
Completed acquisition by Somerfield plc of 114 Safeway stores from WM Morrison Supermarkets plc

The OFT's decision on reference under section 22 given on 23 March 2005. Full text of decision published 8 April 2005

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' request for reasons of commercial confidentiality.

PARTIES

1. **Somerfield plc (Somerfield)** is the fifth largest grocery retailer in the UK, with a total pre-acquisition portfolio of 1219 stores. The company operates nationally across the UK and achieved sales of £4.52 billion in the financial year ending 24 April 2004.
2. **Wm Morrison Supermarkets plc (Morrisons)** is the fourth largest grocery retailer in the UK, following its acquisition of Safeway in 2004. Its annual turnover for the year ending 1 February 2004 was £4.94 billion.

TRANSACTION

3. On 25 October 2004, Somerfield acquired 114 smaller Safeway stores (the acquired stores) from Morrisons by way of a sale and purchase agreement. The total consideration was £260.2 million and the annual turnover of the acquired stores is approximately £750 million.
4. Somerfield notified the transaction on 8 December 2004. The extended statutory deadline is 24 March 2005.

JURISDICTION

5. As a result of this transaction Somerfield and the acquired stores have ceased to be distinct. The UK turnover of the acquired stores exceeds £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 a relevant merger situation has been created.

RELEVANT MARKET

Product market

6. The transaction gives rise to an overlap in grocery retailing, primarily through mid-range stores (stores between 3,000 sq feet and 15,000 sq feet) and, to a lesser extent, through convenience (under 3,000 sq feet) and one-stop stores (over 15,000 sq feet).¹
7. In recent years, the grocery retailing sector has been examined by both the Competition Commission (CC) and the OFT.² The types of grocery shopping 'trips' made by consumers and recognised in previous cases include:
 - (a) one-stop shopping
 - (b) secondary shopping³ and
 - (c) convenience shopping.

In order to analyse the competitive constraints on an individual grocery store, it is necessary to identify the types of shopping undertaken at that store.

8. **One-stop stores** appear able to cater for the full range of grocery shopping trips, including convenience shopping and one-stop shopping. However, recent analysis of the sector has suggested that one-stop stores are generally not constrained in their competitive behaviour (pricing, range/service) by convenience and mid-range stores. On the other hand, one-stop stores are likely to provide a competitive constraint on convenience and mid-range stores within a certain catchment area for the types of shopping that these latter stores offer.
9. **Convenience stores** can only carry a limited range of products. For this reason, they predominantly meet customers' needs for convenience or 'impulse' shopping. However, convenience shopping is carried out by customers in a wide range of retail outlets, including mid-range and one-stop stores – consumer 'choice' being

¹ These categories of store follow those used by the Competition Commission in the following reports - *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (2000, Cm 4842) ('the Supermarkets Report 2000') ; and *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc* (2003, Cm 5950) ('the Safeway Report').

² See, for example, the OFT's decision on the completed acquisition by J Sainsbury's plc of Jacksons Stores Ltd (26 October 2004) and the OFT's decision on the anticipated acquisition by Tesco plc of 45 stores from Adminstore Ltd (5 March 2004).

³ The CC used 'secondary shopping' to describe other shopping trips designed to top-up or to complement the main shopping trip (Safeway Report, para 5.4).

driven more by location than by price. Evidence from the CC's Safeway Report and the OFT's investigations indicates that mid-range and one-stop stores represent a competitive constraint on convenience stores within a certain catchment area for convenience shopping.

