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Anticipated acquisition by Co-operative Group Limited of Plymouth & South West Co-operative Society Limited

ME/4160/09

The OFT's decision on reference under section 33 given on 4 September 2009.  
Full text of the decision published 22 September 2009.

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

**PARTIES**

1. **Co-operative Group Limited (CGL)** is the UK's largest co-operative society. With 4.5 million members, it has trading interests in a number of sectors including banking, insurance, travel, funeral service provision, farming, food retail, legal services and pharmacies.
2. **Plymouth and South West Co-operative Society Limited (PSW)** comprises approximately 175,000 members and is a business with diverse trading interests in a number of sectors, with its primary focus on food retail and funeral service provision. The geographic scope of PSW's activities has traditionally been confined to its membership heartland in the South West of England. PSW's turnover for the year ending 24 January 2009 was approximately £154 million, all within the UK.

**TRANSACTION**

3. PSW is proposing to transfer its engagements to CGL under section 51(1) of the Industrial and Provident Societies Act 1965 (the Transaction). The Transaction has been approved by the members of PSW and it is anticipated that completion will occur (subject only to registration by the Financial Services Authority) on 6 September 2009.

4. The OFT received a satisfactory submission by CGL on 30 June 2009 and the administrative deadline is 4 September 2009.<sup>1</sup>

## **JURISDICTION**

5. As a result of this transaction CGL and PSW will cease to be distinct. The UK turnover of PSW 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **COMPETITIVE ASSESSMENT**

6. CGL and PSW (Parties) overlap in the provision of funeral services, grocery retailing and petrol forecourts.

## **SECTION ONE: FUNERAL SERVICES**

### **Product scope**

7. The Parties overlap in the provision of funeral directing services, including services provided by the funeral director<sup>2</sup> as well as services offered by others (including cemetery or crematoria services) for which funeral directors are also responsible. 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.<sup>3</sup>
8. The Parties also overlap in the supply of mortuary services. On the basis of the evidence provided to the OFT the Transaction does not raise any competition issues in the supply of mortuary services. The remainder of this section therefore focuses on the supply of funeral services to individuals.

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<sup>1</sup> The parties requested that the OFT not rigidly adhere to its administrative timetable so that the grocery retailing issue in Bideford (see below) could be resolved. In accordance with paragraph 4.66 of its Jurisdictional and Procedural Guidance, therefore, the OFT agreed to an extension of the administrative deadline by eight working days.

<sup>2</sup> Such as providing a coffin and managing the funeral.

<sup>3</sup> In both cases the service provided is the same and will therefore be considered together within the same product scope.

## Geographic scope

9. Information provided by the Parties and third parties in this case suggests that the market for funeral services to individuals is local.<sup>4</sup>
10. Following the approach developed in CGL/Fairways<sup>5</sup> and accepted by the OFT in CGL/United<sup>6</sup> and CGL/Lothian<sup>7</sup>, the analysis by the Parties was carried out as follows:
  - the Parties' shares of supply was calculated on the basis of the number of funerals they conducted (as a proportion of recorded deaths) within a local market defined by a series of contiguous postcode areas within which 80 per cent of the funerals of the reference branch are performed, and
  - the Parties' share of supply based on funerals performed by all competitors within a 5 miles radius of the reference branch in locations where the Parties overlap at 5 miles.
11. As an additional cross-check, the Parties have verified whether the other party is the reference branch's closest competitor.

## HORIZONTAL ISSUES

### Local assessment

12. Consistent with past precedent the OFT has adopted a 25 per cent threshold for share of deaths as a first screen to identify areas which will give rise to prima facie competition concerns.
13. On the basis of the methodology described in paragraph 10 above<sup>8</sup>, the Parties overlap in 19 local areas namely, Bideford, Callington, Dawlish, Ivybridge, Launceston, Newton Abbot (Albany Street), Newton Abbot, (Kingsteignton), Paignton (Dartmouth Road), Plymouth (Crownhill), Plymouth (Devonport), Plymouth (Exeter Street), Plymouth (Plymstock),

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<sup>4</sup> 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 and subsequent OFT decisions.

