADs) are currently presenting strong cases for their inclusion in the mid range and one-stop competitor sets.
101. In respect of top-up shopping (served by both one-stop and mid-range stores) the CC concluded in *Somerfield/Morrisons* that the LADs, Iceland and Marks & Spencer should be excluded from the competitor set for the purposes of its initial fascia reduction screening analysis. It identified the effective competitor set as incorporating Asda, Booths, Budgens, Co-op, Somerfield/Kwik Save, Morrisons/Safeway, Sainsbury's, Tesco and Waitrose (the Kwik Save chain has since been sold by Somerfield).
102. In the CC's recent working paper, it explains a finding that Asda, Morrisons, Sainsbury's, Tesco and Waitrose compete in the same product market. It points to some evidence⁴⁵ that Marks & Spencer exerts a sufficient competitive constraint to potentially warrant inclusion in the same product market, but considered that there is little evidence to warrant including the LADs. The CC is continuing to assess the position in relation to the product market. Therefore, in advance of more concrete conclusions from the CC's current investigation, the OFT has adopted a cautious approach and not widened the effective competitor set used to include Marks & Spencer or the LADs in the local area fascia analysis for this case. However, the second stage of analysis does not ignore constraints provided by suppliers outside the 'effective competitor' set, so this exclusion at the market definition stage is not definitive for the purposes of the overall competitive assessment.

⁴⁴ Stores between 280 – 1,400 square metres are generally referred to as 'mid-range stores'.

⁴⁵ Derived from analysis of the impact of new store openings on the revenues of other local stores.

Geographic market

103. Previous investigations by the OFT and CC have concluded that the scope of the geographic frame of reference is essentially local,⁴⁶ as most consumers are prepared only to travel a limited distance for their grocery shopping, and that distance may vary according to the type of shopping trip required.
104. At the same time, on the supply-side, national dimensions of competition also exist.⁴⁷ Key decisions affecting the operation of stores and other aspects of their business (such as supplier relationships and general promotional activity) are taken centrally on a national basis.
105. Consistent with *Somerfield/Morrisons* and *The Safeway Report*, the OFT has applied the following local catchment areas when analysing this case:
- a) One-stop shops – 10 minute (for urban areas⁴⁸) to 15 minute (for rural areas) drive-time isochrones drawn around individual stores, approximating to the area within which customers generating most of the revenue of that store would live and shop.
 - b) Mid-range stores – five minute (for urban areas) to 10 minute (for rural areas) drive-time isochrones drawn around individual stores.
 - c) Convenience stores – one mile radius.

⁴⁶ See for example *The Safeway Report*, 2003; *Somerfield/Morrisons*, September 2005; and the OFT's decision on the *proposed acquisition of former Safeway stores by J Sainsbury plc from Wm Morrison Supermarkets plc*, 3 October 2005.

⁴⁷ Such as national advertising, promotional activity, purchasing arrangements, etc.

⁴⁸ Urban areas were defined by the CC in *The Safeway Report* as those with a minimum population of 10,000.

Overview of horizontal issues raised

106. The transaction raises issues only in relation to mid-range store overlaps at the local level. The parties' national estates of grocery stores are summarised in the table below. United's regional focus serves to limit the degree of overall geographic overlap between the parties.

Store type	CGL	United
One-stops	[40 to 60]	[zero to 20]
Mid-range	[340 to 360]	[100 to 120]
Convenience	[1,180 to 1,210]	[430 to 450]

107. The parties' combined UK share of supply of groceries is estimated at [zero to five per cent] (increment [zero to five per cent]). These figures rule out the prospect of either non-coordinated effects or coordinated effects⁴⁹ concerns arising on a national basis as a result of the transaction.

108. At local level, no overlaps were identified between the parties' one-stop stores. One-stop shopping is therefore not considered further. For convenience stores, the four-to-three fascia reduction rule was applied to one mile radii centred on the parties' stores and local competitor stores. On this basis, the merger did not give rise to a reduction in fascia to three or less in the local areas. Convenience store overlaps are therefore not considered further.