10. The majority of the stores acquired in this transaction are **mid-range stores**. The CC did not reach a clear conclusion on whether such stores constitute a separate market, but the analysis of possible 'problem' stores (i.e. stores in respect of which competition concerns arise) was different to that for one-stop stores. Moreover, the CC noted that there was likely to be a scale moving from stores close to 15,000 sq feet (for which the issues would be similar to the issues set out for its one-stop shop analysis) to very small stores (closer to 3,000 sq feet) for which the issues would be more similar to the issues pertaining to convenience stores.⁴
11. In Somerfield's view, the fact that the CC did not reach a conclusion on whether mid-range stores constitute a separate market underscores the dangers of relying on a rigid market segmentation based on floor area. Somerfield argues that the analysis must also take account of product range and consumer profile in the local area on a case by case basis.
12. It has been put to us in this and previous merger cases that, contrary to the position taken in the Safeway Report, there is a single 'market' for the supply of all groceries. We have considered the submissions put to us on this issue, but consider that the evidence available to us at this stage is not sufficient to justify departing from the approach outlined above.
13. The focus of our analysis in this case has been the constraints placed on each store by its competitors, more specifically:
 - (a) for small stores, convenience shopping (in all grocery stores)
 - (b) for mid-range stores, the alternative fora for the shopping trips such stores cater for and
 - (c) for one-stop stores, the alternative fora for the shopping trips such stores cater for.

Geographic market

National competition

14. There are important interactions between local and national competition in grocery shopping, particularly on the supply side. In the Safeway Report, the CC found

that key decisions affecting the operation of stores and other aspects of businesses are taken centrally by the largest players in the supermarket sector. In particular centralised buying enables supermarkets to utilise better buying terms from suppliers. For these reasons, the national impact of the merger will be considered briefly below.

Local competition

15. On the demand side, the geographic scope of supply of a particular grocery store is determined by the distance that customers are able or prepared to travel to do their shopping at that store which, in turn, is influenced by the range of groceries it is able to provide. Therefore, regardless of the size of the store, the appropriate geographic scope is considered to be local. However, the actual catchment of a store will differ depending in the size of store and so the range of goods it can provide and the purpose of the consumer's 'shop'.

One-stop stores

16. In the Safeway Report, the CC concluded that the appropriate geographic scope for one-stop stores is a ten-minute isochrone in urban areas and a fifteen-minute in rural areas.⁵ We have seen no evidence to justify departing from this approach in this case.

Smaller stores

17. In considering stores less than 15,000 sq feet, the CC ignored any overlap where the Safeway store was 280 square metres (roughly, 3,000 sq feet) or below⁶ (i.e. convenience stores), on the basis that low barriers to entry should address any local 'problem'. For the remaining smaller stores (between 3,000 and 15,000 sq feet) the CC applied a five-minute isochrone in urban areas and a ten-minute isochrone in rural areas. However, it recognised that this approach might not accurately reflect the actual draw of the smallest and largest stores in this category. The largest stores in this category might be expected to draw customers from wider drive times and hence analysis on five and ten-minute isochrones would underestimate the area over which such a store competes, or offers effective choice. Conversely, a store closer to convenience store size might be expected to draw customers primarily on foot, such that a drive time may represent an unrealistically large catchment area.

⁴ Safeway Report, para 5.344.

⁵ The CC adopted the ODPM's definition of 'urban' as a population of 10,000 or more.

⁶ Safeway Report, para 5.343.

18. In the context of the acquisition of convenience stores, the OFT recognised this approach in Tesco/Adminstore and Sainsbury's/Jacksons and so considered a catchment area of up to one mile for small stores in those cases. We have seen no evidence to justify departing from this approach in this case.

Mid-range stores

19. Given that the vast majority of the stores acquired by Somerfield fall in this category, we have carefully considered the appropriateness of the five and ten-minute isochrones adopted by the CC in the Safeway Report. Our methodology is discussed below. In both Tesco/Adminstore and Sainsbury's/Jacksons, there were only two mid-range stores involved but these did not raise any competition concerns applying the CC's methodology.⁷

HORIZONTAL ISSUES

National competition

20. One third party raised concerns about Somerfield's post-acquisition national share of mid-range stores, which it calculated to be 33 per cent in Great Britain. Somerfield does not accept that there is a distinct market for mid-range stores; even if there is, it states that its post-acquisition share of supply would be between 16 per cent and 20 per cent.
21. We agree that competition issues could not arise solely from having high shares in the mid-range segment. Given the asymmetry in competition between large stores and smaller stores, Somerfield's mid-range stores will continue to face competition from large stores post-acquisition. Similarly, in terms of buyer power all grocery retailers appear to procure centrally and not separately for stores of different sizes, so a high proportion of stores of a certain size range is less significant than overall turnover. At the national level, Somerfield's share of all grocery sales – which might be indicative of any buyer power – remains fairly modest at [5-10] per cent with the increment arising from this acquisition being [less than 1] per cent.

