OFFICE OF FAIR TRADING

Completed acquisition by Costcutter Supermarkets Group of the Symbol Group Business of Palmer & Harvey McLane Limited and creation of a joint buying company

ME/6027/13

The OFT's decision on reference under section 22(1) given on 21 August 2013. Full text of decision published 5 September 2013.

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

PARTIES

1. **Costcutter Supermarkets Group** (**Costcutter**) is a symbol group[1] operator, providing symbol group and wholesale services to approximately 1,600 member stores, through its Costcutter, myCostcutter and Kwiksave brands. Costcutter also owns 23 stores. Costcutter is (indirectly) wholly-owned by Bibby Line Group Limited. Costcutter's turnover in its 2012 financial year was £655.8 million.

2. **Palmer & Harvey McLane Limited** (**P&H**) is a wholesale supplier of tobacco, confectionery, soft drinks, chilled and frozen foods and other groceries, delivering across the UK from 14 depots. P&H also operates and provides symbol group services to approximately 834 stores through its Mace, Supershop and Your Store brands. P&H also owns 10 stores. P&H's turnover in its last financial year ending 6 April 2013 was £4.165 billion, of which the symbol group business being acquired by Costcutter (the '**Mace Business**') generated approximately £[ ] million in the UK.

[1] A group of stores, some of which may operate under a franchise arrangement, and trade under a common fascia (symbol).

TRANSACTION

3. Costcutter acquired the Mace Business on 6 April 2013. This comprises symbol group services to [700-800] stores and accounts for most of P&H's symbol group business. In addition, but as a part of the transaction, Costcutter and P&H entered into a supply agreement for the delivered wholesale supply of products to members of the enlarged Costcutter symbol group and established a 50-50 buying joint venture for the purpose of negotiating terms with suppliers on behalf of P&H. In this decision the transaction comprising these two broad elements are known as the merger. The merger was announced on 13 March 2013.

4. The Office of Fair Trading (**OFT**) opened an investigation into the merger on 11 April 2013. The administrative deadline for a decision is 23 August 2013. The statutory deadline is 31 August 2013.

JURISDICTION

5. As a result of this merger Costcutter and the Mace Business have ceased to be distinct. The UK turnover of the Mace Business 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.

FRAME OF REFERENCE

6. The parties overlap in the supply of symbol group services in the UK. As part of these symbol services, the parties also offer delivered wholesale services to their members.

7. The parties submitted that there is no overlap at the retail level. The OFT notes that Costcutter owns and manages 23 stores across the UK while P&H owns and manages 10 stores in the Bournemouth area. There is no direct retail overlap between the parties. While there is no overlap between the parties at the retail level, the OFT has nevertheless considered the impact of the merger on local retail competition.

8. The parties also submitted that the purchase of goods by wholesalers from manufacturers in the UK is a relevant market for the assessment of this merger. However, given there is no vertical impact and the fact that no third party raised any substantive competition concerns in this respect, the

OFT does not consider it necessary to conduct an assessment of the purchase of goods by wholesalers from manufacturers in the UK.

Product scope

Symbol group services

9. The parties submitted that the relevant market for the assessment of the merger is the supply of symbol group services. Symbol group services include branding the shop fascia of their members, access to own brand products, sourcing other products as a part of the wider buying group, IT and logistical support and promotional support, and wholesale supply of goods.[2] Costcutter and P&H provide symbol group services to their members (typically CTN,[3] convenience, forecourt and mid-size stores).

10. The parties submitted that member stores could self-supply services offered by symbol groups and become non-affiliated independent retailers (that is, they could source their products from alternative wholesale channels such as cash and carry outlets, delivered grocery wholesalers, large multiple retailers and other specialist suppliers).