Mid-range stores

Local overlaps

109. In *Somerfield/Morrisons* the CC concluded⁵⁰ that the loss of competition in that case between acquirer and target stores in each local area would

⁴⁹ In the 2003 *Safeway* report the CC found that the merger increment to market concentration was large enough under each of the proposed acquisitions to affect the likelihood of coordinated effects, and that the conditions necessary for coordinated effects existed in the one-stop shopping market.

⁵⁰ Paragraph 8.1

result in higher prices or a reduction in quality, range or service compared with that available in other stores. The CC also noted⁵¹ that customers in the relevant local areas would experience a reduction in choice between the formerly competing stores, for example between different prices, qualities or ranges of goods on offer, or services provided.

110. In this case, other grocery retailers explained that they tend not to distinguish between stores operated by different co-operative societies in their analysis of competitors. Both parties' decisions on product ranges are made in consultation with CRTG, and the 'Co-op' own-brand products available in both parties' stores are identical. National promotional activity is co-ordinated by CRTG, which negotiates the terms with relevant suppliers.

111. However, the parties at no point sought to argue that their stores should *not* be treated as competing local propositions in the merger assessment. Indeed, there would appear to be scope for the PQRS offering to vary between the parties' local overlap stores. Each party is free to determine the amount of shelf space allocated to different product categories, and price-setting decisions are taken independently. Local managers have some ability to propose local pricing, promotional or product range initiatives, subject to sign-off from their society management. There is also clearly scope for local quality and service aspects of competition to vary between stores, and for consumers to respond to such variation through switching behaviour.

112. In order to identify local overlaps requiring further analysis in this case, the parties used double isochrones⁵² which highlighted a total of 258 stores for more detailed analysis.

Stage 1 – fascia reduction filter

113. For mid-range (and convenience) stores, the parties applied filtering methodology in keeping with the CC's approach in *Somerfield/Morrisons*.⁵³ For mid-range stores, this involves sequentially applying and examining

⁵¹ Paragraph 8.2

⁵² Using double isochrones in this way will capture situations in which stores may represent competing alternatives for households located between them, even if each store is not within the other's store-centred isochrone.

⁵³ *Somerfield/Morrisons*, paragraph 6.87.

relevant-sized isochrones centred on:

- a) one of the parties' stores (the primary isochrone)
- b) each relevant competitor's store (including the other party's store) located within the primary isochrone
- c) population centres within the primary isochrone, and
- d) census output areas within the primary isochrone.

114. At each sequential stage, the approach identified isochrones (and relevant stores) subject to a local fascia reduction, as a result of the merger, from four to three, or less, in stores above 280 square metres.
115. Of the 51 mid-range stores subject to the isochrone analysis, 15 triggered the four-to-three fascia reduction rule based on their primary isochrones, a further nine did so on the basis of competitor re-centring, and a further two on the basis of population re-centring.
116. In *Somerfield/Morrisons* the CC recognised that in relation to output area re-centring, given the large number of output areas located within any primary isochrone, the proportion of the population in the primary isochrone affected by the fascia reduction was a relevant consideration. There were no acquired stores ultimately of concern to the CC in which population re-centring showed an effect on less than 10 per cent of the population of the primary isochrone. Based on the evidence available in this case, the OFT believes this is a credible *de minimis* threshold for identification of potential problem stores on an output area basis. Indeed, it appears highly unlikely that the merging parties could profitably engage in in-store price discrimination – or rather, discrimination based on PQRS factors alone or in combination – against such a small proportion of customers.
117. In this case, of 12 further stores (8 CGL and 4 United) identified just on the basis of output area re-centring, in two areas⁵⁴ more than 25 per cent of the population would be subject to a four-to-three (or lower) fascia reduction, and in another two areas⁵⁵ between 10 per cent and 25 per cent would be subject to such a reduction.

⁵⁴ Kippax (CGL) and Garforth (United).

⁵⁵ Elland (CGL) and Sherburn in Elmet (United).