<sup>5</sup> *Completed Acquisition by the Co-operative Group (CWS) Limited of Fairways Group UK Limited*, 19 July 2006.

<sup>6</sup> *Anticipated merger between Co-operative Group (CWS) Limited and United Co-operatives Limited*, 23 July 2007.

<sup>7</sup> *Anticipated acquisition by Co-operative Group Limited of Lothian Borders and Angus Co-operative Society Limited*, 6 March 2009.

<sup>8</sup> In particular, on the basis of the first methodology described in paragraph 10 above, as the Parties have submitted that there was also no overlap between these CGL and PSW funeral homes on a five mile basis in these areas.

Plymouth (St Budeaux), Saltash, South Molton, Teignmouth, Torquay, Totnes (Moreleigh) and Totnes (Stoneleigh).

14. Analysis of these overlap areas indicates that the increment in 17 of the above local areas did not exceed both [0-10] per cent and [1-10] funerals.<sup>9</sup> Consistent with OFT precedent,<sup>10</sup> these increments are not considered indicative of significant competitive interaction between the Parties.
15. The Parties submitted that there are only two PSW locations – Bideford and Dawlish – in which competition concerns may arise.

#### Dawlish

16. PSW Dawlish lies within 5 radial miles of CGL Dawlish, but is, in fact, some distance by road – approximately 19 miles (40 minutes' drive) around the Exe Estuary. The Parties submit that the only potential overlap in the provision of funeral services is between PSW Dawlish and CGL Exeter, over 10 miles away. PSW Dawlish and CGL Palmers Exmouth do not conduct any funerals in the same postcodes, but PSW Dawlish and CGL Exeter do.
17. The combined share of supply around PSW Dawlish on an 80 per cent catchment basis is [25-35] per cent with an increment of [0-10] per cent. Around CGL Exeter the overlap is smaller, with a combined share of supply of [5-15] per cent with an increment of [0-10] per cent.
18. The OFT notes that the 25 per cent 'rule of thumb' is a conservative threshold, particularly given that competition between funeral homes has been noted to be muted. However, it provides a useful initial basis for assessing whether overlaps can be ruled out of giving rise to a substantial lessening of competition, thereby allowing the OFT to concentrate its analysis on the remaining overlap areas. In respect of Dawlish, the OFT notes the following:
  - the combined market share in the 80 per cent catchment area is only marginally above 25 per cent with a small increment of [0-10] per cent
  - PSW Dawlish and CGL Exeter are 10 miles apart (with a drive time of 27 minutes)

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<sup>9</sup> In only one local area – South Moulton – was the increment over [0-10] per cent. In this area an increment of [0-10] per cent was equivalent to [1-10] funerals.

<sup>10</sup> *CGL/United*, paragraph 69.

- looking at the individual postcode bricks that make up the 80 per cent catchment area suggests that competition concerns only arise in one postcode brick, namely EX6 8. The OFT notes that there are five competitors to the Parties within a five mile radius from the centre of EX6 8, and
- the parties are not each other's closest competitors by distance, as the CGL Exeter branch is 10 miles from the PSW Dawlish branch. In addition, PSW Dawlish faces competition from five independent funeral homes that are closer to it than CGL Exeter (three of these are within five miles). CGL Exeter also faces competition from three independent competitors (all within five miles) that are closer to it than PSW Dawlish.

19. The combination of the above factors led the OFT to the conclusion that despite the fact that the acquisition of the Dawlish PSW branch failed this initial filter, there was no substantial lessening of competition in the Dawlish area.