11. In previous decisions,[4] the OFT considered that delivered wholesale and cash carry wholesale combined form the appropriate product frame of reference. In another case, the Competition Commission (**CC**) distinguished between delivered wholesale and cash and carry services.[5]

12. In this case, while P&H provides delivered wholesale services directly to its member stores, Costcutter sub-contracts its delivered wholesale services to Nisa.[6] As a result, there is no direct overlap between the parties in the supply of delivered wholesale services, over and above the overlap between them in the supply of symbol services. There is no material

[2] While it is possible for symbol group services and delivered wholesale services to be provided by different upstream suppliers (for example, Costcutter and Nisa), in this case such mixed sourcing is only done through the relationship the retailers have with Costcutter.
[3] Confectionery, tobacco and news store.
[4] See Completed acquisition by Musgrave Investments plc of Londis (holdings) Limited, OFT, 30 September 2004 (Musgrave/Londis); and Anticipated acquisition by Musgrave Investments plc of J & J Haslett Holdings Limited, OFT, 12 September 2007 paragraph 15 (Musgrave/Haslett).
[5] A Competition Commission report on the completed acquisition by Booker Group PLC of Makro Holding Limited, 19 April 2013 (Booker/Makro).
[6] On 2 July 2013, Costcutter served Nisa Today's with notice of termination of the existing supply agreement, as a result of which that contract will come to an end on 2 July 2014.

vertical impact arising from the transaction. The OFT has therefore focused on the overlap in supply of symbol group services (noting that an assessment of this takes account of the overlap in wholesaling).

13. The OFT has considered whether members of the parties' symbol groups are able to self-supply symbol group services. Third parties comments suggested that member stores were highly unlikely to switch completely to self-supply in the event that, for example, the prices received from symbol groups increased, mainly because it would make their retail offer less competitive (given individual member retailers do not possess the buying power that the symbol groups possess). In many areas, member stores will not consider using cash and carry wholesalers typically because they were considered too far away, and more costly and inconvenient to use. Further, the vast majority of member stores that responded to the OFT's market testing considered that complete self-supply independent of a symbol group was not feasible.

14. Further, the parties – and symbol groups generally – have contractual restrictions on member stores purchasing products from other suppliers. While these do not enforce exclusivity they limit the extent of partial substitution away from the symbol group as opposed to switching completely from the symbol group to independent self-supply.

15. The OFT notes that while some third party comments confirmed that members of symbol groups in some cases use non-symbol group delivered wholesale operators, cash and carry wholesalers, or specialist local suppliers for a proportion of their supplies, member stores generally did not use other delivered wholesalers outside their symbol group or large multiple retailers[7] (unless in an emergency). Although, one third party competitor did not recognise any distinction between delivered wholesale and cash and carry as many wholesalers offered both.

16. Based on third party comments, taking a cautious approach, the OFT does not consider that retailers replicating all the services of a symbol group through self-supply should be included in the product scope. Nevertheless,

[7] Third party comments did not suggest that large multiple retailers are a viable alternative wholesale channel given products would be purchased at retail prices thereby making retail offers less competitive. This suggests that large multiple retailers do not impose a competitive constraint on the parties' symbol services.

any constraints imposed by self-supply are considered as part of the competitive assessment.

Retail supply of groceries

17. In line with its previous decisions,[8] the OFT has also considered the possible impact of the merger on local retail competition, first, given symbol group operators own and operate local retail stores and, second, wholesale services are provided to competing retailers and such symbol group services explicitly affect the competitive interaction between suppliers and retailers.

18. In its assessment of retail supply of groceries, the OFT has not received any evidence to suggest that the approach adopted in its previous decisional practice to date[9] – in relation to the classification of stores (including petrol kiosks) and the effective competitor set – should be departed from and has therefore assessed the merger on this basis. However, in the absence of competition concerns at the retail level on any basis, the OFT has not found it necessary to conclude on this point.

Conclusion on product scope

19. The OFT does not consider it necessary to conclude on the exact product scope in this case. Therefore for the purpose of this assessment, the OFT has examined the impact of this merger on the supply of symbol group services excluding self-supply of these services by retailers as well as on local retail competition.