118. Applying this 10 per cent cut-off to the output area results would therefore remove eight stores from consideration. Therefore, in total, the OFT identified 30 stores which may be potentially problematic. The various steps in this analysis are summarised below.

Table 2	
Stage 1 analysis summary	# of areas
Store overlaps subject to Stage 1 isochrone analysis	51
Isochrone analysis results	
- 4 to 3 on primary isochrone	15
- 4 to 3 on competitor re-centring	9
- 4 to 3 on population re-centring	2
<i>(- 4 to 3 on simple census output area re-centring</i>	<i>12)</i>
<i>(- apply 10% de minimis filter</i>	<i>- 8)</i>
- Adjusted 4 to 3 on census output area re-centring	4
Total potential problem areas after Stage 1	30

119. However, as demonstrated by the CC's findings in *Somerfield/Morrisons* the actual number of stores which may give rise to a substantial lessening of competition may be substantially less than the total number identified using the CC's stage one filter. In order to facilitate a more detailed assessment, the parties sought to replicate the second stage of the CC's analysis in *Somerfield/Morrisons*, involving analysis of survey data to estimate relevant diversion ratios, which they provided for the 30 stores identified above as well as eight further stores the OFT was able to screen out in relation to census output area re-centring (see paragraph 117).

Stage 2 – Diversion ratio analysis

120. Diversion ratios are generally considered to provide a potentially useful measure of the degree of rivalry between two firms (or stores) and therefore the scope for non-coordinated effects arising from a merger. For two firms (A and B), the diversion ratio reflects the extent to which A's customers would choose firm B (as opposed to firms C, D and so on) as their second choice (the customer diversion ratio), and the proportion of firm A's revenue accounted for by those customers (the revenue diversion ratio). The diversion ratio from a given United store to local CGL stores (and vice versa) would therefore offer a measure of the degree to which

they were locally competitors and the extent to which they constrain each other's behaviour.

121. Potential advantages of diversion ratio evidence over a simple fascia test (and over market share based tests) are that it can reflect influences on consumer choice and substitution driven by local, area-specific factors, such as store size, store fascia (including from those outside the basic competitor set) and local factors affecting transport options and the geographic scope of competition. Diversion ratios can provide direct evidence (albeit, in this instance, based on hypothetical switching behaviour) of the 'closeness' of competition between merging parties' stores for any given local area.
122. In this case, the parties commissioned surveys at each of the 38 stores⁵⁶ which they identified in their analysis at the first stage. Exiting shoppers were asked a number of questions, including the amount they had spent and where they would have shopped instead if the store just used was not available. Respondents' alternative store options were not constrained with respect to geographic location or effective competitor set, thereby circumventing the 'binary fallacy' implicit in rigid market definitions. Data derived from these survey responses enabled diversion ratios to be calculated for the alternative stores identified by shoppers. As a result of the OFT identifying a number of errors in the survey results, the parties carried out further surveys at three stores.⁵⁷ Following discussion with the parties, the OFT was able to satisfy itself that the new survey results were sufficiently robust to proceed with the diversion ratio analysis.
123. In *Somerfield/Morrisons* the CC noted⁵⁸ that the diversion ratio will not be sufficient to measure the degree to which a merger might locally reduce competitive constraints leading to unilateral effects. Higher margins, implying a lower residual elasticity of demand for the merging stores, would result in larger incentives to increase prices (or otherwise worsen PQRS – the retail offer) post-merger, for given diversion ratios. The CC therefore calculated 'illustrative post-merger price rises'⁵⁹ using a simple formula which combines the diversion ratio and margin data. The parties in

⁵⁶ Note that the OFT's analysis at the first stage identified only 30 stores for further consideration.

⁵⁷ CGL's stores at Ackworth and Moorthorpe, and United's store at Hemsworth.

⁵⁸ *Somerfield/Morrisons*, paragraph 7.5.