Local competition

One-stop stores

22. Twelve of the acquired stores fall in this category. These stores have been analysed using the same criteria as the CC in the Safeway Report (i.e. ten-minute isochrones in urban areas and fifteen-minute isochrones in rural areas and using

the same competitor set as the CC). As in previous cases, potential competition concerns are most likely to arise in areas where there will be three or fewer fascia competing with the merged entity post-acquisition.

23. This analysis identified only one potential 'problem' store at Johnstone, where the acquisition results in a reduction of the number of competing fascia from four to three. Somerfield provided us with its own analysis of this site which indicated this was not a 'problem' store. However, this analysis included some fundamental differences in parameters to the CC's approach, in particular a wider effective competitor set.

Convenience stores

24. Three of the acquired stores fall in this category. Our analysis identified one potential 'problem' store at Filey, where there are no competing fascias post-acquisition. As discussed below, it is possible that the barriers to entry may be sufficiently low to address the competition issue.

Mid-range stores

25. Ninety-nine of the acquired stores fall in this category. As noted earlier, the CC did not reach a clear conclusion on whether such stores constitute a separate market, but its analysis of possible 'problem' stores was different to that for one-stop stores.

A proposed methodology

26. In light of the CC's comments above, representations from Somerfield and the comments received by the OFT in previous grocery retailing merger cases, we considered whether it was possible to develop the analysis of mid-range stores. For example, we considered whether it was appropriate to apply an alternative first screen device in analysing the effect on competition of the mid-range store acquisitions.⁸
27. Firstly, the CC's criteria for mid-range stores would be applied (i.e. the reduction in the number of fascia of effective competitors in a five or ten minute isochrone depending on whether the area is urban or rural).

⁷ This methodology is discussed further below.

⁸ This approach was adopted for the two mid-range stores in Tesco/Adminstore and Sainsbury's/Jacksons although competition concerns were not raised on either methodology therefore it was not necessary to reach a conclusion on its appropriateness.

28. Secondly, all of the areas in which Somerfield has acquired a Safeway store could be split into three ranges:

- (a) 3,000-7,000 sq ft ('closer to convenience store')
- (b) 7,000-11,000 sq ft (mid-range) and
- (c) 11,000-15,000 sq ft ('closer to one-stop store').

The analysis would then be carried out on:

- (a) a one mile radius for those stores in the 'closer to convenience store' range;
- (b) a five or ten minute isochrone (depending on rural/urban split) for those stores in mid-range;
- (c) a ten or fifteen minute isochrone (depending on rural/urban split) for those stores in the 'closer to one-stop store' range; and
- (d) consider an expanded competitor 'set' for each of these segmentations.

To the extent that there was a divergence between the outcomes in applying the two methodologies, we would then consider which was the most 'appropriate' given the size of store concerned and any further evidence which might mitigate the competition concerns.

29. However, in seeking comments on this suggested approach the vast majority of third parties had substantial reservations about the proposed methodology, and raised a number of concerns, including the following:

- (a) dividing grocery retailing into rigid segments based on area is an artificial approach to analysing supply
- (b) segmenting by current sales area ignores the fact that in most cases, the sales area of a store can be easily extended
- (c) application of a more complex set of rules to the secondary shopping segment than the one-stop shopping segment is unlikely to be proportionate
- (d) it is not clear that the OFT's proposed basis for analysing the mid-range segment is the correct way, and alternative options over a longer time horizon should be considered and
- (e) the fascia rule on isochrones is flawed because it does not take account of the relative strengths of stores within that isochrone.

30. While some of these comments could equally be directed at the CC's analysis of local competition issues between one-stop and smaller stores in the Safeway Report, we accept that some of the comments may have some merit. Bearing these concerns in mind, we conducted the analysis to determine the extent to

which a divergence of outcomes between the methodologies exists. Applying the CC's methodology for 'smaller' stores resulted in 22 'problem' mid-range stores in this case, of which 15 stores were found to be problematic on both methodologies and a further 13 were problematic only on the OFT's proposed methodology (excluding any attempt to expand the competitor set). Thus, while the total number of potential 'problem' stores is similar, the actual location of those stores is substantially different.