Geographic scope

Symbol group services

20. The parties submitted that the geographic scope for the operation of symbol groups is national given the location of member stores spreads across the UK and contractual arrangements with retailers are the same

[8] *Musgrave/Londis, (supra.*, *Musgrave/Haslett, supra.* , paragraphs 33 - 34

[9] See *Completed acquisition by the Midcounties Co-operative Group Ltd of Tuffin Investments Ltd*, OFT, 18 October 2012.; See also, for example, *Anticipated acquisition by Co-operative Group Limited of Somerfield Limited*, OFT, 20 October 2008 (CGL/Somerfield), *Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited,* OFT, 23 September 2010 (Asda/Netto)

across the UK. In addition, the parties stated that there are no significant regional differences in the prices, range or services offered to members, no clusters of stores or variation in brand strength in particular local or regional areas.

21. The OFT has previously assessed a symbol groups merger in both Northern Ireland and UK separately.[10] In a more recent case the CC[11] recognised that there may be limits to the distances that delivered operators will operate from their depots but found delivery limits to be flexible in practice, with number and types of delivered operator varying by region and local area.

22. The OFT received mixed views from third parties on the geographic scope. While most third parties considered the geographic scope to be national, some third party comments suggest that it is regional given some symbol groups have particular strength in some parts of the country due to historical factors. One third party informed the OFT that from a logistics perspective, the geographic scope may be divided into six distinct regions (i.e. England South East and London, England South West, Yorkshire and England Midlands, North Yorkshire and England North, Wales, and Scotland and Northern Ireland).

23. It is not necessary for the OFT to come to a conclusion on the geographic scope given there are no competition concerns arising on any possible frame of reference. For the purposes of the assessment of the competition effects arising from this merger, and adopting a cautious approach, the OFT has considered the impact of the merger on the supply of symbol group services at both the regional and national level.

Retail supply of groceries

24. The OFT has also considered the possible impact of the merger in areas where the parties' symbol (owned and member) stores overlap. The OFT considers that undertaking local area analysis using the geographic scope

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[10] *Musgrave/Haslett, supra.*, paragraph 20. In this case, the overlap between the parties was limited to Northern Ireland.

[11] *Booker/Makro supra*

adopted in previous retail merger cases[12] is appropriate in this case to assess the potential impact of the merger on retail competition.[13]

HORIZONTAL ISSUES

25. The OFT has assessed the potential for competitive harm to arise through unilateral effects in the supply of symbol group services and the loss of local retail competition both between parties' member stores and between Costcutter owned stores and member stores of the Mace Business.

SUPPLY OF SYMBOL GROUP SERVICES

26. The parties overlap in the supply of symbol group services. The OFT has therefore examined evidence on shares of supply and the closeness of substitution between the parties to assess the competition lost as a result of the merger.

27. The parties provided the OFT with the share of supply for symbol group services by number of member stores in the UK based on the Institute of Grocery Distribution ("IGD") data. IGD estimates that more than 16,000 retailers are members of symbol groups. Based on these data, at a national level, the parties have an estimated combined share of supply in symbol group services by number of member stores in the UK of approximately 15 per cent, with an increment of approximately five per cent (Table 1). The OFT does not have precise data on share of supply by value and has therefore considered the share of supply by store concentration as indicative of the parties market position.

[12] See *Midcounties/Tuffins, supra.; and Anticipated acquisition by Co-operative Group Limited of Somerfield Limited,* OFT 20 October 2008

[13] However, the OFT has not considered it necessary to carry out a detailed local analysis given the findings from its market testing discussed further below.

Table 1: Supply of symbol group services in the UK (2012)[14]

Symbol Group	Number of stores	Market Share (per cent, by number of stores)
Costcutter	1,620	10.0
P&H (Mace)	892[15]	5.5
Combined	**2,512**	15.4
Booker (Premier)	2,700	16.6
Bestway (Best One)	2,511	15.4
SPAR UK	2,427	14.9
Musgrave (Budgens, Londis)	2,224	13.7
Landmark (Lifestyle Express)	2,198	13.5
Nisa	844	5.2
Today's	337	2.1
Bargain Booze (Select Convenience)	184	1.1
Filshill (Keystore)	160	1.0
Select and Save	85	0.5
VG/VIVO (NI)	83	0.5
TOTAL	**16,265**	**100.0**

Source: IGD/William Reed Business Media – The Grocery Retail Structure Report 2012. OFT analysis

28. Most third party comments suggested that there were many symbol groups competing with the parties in the UK. The OFT also notes that five symbol group operators remain that are of a similar size to the parties post-merger. The OFT considers that these symbol group operators will continue to impose significant competitive constraints on the parties. In addition to the five similar-sized competitors, Nisa will continue to be an alternative wholesaler in areas where Costcutter and P&H are active since Costcutter uses Nisa as its wholesaler in all these areas pre-merger.