⁵⁹ These were not price predictions but reflect the potential for wider deterioration of PQRS.

this case have similarly used gross margin data⁶⁰ and the survey-based (revenue) diversion ratio estimates to calculate illustrative post-merger price rises using the same formula as the CC.

124. The value of this illustrative data is not in its ability to predict actual post-merger price increases but as a proxy for ranking areas where the deterioration in the retail proposition – the PQRS effect – is most likely to be an issue post-merger.
125. The illustrative price rises focussed on by the CC in *Somerfield/Morrisons*, and by the parties in this case, were calculated using the 'isoelastic demand' formula, which assumes that the price elasticity of demand is constant at different price levels. The OFT also had regard to the illustrative price increases submitted by the parties based on the alternative 'linear demand' formula, which produces less extreme outputs for relatively high diversion ratios.
126. In *Somerfield/Morrisons*, the CC applied a double minimum threshold of (1) a five per cent for the illustrative price rise⁶¹ and (2) 14.3 per cent for the revenue-weighted diversion ratio below which no concerns arose. The figure of 14.3 per cent (one-seventh) was derived from the expected diversion ratio between merging firms in an undifferentiated market with eight symmetric pre-merger players, whereby the two merging parties would have a combined market share of 25 per cent.
127. The OFT considers the provision of gross margin and consumer survey data as useful evidence, especially when triangulated against other evidence on fascia count, geographic proximities of relevant stores, and other available data. At the same time, it recognises that elements of the calculation of these thresholds were specific to the *Somerfield/Morrisons* case and should therefore not necessarily be applied as automatic safe harbour or be given hard and fast weight as a bright-line threshold in all instances.
128. It would be inappropriate for the OFT to give these thresholds the status of blanket safe harbours not least given the OFT's lower statutory test for reaching a belief that the merger may be expected to result in a substantial

⁶⁰ We have also used the store level gross margin data provided to examine the relationship between margins and concentration – discussed in Annex 3. [Endnote 7] No significant relationship is evident from the raw data.

⁶¹ Calculated using the isoelastic demand formula.

lessening of competition. Conversely, however, nor is it necessarily the case that figures above 14.3 per cent should be rigidly be considered 'unsafe' and therefore a problem without further analysis and consideration.

129. Further, as the CC also noted in *Somerfield/Morrison*⁶² there is inevitably some uncertainty regarding the reliability of any survey results and accepted that the sample size for any individual store (100 or less) was much smaller than the total survey exercise. The same caveats clearly apply here. 'True' diversion ratios could be significantly higher (or lower) than the sample estimates. Confidence intervals were therefore calculated for the estimated customer diversion ratios (although not for revenue diversion ratios) in order to test whether they are statistically significantly different from any given threshold proportion.
130. Therefore, while the OFT has had regard to the thresholds applied in the *Somerfield/Morrison* case, it has sought to analyse each overlap on its own merits based on the individual local circumstances found in that area.
131. In this case, the OFT individually examined each of the 30 stores identified, comparing the result of the diversion ratio and illustrative prices analysis alongside the stage one isochrones. On this basis, the OFT was able to screen out 17 stores as failing to raise concerns due to a combination of all relevant evidence, including (i) the OFT's analysis of fascia count and factors relating to geographic proximity of the parties' stores relative to their rivals and (ii) the survey data showing particularly low revenue diversion ratios well below the 14.3 per cent figure (no higher than [zero to 10] per cent in respect of any of the 17 stores).
132. This left 13 stores identified for which the merger may result in a substantial lessening of competition. None of these 13 stores showed a relevant effect (four-to-three fascia reduction) on less than 10 per cent of the population of their primary isochrone under output area re-centring, which suggests that such a threshold may have merit as a filter in the first stage of store identification, as discussed earlier. The relevant data for the set of 13 stores is set out below.
133. Note again that the fascia reductions featured in the table are only in the primary isochrone; as described in the Stage 1 analysis, all the above store overlaps are at

⁶² *Somerfield/Morrison*, Appendix D, paragraph 10.

least a four-to-three fascia reduction on at least one of the relevant lenses employed for that stage.