31. In its analysis of mid-range stores, the CC concluded that a limited number of fascia were effective competitors for one another in this range of stores: Asda, Booths, Budgens, Co-op, Iceland, Sainbury's, Safeway, Somerfield (including Kwik-Save), Morrisons, Tesco and Waitrose.
32. Somerfield has argued strongly that this competitor set is fundamentally flawed because it does not include stores such as Marks & Spencer, Netto, Lidl, Aldi and any symbol group (such as Spar and Londis). Somerfield provided us with various data to demonstrate that it competes with such stores in the mid-range sector. To some extent this has been borne out by our own experiences in monitoring the sale by Morrisons of some of the divestment stores arising out of the Safeway Report. However, a number of third parties expressed the view that there have not been any market changes which would change the competitor set identified by the CC in the Safeway Report.
33. In light of the comments from third parties, we considered that applying additional criteria to those used by the CC is not sufficiently robust to be certain that the competitive dynamics are preserved in all these areas. For these reasons, we have not sought to apply or rely upon the proposed methodology in our assessment of this case.

Analysis of mid-range stores using CC methodology

34. In light of the issues with our proposed methodology above, the mid-range stores in this acquisition have been analysed according to the criteria adopted by the CC in the Safeway Report for 'smaller' stores (ie smaller than one-stop stores), using five minute isochrones in urban areas and ten minute isochrones in rural areas. Potential competition concerns are most likely to arise in more concentrated areas where there will be three or fewer fascia competing with the merged entity post-acquisition.
35. This analysis identified 22 potential 'problem' areas, which are listed below.

1. Aberdeen – Cornhill
2. Bridge Of Weir

3. Glasgow – Springburn
4. Leeds - Chapel Allerton
5. London Balham
6. London Camberwell
7. Ponteland Main St
8. Renfrew
9. Saltcoats
10. Broughty Ferry Brook St
11. Carlisle
12. Glasgow – Knightswood
13. Frome King St
14. Kelso Roxborough St
15. Leeds – Oakwood
16. Loftus
17. Middlesbrough Linthorpe
18. Preston Pans
19. South Shields
20. Whickham Oakfield Rd
21. Peebles (with PFS)
22. Pocklington The Balk

36. Somerfield provided us with its own analysis of each of these sites, which indicated that there were three or four potential 'problem' stores. Somerfield argued that the application of the CC's methodology produced a number of anomalous results, which could be avoided by modifying various parameters of that methodology such as the effective competitor set and the size of the isochrone. Somerfield also questioned other factors such as the definition of stores as urban and rural, and whether three or fewer competing fascia is the appropriate measure of a potential loss of competition in the mid-range sector.
37. The difficulty for us in accepting Somerfield's analysis has been the lack of consensus about whether, and how, such fundamental elements of the CC's methodology in the Safeway Report ought to be modified.

Barriers to entry and expansion

One-stop stores

38. Previous cases have noted that barriers to entry in this segment are high. Economies of scale, in particular favourable buying terms for large incumbent supermarkets and planning restrictions, have been instrumental in restricting entry (of which there has been none in more than a decade). New entry is therefore

not considered to be a countervailing factor in the one-stop store segment in this case.

Convenience stores

39. The convenience store segment has traditionally been dynamic, with a high proportion of independent ownership and rapid turnover of businesses. In terms of local planning regulations, once A1 planning permission⁹ has been given for any form of retail property such as a clothes store, it is possible to use such a property for other retail purposes such as a convenience store.
40. In the Safeway Report, some large grocery retailers told the CC that barriers to entry for convenience retailing were low.¹⁰ However, in previous OFT investigations, some smaller grocery retailers commented that this sector is becoming increasingly difficult to enter for individual independent retailers, mainly due to the disparity of buying terms between grocery retailers.
41. The views of third parties in this investigation were mixed as to whether barriers to entry in convenience retailing remain low.