[14] Wholesale services are a key part of a symbol group's offer. The parties are both active in the supply of delivered wholesale services, albeit Costcutter sub-contracts its wholesale services to Nisa. IGD data estimates P&H's share of wholesale supply in the UK to be 16 per cent. Based on IGD data, the OFT estimates that Costcutter has a share of supply for wholesale services of three per cent OFT analysis based on IGD data. The OFT estimates that Costcutter accounts for no more than one third of Nisa's wholesale services. Accordingly, the parties' estimated combined share of supply is 19 per cent with an increment of three per cent.

[15] Costcutter will only take control of the direct supply of symbol group services to [ ] Mace member stores. However, the OFT has included all P&H member stores in estimating parties' share of supply on a cautious basis given P&H will manage the symbol group arrangements for the remainder 'mini-multiple' stores using the Mace retail value proposition developed by Costcutter.

29. At a regional level, the OFT does not have precise share data.[16] One competitor explained that the parties have a stronger presence in the Midlands and Yorkshire area. But even in this area, the parties' share of supply was estimated to be around 30 to 33 per cent by store concentration.

Closeness of competition

30. The parties noted that they compete with other symbol groups to recruit and retain members of symbol groups. The parties provided the OFT with data on switching by member stores between symbol groups in the last five years to support their submission.

31. The OFT notes that the level of switching between symbol groups was limited between 2008 and 2012.[17] In particular, over this period, [five-15] per cent of Mace member stores[18] that switched to a known symbol group switched to Costcutter while [0-10] per cent of Costcutter member stores switched to Mace. Nevertheless, the OFT's market testing suggested that the vast majority of symbol group members considered that it was relatively easy to switch symbol group. They explained that they could either switch at the end of their contract (typically three to four years long) or by giving notice (up to six months) and repaying the balance of any store investment.

32. The parties' switching data suggests that [ ] may be closer competitors to Costcutter. Similarly, it suggests that [ ] are closer competitors to Mace. This is on the basis that there is more switching away from Costcutter and Mace to these symbol groups than there is switching between the parties.

33. In addition, third party responses did not suggest that the parties are close competitors with a number pointing, conversely, to the parties being differentiated and other symbol group competitors exerting a stronger constraint on the parties than they do on each other. This is consistent with the parties' internal documents.

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[16] The parties do not have data that provides a regional breakdown of their share of symbol group services.
[17] The OFT analysis estimates that for Costcutter the average churn rate of leavers switching symbol group or becoming non-affiliated is [0-10] per cent, while the average churn rate for the Mace Business is [five-15] per cent.
[18] A member of the Mace Business.

Conclusion

34. In light of the limited switching between the parties, their low share of supply, the number and strength of competitors post-merger, the ease of switching and third party comments, the OFT does not consider there to be a realistic prospect of a substantial lessening of competition in the supply of symbol group services at a national or regional level.

LOCAL RETAIL COMPETITION BETWEEN MEMBER STORES

35. The OFT considered whether the merger could reduce local retail competition between retail members of the parties' symbol groups in areas where the parties' member stores overlap, despite these members' stores neither being owned nor operated by the parties. The OFT notes that this could happen if the parties increased wholesale prices or reduced the quality of members' retail offer at the local level.[19] The OFT therefore considered the degree of control conferred on the symbol group through the contractual arrangements with their members and the extent to which the symbol group may facilitate coordination at the retail level through, for example, recommended retail prices.[20]

36. The parties submitted that the merger will not affect local retail competition because Costcutter is not acquiring any retail stores from P&H. The parties argued that members independently own and manage their stores, make their own decisions on choice of symbol group supplier, retail price, product range, quality and service, and are free to choose what promotions to offer. The parties also noted that members have viable alternative sources of supply, and as such any increase in wholesale prices or reduction in quality of members retail offer would result in members switching to other symbol groups or alternative wholesale channels.