Table 3							
Stage 2 summary of 13 remaining problematic areas							
Overlap store	Merging party	Revenue diversion ratio (%)	Customer diversion ratio (%)	Illustrative price increase* (%)	Illustrative price increase (%)	Primary isochrone fascia reduction	'Pair'
				Isoelastic Demand	Linear Demand		
Ackworth	CGL	[more than 15]	[less than 15]	12.2	3.7	7 to 6	n/a
Amble	United	[more than 15]	[more than 25]	16.0	4.8	2 to 1	A
Dodworth	United	[more than 15]	[less than 15]	11.2	3.5	5 to 4	n/a
Haltwhistle, Aesica Rd	United	[more than 40]	[more than 60]	68.4	14.4	2 to 1	B
Haltwhistle, Main St	CGL	[more than 60]	[more than 40]	Very high*	35.5	2 to 1	B
Littleborough, Harehill Rd	United	[more than 60]	[more than 60]	Very high*	23.2	2 to 1	C
Littleborough, Station Rd	CGL	[more than 25]	[more than 25]	20.1	5.7	2 to 1	C
Marsh	CGL	[more than 15]	[more than 15]	13.7	4.1	5 to 4	D
Moorthorpe	CGL	[less than 15]	[less than 15]	6.5	2.1	2 to 1	n/a
New Mills, Church Rd	CGL	[more than 40]	[more than 60]	Very high*	18.9	3 to 2	E
New Mills, Torr Topp St	United	[more than 40]	[more than 40]	49.6	11.7	3 to 2	E
Queen Street (Amble)	CGL	[more than 60]	[more than 60]	Very high*	48.4	2 to 1	A
Salendine Nook	United	[less than 15]	[less than 15]	4.4	1.5	2 to 1	D

* Isoelastic demand formula: $\text{Change in price} = \frac{m}{1-m-d}$ where m is margin, and d is the revenue diversion ratio. This formula generates extreme price increase results at very high diversion ratios which the OFT does not consider meaningful.

134. For all but two of the 13 stores identified above, the revenue weighted diversion ratio analysis showed that consumers viewed the parties' stores as close substitutes with ratios well in excess of the threshold applied by the CC in *Somerfield/Morrisons*. Similarly, the illustrative price increases were also high or at a minimum significant under either of the demand models, supporting the proposition that the merger may give the parties the profit incentive to reduce the value of their PQRS retail proposition to customers in these areas. For the reasons set out further below, neither entry or expansion or buyer power are sufficient, individually or in tandem, to dismiss the concerns generated by all of the OFT's analysis set out above.
135. These findings do not apply on their face to either Moorthorpe (CGL) or Salendine Nook (United). However, in respect of Moorthorpe, the OFT attaches some weight to the fact that the merger is a two-to-one reduction in the primary isochrone in terms of the 'effective competitor' set. We also note that the margin/survey data generated an illustrative price rises of 6.5 per cent on isoelastic demand (2.1 per cent on linear demand) and the revenue diversion ratio at [more than five] per cent is not statistically significantly below the 14.3 per cent figure. Accordingly, the OFT believes that absent better evidence to the contrary, the merger gives rise to a realistic prospect of SLC in this area.
136. In respect of Salendine Nook, this store is an overlap 'pair' with the CGL store at Marsh (pair D), as indicated in the table. The evidence suggests that the Salendine Nook store places a significant competitive constraint on the Marsh store sufficient to create unilateral effects concerns at the Marsh Store. While, on the available data, this constraint would appear to be relatively asymmetric in its nature, the combination of this pair of stores under single ownership following the merger will result in this constraint being lost. However, given that this pairing is already considered to give rise to competition concerns in the local area, there has been no need to reach an independent conclusion on whether the merger raises separate concerns from the perspective of Salendine Nook alone.
137. Indeed, ten of the thirteen stores identified in the table are 'paired' CGL/United overlaps (pairs A-E), in that the competition concern for each of two paired stores arises from their bilateral relationship. Therefore, overall there are eight distinct local areas (five paired overlaps, and three others) where the OFT believes the merger presents a realistic prospect of

a substantial lessening of competition in terms of the reduced value of the merging firms' PQRS retail proposition to local shoppers, relative to that offer absent the merger.