#### Bideford

20. PSW Bideford overlaps with the CGL branches in Great Torrington and Braunton. The combined share of supply within an 80 per cent catchment of PSW Bideford is [30-40] per cent, with an increment of [0-10] per cent. The shares of supply on the same basis around the CGL Great Torrington and Braunton branches are [30-40] per cent and [40-50] per cent, with increments of [5-15] per cent and [0-10] per cent respectively.<sup>11</sup>

21. The OFT notes that the Great Torrington branch is the closest CGL to the PSW Bideford branch, but that they are not each other's closest geographic competitors. However, on the basis of the information available to it, it considers that there is a realistic prospect of a substantial lessening of competition in funeral services in the Bideford area as a result of the Transaction.

#### Conclusion

22. In Dawlish, while the merger nominally fails the market share tests espoused by the OFT in previous cases, the OFT was able to point to additional factors which suggested that there was no substantial

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<sup>11</sup> The increment around the CGL Braunton branch is mainly due to the overlap with PSW Bideford although there is a small overlap with PSW Barnstable. PSW Barnstable, however, conducted a total of only [1-10] funerals in 2008, [1-10] of which were in the area overlapping with the CGL Braunton branch. The increment around the CGL in Great Torrington is entirely due to the overlap with PSW Bideford.

lessening of competition in the provision of funeral services in that area. In Bideford, however, the OFT was unable to identify such information and, given that the increments in market shares were less modest than those in Dawlish, the OFT believes that there is a realistic prospect of a substantial lessening of competition in the provision of funeral services in that area.

### **Barriers to entry**

23. In past decisions the OFT has found that barriers to entry to funeral services are relatively low. In this case, however, the OFT has not received any evidence that entry is sufficiently timely or likely to remedy any competition concerns in the above areas.

### **SECTION TWO: GROCERY RETAILING**

24. The Parties are both active in the retail supply of groceries in the South West of England.
25. Grocery retailing has been examined extensively in recent years by both the OFT and Competition Commission (CC).

### **Product scope**

26. For the purposes of initial filtering analysis and fascia counting, the Parties followed the approach to the product market as recently defined in CGL/Somerfield.<sup>12</sup>
27. In that case, OFT adopted an effective competitor set and applied store size bands as outlined by the CC in the Groceries report<sup>13</sup>. In particular, the CC identified two major product markets for the supply of groceries by grocery retailers in the UK that are relevant to this case:

**Mid-size stores:** those with a net sales area of less than 1,400 square metres but above 280 square metres. These stores are constrained by other mid sized stores as well as one-stop stores and so one-stop stores must be included in any market definition with mid size stores as its focus, and

**Convenience stores:** those with a net sales area of less than 280 square metres. These stores are constrained by all grocery stores and so the product

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<sup>12</sup> *Anticipated acquisition by Co-operative Group Limited of Somerfield Limited (CGL/Somerfield) (2008).*

<sup>13</sup> *Market investigation into the supply of groceries in the UK (Groceries report) (2006).*

market focussed on convenience stores must also include mid size and one-stop stores.

28. The CC further considered that a number of grocery retailers (such as limited assorted discounters (LADs), frozen food retailers and specialist grocery retailers) may fall outside the product markets identified above due to their limited product range.

### **Geographic scope**

29. Previous CC and OFT reports into grocery retailing have found that there are both national and local aspects to competition. The Parties proposed that, in line with the CC Groceries report and CGL/Somerfield, for the local dimension of competition, the appropriate measures were:

**For mid size stores:** 5 minute drive time in urban areas and 10 minutes drive time in rural areas but these stores are also constrained by one-stop stores within a 10 minute drive time (or a 15 minute drive time in rural areas), and

**For convenience stores:** 5 minutes drive time in all areas but constrained by one-stop stores within a 10-minute drive time (or a 15 minute drive time in rural areas) and by mid size stores within a 5-minute drive time (or a 10 minute drive time in rural areas).