37. The parties also argued that their retail value proposition and prices are set at a national level and that there was an insufficient number of overlap areas where their members faced limited competition to justify changing their national offering. The parties further argued that entry of small scale

[19] The OFT has considered buyer groups in mergers assessment in a number of grocery retail cases involving the Cooperative Group. See, for example, *Midcounties/Tuffins, supra.*
[20] The symbol group would effectively allow members to coordinate at the wholesale level with increased wholesale prices with the increased input prices reimbursed from suppliers to retailers (through, for example, rebates).

convenience stores would be high. They therefore submitted that this entry would undermine any attempt by the parties to lessen competition at the retail level.

38. However, the OFT notes that the parties' contracts with member stores do not appear to corroborate their submission in relation to independence of member stores and their ability to use alternative wholesale channels. Certain provisions in these contracts suggest that the parties exert significant control over their members. In particular, both parties' contracts impose significantly high ([ ]) minimum purchasing obligations on member stores and an obligation to take up all promotions. The OFT considered that these contractual agreements with member stores may facilitate stability of any coordinated outcome, depending on the ability and incentives of member stores to source from outside their symbol group arrangements, for example, to obtain lower input prices. The OFT notes that this is dependent on the strength of the vertical restraints[21] in place between the symbol group and the member stores which could limit the retailers ability to deviate from a coordinated outcome.

39. In order to test the parties' submissions and the theories of competitive harm in this case, the OFT conducted a local area analysis. The OFT found that the parties' member stores overlap in [ ] of the [700-800] local areas where there is a Mace member store within a 10-minute drive time of a Costcutter member store. Of these [ ] local areas, the parties identified 42 local areas where the parties will face limited competition.[22] The OFT therefore focussed its analysis on these local areas.

40. Third party member stores corroborated the parties' submission that member stores are independent and have viable alternative sources of supply. Third party responses to the OFT's enquiries indicated that parties provide advice and influence the store design, but the decision on management and operation of stores is made by the retailers. The large majority of the member stores emphasised their independence and provided the OFT with examples of instances where they have departed from the

[21] In particular, the extent to which any exclusivity arrangements or minimum purchasing requirements in the contracts can be or are enforced in practice and any rebate schemes
[22] This would be the case where there is reduction in competing fascia from four to three or worse post-merger. The OFT has adopted broadly the same effective competitor set as in its recent retail cases including *Anticipated acquisition by Co-operative Group Limited of David Sands Limited*, OFT, 16 April 2012; *Anticipated acquisition by Co-operative Group Limited of Somerfield Limited*, OFT, 20 October 2008.

advice given by their symbol group or purchased products from alternative wholesale channels.

41. The parties also provided data on members purchasing loyalty. In this regard, the parties estimated that overall purchasing loyalty amongst their symbol group members was [ ] per cent.[23] Third party competitors informed the OFT that retailers use a range of wholesale sources despite contractual provisions against this. One competitor for example believed that their member stores purchased only 50 per cent of their requirements from them. Other competitors indicated that their 'loyalty rate' was around 70 to 75 per cent. Estimates from the parties' members indicated their relative spend with the parties typically varied from 60 to 90 per cent of total purchasing requirements.

42. Third party customers noted that if the parties increased their wholesale prices, that they would change symbol group or, in some cases, self-supply such services. Their comments suggest that higher recommended retail prices or rebates would be ineffective at stopping them from switching.

43. Some third party competitors suggested that the merger could, in theory, reduce retail competition in specific local areas where the parties' fascia would face limited or no competition post-merger. However, as noted, the large majority of third party comments suggest that there would be no reduction in competition in such circumstances given the independence of member stores and their ability to differentiate their offerings.