Countervailing constraints

138. The parties argue that that both the top-up and convenience markets have displayed strong signs of growth in recent years. They note that in its *Tesco/Administore* decision⁶³ the OFT found that barriers to entry for mid-range stores appeared to vary with the size of the store in question.
139. In *Somerfield/Morrisons*, the CC concluded⁶⁴ that it could not rely on new entry to resolve any immediate lessening of competition affecting mid-range stores. It found that the availability of space was likely to be limited in most areas and that the process of entry – involving site acquisition, planning approval and fit-out (or construction) – of a new supermarket could often take two years or more.
140. Consistent with the CC's decision in *Somerfield/Morrisons* and the OFT's grocery market report of 2006, the OFT found no evidence during this investigation to suggest that new entry or expansion would be sufficiently timely and likely to eliminate the potential competition concerns in the areas identified above.
141. Nor is the OFT in possession of evidence suggesting that repositioning by the merging parties' rivals in any area – for example, increasing their range, quality or service or otherwise adjusting their PQRS offer – would enable the OFT to dismiss the non-coordinated effects concerns raised.
142. Finally, there can be no suggestion that individual grocery customers possess countervailing buyer power.

Vertical issues

143. CGL manages the CRTG buying group on behalf of various co-operative societies. Amalgamation with United will make CGL even larger relative to the other UK co-operative societies. However, United was already a

⁶³ OFT's decision on the *Anticipated acquisition by Tesco Plc of 45 outlets from Administore Ltd*, 5 March 2004.

⁶⁴ See paragraph 7.46

member of CRTG, so there is no expectation of a substantive change in CRTG's bargaining strength relative to upstream producers or suppliers of grocery products.

144. Both parties have other grocery wholesaling activities which they also make available to third parties (other co-operative societies). However, the merger is not expected to impact materially on these arrangements.

Third party views

145. No significant concerns were raised by third parties in relation to the grocery retail sector.

Conclusion

146. The OFT believes that competition concerns sufficient to give rise to the required belief that the merger will result in a substantial lessening of competition arise in relation to eight distinct local areas (five paired overlaps, and three others) as set out in Table 3 above.

ASSESSMENT

147. The parties overlap in the supply of property investment; financial services; travel agency services; pharmacy services; funeral services; and grocery retail services. The OFT believes that no competition concerns arise in respect of property investment, financial services and travel agency services.

148. In relation to pharmacy services, the OFT applied the method of analysis used in its previous decisions of *Boots/Alliance Unichem*⁶⁵ and *Lloyds/IPCC*.⁶⁶ On this basis, the OFT identified two local areas (Heckmondwike and Orrell) within in a one mile radius that resulted in a substantial lessening of competition.

149. In relation to funeral services, the OFT applied the method of analysis used in previous OFT and CC decisions⁶⁷ including (to the extent possible)

⁶⁵ *Anticipated acquisition by Boots plc of Alliance UniChem plc*, 6 February 2006.

⁶⁶ *Anticipated acquisition by Lloyds Pharmacy Limited of Independent Pharmacy Care Centres plc*, 8 June 2007.

⁶⁷ See MMC report on the acquisition by *Service Corporation International and Plantsbrook Group plc*, 1995; Case No 1044/2/1/04, *ME Burgess, JJ Burgess and SJ Burgess v Office of*

CGL/Fairways.⁶⁸ Following its analysis, the OFT identified five local areas (Bangor, Belfast, Barnton, West Yorkshire and Sheffield) giving rise to a substantial lessening of competition as a result of the merger.