30. The Parties have followed this approach in their submission to the OFT.

### **HORIZONTAL ISSUES**

#### **National competition**

31. When considering the merger effect at the national level it is appropriate to consider the merged entity's share of supply across all store sizes combined since national competition does not take place according to the size of an operator's retail stores. On this measure, after the merger the transaction will result in an increment to CGL's national market share of significantly less than one per cent.

32. In light of this the OFT does not consider that competition concerns arise at a national level as a result of this merger.

#### **Local competition**

Stage 1

33. In its submission to the OFT, the Parties followed the methodology set out in Annex 1 of CGL/Somerfield in filtering out those stores where no competition concerns could arise on any plausible candidate market: this involves finding any overlap in the 'maximum reach isochrone' (the maximum area of geographic overlap, essentially), and then filtering in the 'primary isochrone' (centred on the PSW store) on all relevant competitors identified in the primary isochrone, on all population centres in the primary isochrone (for one-stop and mid size stores only), and on all census output areas in the primary isochrone (for one-stop and mid size stores only).

#### Mid range stores

34. At the initial screen stage, a total of 10 mid range PSW stores were identified as requiring stage 1 isochrone analysis. On the basis of a 4 to 3 or fewer fascia reduction count:
- at the primary isochrone stage no stores were identified
  - at the competitor re-centring stage, no stores were identified
  - at the population re-centring stage, one store was identified, and
  - at the output area re-centring stage, no additional stores were identified.
35. At the time when the Transaction was notified to the OFT, only one PSW store failed the stage 1 analysis. This was the PSW store in Bideford, which overlapped with a former Somerfield store in that local area.

#### Pre-existing divestment obligation in Bideford

36. The OFT notes that CGL is already subject to a pre-existing divestment obligation under the CGL/Somerfield undertakings in lieu (UILs) in respect of the former Somerfield store in Bideford.<sup>14</sup> The OFT, however, did not consider the existence of the obligation under the CGL/Somerfield UILs to be sufficient in itself to prevent a realistic prospect of a substantial lessening of competition from arising in respect of this case, given that (a) this is a distinct case on which the OFT needs to decide whether there is a realistic prospect of a substantial lessening of competition (on the basis of current circumstances), and (b) CGL had not identified a suitable purchaser for the Somerfield store in Bideford so that that remedy had not yet been implemented.

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<sup>14</sup> CGL was not given the choice to divest the PSW store in Bideford given that it did not own PSW at the time.



## Inevitability of exit of the PSW Bideford store

37. During the course of the OFT's investigation, the Parties submitted that in its analysis the OFT should take into account the fact that the PSW Bideford store would exit from the market and that this exit was independent of, and causally unrelated to, the merger.<sup>15</sup> PSW explained that the exit was because the PSW store had been unable to operate profitably since the opening of a new one-stop Asda store in very close proximity to it. In addition, PSW submitted to the OFT that while it had investigated the possibility of re-locating to another site, this had not been considered to be a viable option.<sup>16</sup>
38. The Parties submitted detailed evidence indicating the impact on the store's profitability since the opening of the new Asda in Bideford in July 2008. The evidence shows that there has been a significant decrease in the store's revenues since July 2008 which has continued up to present time. In addition, PSW submitted a set of Board minutes (dating from prior to the merger) showing PSW's efforts to either sell the store or to surrender the lease of the store to the landlord. The Board minutes of July 2009 indicate that PSW was willing to pay up to £[ ] in order to either surrender the lease or sell the store which the OFT considers a strong indication that PSW definitely viewed exit as the only feasible course of action.<sup>17</sup> On the basis of the compelling evidence presented, the OFT was therefore confident that, in the absence of the merger, PSW would have exited from the Bideford area.
39. The OFT therefore considered what would have happened to the store in the absence of the merger, and in particular whether PSW would have sold the store onto another grocery operator. PSW confirmed that it had indeed sought to transfer its lease to another grocery operator but that it had been unable to find an alternative purchaser for the store or a suitable tenant to whom to sub-lease the premises. PSW provided evidence to the OFT that, despite it having approached those grocery retailers that it regarded as the most likely purchasers for the store, it had been able to attract interest from only one purchaser, however, the terms of the existing lease held by PSW were not attractive to that operator. Therefore, PSW had concluded that the only option available to it (despite its obligation, when considering store closures, to try to find a solution that will result in the fewest job losses to the store's employees) was to