44. The OFT considers that the parties would have to engage in bespoke strategies in certain local areas to successfully reduce local retail competition. For the reasons set out above, the OFT considers that it would be very difficult for parties to profitably increase wholesale prices or reduce the quality of retail offer to its member stores, even to those member stores in the 42 local areas identified by the parties as having fascia reduction from four to three or worse post-merger.

45. In light of the available evidence, the OFT does not consider there to be a realistic prospect that the merger will result in substantial lessening of competition between member stores at the local retail level.

[23] Costcutter had specific data which showed a purchasing loyalty rate of [ ] per cent (based on a sample of [ ] per cent of Costcutter stores [ ]). That is, on average [ ] per cent of Costcutter members wholesale spend was 'leakage' from other sources outside the symbol group.

LOCAL RETAIL COMPETITION WHERE COSTCUTTER OWNS STORES

46. The OFT has considered whether the merger could reduce local retail competition in the 23 areas where Costcutter owns and operates stores. The OFT notes that this could happen in local areas where there is limited or no competition around a Costcutter owned and managed store overlapping with a Mace store. The OFT considered whether Costcutter could increase its profits by raising its retail prices or reducing the quality of its retail offer in a Costcutter owned and managed store. This might be a profitable strategy if a proportion of the retail sales lost would be recaptured by the local Mace stores. As such, Costcutter might recoup any profit lost on retail sales from increased sales at the wholesale level.

47. The parties' data shows that only five Costcutter owned and managed stores overlap with a Mace store within a 10-minute drive time. The parties submitted that their incentive to worsen their offer in these areas was weakened by the [ ] of Mace's members in the area and the fact that the Mace members could change symbol group. As such, they submitted any lost sales at the retail level would not necessarily translate into recaptured sales by Costcutter at the wholesale level. In addition, they argued any recaptured sales would generate a lower variable profit margin at the wholesale level when compared to what it could generate at the retail level.

48. The OFT notes that in these areas, there are at least three other independent and effective competitor stores within a five minute drive from the Costcutter owned and managed stores. In light of this, the OFT considers that in the overlap areas there are a sufficient number of competitors for there not to be local retail concerns.

49. The OFT further considered whether Costcutter might have greater incentives to increase its wholesale prices (and so its margins) to member stores in the expectation that a proportion of any displaced sales will be recaptured by a local Costcutter owned and managed store. In light of the available evidence, the OFT considers that the parties would have no ability or incentives to engage in this behaviour given the analysis outlined above.

THIRD PARTY VIEWS

50. In this case, the OFT contacted members of the parties' symbol group, wholesale customers, symbol group competitors of the parties, cash and carry wholesalers, large grocery retailers and suppliers. Some competitors raised concerns regarding the merger. Almost all customers had no concerns about the transaction. Most customers were supportive of the merger because they considered it would result in lower wholesale prices given the parties' increased buying power post-merger. Third party views have been incorporated where relevant in the decision.

ASSESSMENT

51. The parties overlap in the supply of symbol group and delivered wholesale services offered by symbol groups in the UK, albeit Costcutter sub-contracts its delivered wholesale services to Nisa. The OFT has assessed the merger on the basis of supply of symbol group services at the national level. The OFT has also considered the potential impact of the merger on local retail competition.

52. The OFT found that in relation to the supply of symbol group services, the parties will continue to face competitive pressure from the remaining main symbol group competitors and alternative wholesale channels, in areas where these are present. In addition, the switching data and third party comments suggest that parties are not close competitors and member stores could easily switch to alternative sources of supply. On that basis, the OFT did not consider there to be a realistic prospect that the merger may result in a substantial lessening of competition in the supply of symbol group services either nationally or on a more regional basis.

53. As regards the potential impact of the merger on local retail competition, the OFT found that the parties would not have an incentive to increase prices, reduce the quality of retail offer or facilitate co-ordination given the independence of member stores, their ability to differentiate their offerings and the risk that they would switch to another symbol group. On that basis, the OFT did not consider there to be a realistic prospect that the merger may result in a substantial lessening of competition locally.

54. Consequently, the OFT does not believe 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.

DECISION

55. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.