150. In relation to grocery retail services, the OFT was guided by the methodology adopted by the CC in *Somerfield/Morrisons*⁶⁹ and *The Safeway Report*⁷⁰ but took into account the totality of the evidence available in respect of local areas, including location maps, fascia counts, store margin data and local customer preferences evidence before reaching its conclusions. On this basis, the OFT identified eight local areas (five paired overlap stores and three non-paired stores) where it believes the merger gives rise to at least a realistic prospect of a substantial lessening of competition.
151. Consequently, the OFT believes 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.

UNDERTAKINGS IN LIEU

152. Where the duty to make a reference under section 33(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. In addition, pursuant to section 73(3) of the Act, in considering whether to exercise its discretion to accept such undertakings, the OFT is required, in particular, to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it.

Fair Trading and W Austin and Sons, the Harwood Park Crematorium and the Consumer's Association, 2005 and OFT investigation of the *Anticipated Acquisition by Co-operative Group Limited of McIntosh Funeral Directors*, 4 April 2006.

⁶⁸ *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited*, 19 July 2006.

⁶⁹ CC's report on the *acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, September 2005.

⁷⁰ CC's report on *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets Plc, J Sainsbury plc and Tesco plc*, 18 August 2003.

153. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Mergers Substantive Assessment Guidance* states that, 'In order to accept undertakings in lieu of reference, the OFT must be confident that the competition concerns identified can be resolved by means of undertakings without the need for further investigation. Undertakings in lieu of reference are therefore 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.' (Paragraph 8.3).
154. The parties have indicated that in order to remedy any substantial lessening of competition identified by the OFT and to avoid a reference to the CC, they would be prepared to offer undertakings in lieu. The parties therefore offered [] divestment packages for each of the pharmacy, funeral and food retail sectors. The extent to which these packages are considered by the OFT to 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 case-practice, is addressed in turn below.

Divestments - Pharmacy services

155. The parties offered to divest either the United branches or the relevant CGL branches in the two local areas giving rise to competition concerns (Heckmondwike and Orrell) to a suitable purchaser or purchasers approved by the OFT.
156. In relation to Heckmondwike, the parties offered to divest either the United branch on Batley Road, Heckmondwike or up to two specified CGL branches in the local area, namely Heckmondwike Morrisons Superstore and Heckmondwike Northgate. The OFT believes that it is necessary for the parties' to divest either the United branch on Batley Road, Heckmondwike or both of the two specified CGL branches, Heckmondwike Morrisons Superstore and Heckmondwike Northgate, in order for the remedy to be sufficiently clear cut to address the competition concerns arising in that local area.
157. In relation to Orrell, the parties offered to divest either the United branch on Church Street, Orrell or the CGL branch on Orrell Road, Orrell. The OFT

believes that this remedy is sufficiently clear cut at first phase to address the competition concerns arising in Orrell.

158. The OFT therefore believes that the undertaking offered is capable of clearly addressing the competition concerns arising in the local areas identified above, as it would restore pre-merger competition (and fascia count) to the relevant local areas.

Divestments – Funeral services

159. The parties offered to divest a number of funeral branches listed in each of the five local areas identified as giving rise to competition concerns above. The following addresses each area in turn.

Bangor, Northern Ireland

160. The parties offered to divest either the CGL branch (Russells of Bangor) or the United branch (John Gray) in Bangor. The OFT believes that this remedy is sufficiently clear cut to address the competition concerns arising in Bangor as it removes the overlap between the parties in that area.

Belfast, Northern Ireland

161. The parties offered to divest either all of the five CGL funeral branches⁷¹ or all of the eight United funeral branches,⁷² thus removing any local overlap in the Belfast area. The OFT is satisfied that this remedy is sufficiently clear cut to address the competition concerns arising in Belfast as it removes the overlap between the parties in that area.

⁷¹ McConnell's Funeralcare in Carrickfergus, Wilton's in Newtownabbey, Belfast Ravenhill Co-operative Funeralcare, Belfast Woodstock Wilton's and Belfast Shankhill Co-operative Funeralcare.