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<sup>15</sup> CGL had clearly not been in a position to raise this point at the time of the *CGL/Somerfield* transaction given that it did not know of PSW's intention to exit this area.

<sup>16</sup> This was the case despite the fact that the PSW Board is under an obligation, when considering store closures, to try to find a solution that will result in the fewest job losses to the store's employees.

<sup>17</sup> The OFT understands that the lease for the Bideford premises would have expired in [ ] and the annual rent was [ ] PSW was therefore willing to pay [ ] in order to release itself from the lease given the level of losses it was experiencing in its Bideford operations.

surrender the lease to the landlord. The OFT considered that the evidence provided to the OFT by PSW in this regard was compelling.

40. The OFT therefore concluded that the only realistic circumstances under which a grocery store would have continued operating from that location were if PSW were to surrender the lease and the landlord were to sell his interest to a third party grocery purchaser or was able to agree a new lease for the premises to a third party grocery tenant. The question for the OFT was therefore whether the merger could reduce this possibility from occurring so as potentially to lead to a substantial lessening of competition.
41. Towards the end of the OFT's investigation, PSW entered into an agreement with the landlord of the Bideford store to surrender the lease and completion of the surrender took place on 3 September 2009. PSW paid the landlord £[ ] in order to surrender the lease.
42. As the surrender of the lease took place prior to the completion of the Transaction, the OFT's view is that this removed any prospect of a substantial lessening of competition resulting out of the Transaction. As a result of the surrender, CGL lost any ability to influence the future of the PSW Bideford store in a way that could reduce competition in the Bideford area (that is, by either running the store itself or by ensuring that the premises are sub-let/sold to a non-grocery retailer). The OFT has, in respect of this, reviewed the surrender documentation and is satisfied that it does not limit or influence the landlord's ability to lease the property to another grocery retailer.
43. In addition, the OFT considers that the landlord's incentives would be to lease the premises to another grocery retailer as quickly as possible. A grocery retailer would be expected to be the most attractive option for the landlord as it would take advantage of the existing premises and would be able to occupy the premises immediately given that the store is already laid out in a grocery retailer format.<sup>18</sup>

## Conclusion

44. On the basis of the above, therefore, the only prospect for a substantial lessening of competition arising in the existing potentially problematic overlap between the parties was removed prior to the OFT's decision. The Transaction, therefore does not give rise to a substantial lessening of competition in relation to grocery retailing in any local area in the United Kingdom.

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<sup>18</sup> The OFT notes that [ ].

### **SECTION THREE: PETROL FORECOURTS**

45. CGL operates 231 petrol forecourts located throughout the UK. PSW operates 3 petrol forecourts namely in Kingsbridge, Marlborough and Staddiscombe.
46. CGL has tested the overlap in fuel sales, by applying the test used by the OFT in Tesco/21 BP/Safeway<sup>19</sup>, namely examining the fascia present within 3 radial miles of each acquired site.
47. With regard to Kingsbridge and Marlborough, there is no overlap between PSW and CGL petrol forecourts at 3 radial miles. CGL has also confirmed that there are no overlaps between these PSW locations and CGL at 5 radial miles. With regard to Staddiscombe, a CGL forecourt is located 2.8 miles from the PSW location. The fascia count at 3 miles would be 8-to-7 (applying a 5 mile isochrone, this would be 11-to-10), confirming that the Transaction would not give rise to any competition concerns in this local area.
48. The OFT does not therefore believe that the Transaction gives rise to a substantial lessening of competition in respect of petrol forecourts in the local areas identified above.