Mid-range stores

42. The extent to which barriers to entry exist for mid-range stores depends upon how far along the continuum of store sizes a particular store is placed. There was agreement amongst third parties that the larger a proposed new store the harder it is to achieve entry.
43. For the potential 'problem' stores in this segment, all but two of which are over 7,000 sq ft, it is unlikely that barriers to entry will be low enough to alleviate the competition concerns raised by the local overlaps.

Fourth national player

44. In the course of the Safeway inquiry, Morrisons told the CC that it planned to keep all the Safeway stores, other than those it was required to divest.¹¹ In doing so it was expected that a stronger fourth national player would be established, which could potentially increase the rivalry between supermarkets, reduce the

⁹ A1 includes shops, retail warehouses, hairdressers, undertakers, travel agencies, post offices and dry cleaners.

¹⁰ Safeway Report, paras 5.14-5.16.

¹¹ Safeway Report, paras 2.357-2.358.

likelihood of coordination as well as creating a more potent entry threat throughout the UK.¹²

45. Only one of the acquired stores is part of the package that Morrisons was required to divest. Some third parties raised concerns that, by selling these non-divestment stores to Somerfield, Morrison's position as a fourth national supermarket was threatened and the expected advantages set out above could be lost. However, it should be noted that the vast majority of stores acquired in this transaction are smaller stores and so their proportion of total turnover will be lower than by numbers of stores. Moreover, this is a transaction between the fourth and fifth largest national grocery retailers. Therefore, to the extent that the acquisition has an impact, if any, on Morrisons' ability to compete as a fourth national player then it would be beneficial to Somerfield.

VERTICAL ISSUES

46. The issue of upstream buyer power, particularly negotiating strength, was considered at some length in the Safeway Report. The focus there, however, was primarily on the larger supermarket groups. Given that the national impact of this acquisition is limited, it is unlikely to add materially to Somerfield's negotiating strength.

THIRD PARTY VIEWS

47. Third party views in relation to the acquisition were mixed. Some competitors considered the transaction raised competition concerns, while others did not. None of the suppliers that we contacted were concerned about the transaction. We received a number of complaints from individual consumers in relation to certain sites, but we did not receive any submissions from any consumer groups.

ASSESSMENT

48. The transaction gives rise to an overlap in grocery retailing, primarily through mid-range stores.
49. Certain aspects of competition at the national level have been considered. However, the increment to Somerfield's share of supply is small and there remain a number of substantially larger players. The OFT considers that the transaction does not give rise to any competition concerns at the national level, including in terms of upstream buyer power.

¹² Safeway Report, para 2.345.

50. The starting point for the OFT's analysis of the effect on competition at a local level was the CC's methodology in the Safeway Report.
51. In relation to one-stop stores, the analysis identified one area where the acquisition has resulted in three or fewer competing fascia post-acquisition, and therefore, horizontal competition concerns arise.
52. In relation to convenience stores, the analysis identified one area where the acquisition has resulted in no competing fascia post-acquisition and therefore, competition concerns may arise. However, there is evidence to suggest that barriers to entry in convenience retailing are sufficiently low that the potential for new entry would be sufficient to mitigate these competition concerns.
53. The OFT has considered whether it might be possible or appropriate to develop the CC's position in relation to the assessment of competition between mid-range stores at the local level. We proposed a methodology for analysing the scale of competition between stores in this category but there was no consensus amongst third parties (or Somerfield) about the appropriateness of this approach. In light of this, we adopted the CC's methodology for analysing stores smaller than one-stop size, which identified 22 potential 'problem' stores. We examined Somerfield's own analysis that suggested a much smaller number of potential 'problem' stores by modifying certain of the factors in the CC's methodology, such as the effective competitor set. Again, in the absence of consensus about the appropriateness of such modifications, we did not rely on this analysis.
54. 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 being the one area where there is a 'problem' one-stop store and the 22 areas where there are 'problem' stores in the mid-range.

UNDERTAKINGS IN LIEU

55. Somerfield has indicated a willingness to divest the limited number of overlap stores which it considers to give rise to local competition concerns. However, this would not address all of the potential local competition concerns identified by the OFT.

DECISION

56. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.