⁷² Mulhollands in Carrickfergus, John Gray & Co Holywood, Browns Houston & Williamson Newtownabbey, James Brown and Sons 719 Upper Newtownards Rd Belfast, Houston & Williamson Belfast, James Brown and Sons 300 Newtownards Rd Belfast, James Brown and Sons Lisburn Rd Belfast and James Elwood Belfast.

Barnton

162. The parties offered to divest either the CGL branch (F Hayes) in Barnton or the United branch (G Lightfoot) in Cheshire. The OFT believes that this remedy is sufficiently clear cut to address the competition concerns arising in Barnton as it removes the overlap between the parties on the basis of a five mile radii in that area and results in an insignificant increment in the parties combined share of deaths for that area.

West Yorkshire

163. The parties offered to divest either four specified CGL funeral branches⁷³ or four specified United funeral branches.⁷⁴

164. The OFT considers that divestment of the four CGL funeral branches is sufficiently clear cut to address the competition concerns identified in West Yorkshire as there is only one instance remaining where the parties shares of deaths exceed 25 per cent and with an increment of only three funerals.

165. The OFT does not consider that the divestment of the four United funeral branches is sufficiently clear cut as it would result in the parties' share of deaths continuing to exceed (and in some cases, substantially exceed) 25 per cent in six catchment areas. Furthermore, the remaining increments to the parties' share of deaths (ranging from [zero to 20] funerals) are not immaterial.

Sheffield

166. The parties offered to divest either three specified CGL funeral branches⁷⁵ or a different three specified CGL funeral branches.⁷⁶

167. The OFT believes that this remedy is sufficiently clear cut to address the competition concerns identified in Sheffield as it reduces the share of

⁷³ Huddersfield Co-operative Funeralcare, Halifax Co-operative Funeralcare, Elland Simpsons Funeralcare and Brighouse Charles Wood St John's Chapel of Rest.

⁷⁴ Arthur Holdsworth Bradford, Heckmondwike Westgate, Brighouse Co-op Huddersfield Rd and Longfiled Co-op Bradford.

⁷⁵ CGL Swallownest Co-operative Funeralcare, CGL Hoyland Co-operative Funeralcare and CGL Greasborough A J Smith.

⁷⁶ CGL Swallownest Co-operative Funeralcare, CGL Hoyland Co-operative Funeralcare and CGL Rotheram Co-operative Funeralcare.

deaths of the parties to less than 25 per cent in each catchment area or substantially eliminates the overlap between the parties.

Divestments – Grocery retailing

168. In order to address the OFT's competition concerns in relation to grocery retail services, the parties offered to divest one of each of the paired stores and the three additional stores identified in Table 3 above to a purchaser or purchasers approved by the OFT.

169. The OFT believes that the undertaking offered is capable of clearly addressing the competition concerns arising in the local areas identified above as it removes all of the problematic overlaps between the parties in the eight local areas and restores the fascia count to its pre-merger level in each relevant area.

DECISION

170. The OFT therefore believes that the anticipated merger between Co-operative Group (CWS) Limited and United Co-Operatives Limited meets the test for reference to the Competition Commission pursuant to section 33 of the Act. However the OFT's duty to refer is suspended while the OFT is considering whether to accept undertakings in lieu of reference from the parties pursuant to section 73 of the Act.

ENDNOTES

1. Correction – Financial Services Authority.
2. Correction – United's Co-op Health Care Limited has 232 retail pharmacy stores in the north of England and the Midlands.
3. The parties wish to clarify that CGL provides funeral services under a number of private names as well as the Funeralcare brand.
4. Correction – the CGL branches in Greater Manchester were sold to Funeral Services Limited; a new company incorporated by Carriages Funeral Services Limited for the purposes of making the acquisition.
5. Correction – the sale of three branches to Carriages Funeral Services Limited took place on 22 June 2007, not 26 June 2007.
6. Correction – the sale of six branches to Funeral Services Partnership Limited took place on 25 June 2007, not 26 July 2007.

7. Correction – there is no Annexe 3 in this document. Reference to Annexe was included in error.