### **THIRD PARTY VIEWS**

49. No third parties expressed any competition concerns in respect of this transaction.

### **ASSESSMENT**

50. The Parties overlap in grocery retailing, funeral homes and petrol forecourts. There are no problematic overlaps in respect of petrol forecourts.
51. As regards funeral homes, in Dawlish, while the merger nominally fails the market share tests espoused by the OFT in previous cases, the OFT was able to point to additional factors which suggested that there was no substantial lessening of competition in the provision of funeral services in that area. In Bideford, however, the OFT was unable to identify such information and, given that the increments in market shares were less modest than those in Dawlish, the OFT believes that there is a realistic prospect of a substantial lessening of competition in the provision of funeral services in that area.

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<sup>19</sup> *Anticipated acquisition by Tesco Stores Limited of former BP/Safeway petrol forecourts and stores from Wm Morrison Supermarkets plc, 24 October 2005.*

52. In respect of grocery retailing, at the time when the Transaction was notified to the OFT, only one PSW store failed the stage 1 fascia count analysis. This was the PSW store in Bideford, which overlapped with a former Somerfield store in that local area.
53. The OFT notes that CGL is already subject to a pre-existing divestment obligation under the CGL/Somerfield UILs in respect of the former Somerfield store in Bideford. The OFT, however, did not consider the existence of the obligation under the CGL/Somerfield UILs to be sufficient in itself to prevent a realistic prospect of a substantial lessening of competition from arising in respect of this case, as this is a distinct case (which needs to be decided under current circumstances). In addition CGL informed the OFT that it had not yet located an appropriate buyer for the Somerfield store in Bideford so that that remedy had not yet been implemented.
54. The Parties initially submitted to the OFT that absent the Transaction, the PSW Bideford store would have closed in any event since it was heavily impacted by the opening of a new Asda store in very close proximity to it. During the course of the OFT's investigation, PSW informed the OFT that it had surrendered the lease to the landlord as it was unable to return the Bideford store to a profitable status and had been unable to locate another suitable tenant for the premises. Completion of the surrender took place on 3 September 2009.
55. The OFT's view is that since the surrender of the lease took place prior to the completion of the Transaction, this removed any prospect of a substantial lessening of competition resulting from the Transaction in respect of grocery retailing. As a result of the surrender, CGL lost any ability to influence the future of the PSW Bideford store in a way that could reduce competition in the Bideford area (ie by either running the store itself or by ensuring that the premises are sub-let/sold to a non-grocery retailer).
56. 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 in the United Kingdom.

## **UNDERTAKINGS IN LIEU**

57. 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.
58. 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, 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.' (para 8.3).
59. The parties indicated that in order to remedy any competition concerns 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 a divestment package for the funeral sector in Bideford. The extent to which the divestment package is 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 decisional practice, is addressed in turn below.

### **Divestment(s) – funeral services**

60. The Parties offered to divest either (a) the PSW Bideford funeral home; or (b) the CGL Great Torrington and Braunton branches in order to remedy the competition concerns arising in these areas. The OFT considered that either of these options would constitute an appropriate remedy given that no material overlap remains between PSW and CGL in the Bideford area.<sup>20</sup>

### **Impact on undertakings in lieu for CGL/Somerfield merger**

61. The exit of the PSW Bideford store from the market constitutes a change in circumstance in relation to the undertakings in lieu accepted by the OFT in the CGL/Somerfield merger so that there would be no overlap resulting from the merger.

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<sup>20</sup> See footnote 11 above.

62. The OFT, therefore, proposes to vary the undertakings in that case so as to release CGL from its obligation to sell the Somerfield store in that area as, under current conditions, there is no substantial lessening of competition following either the CGL/Somerfield merger or the Transaction.

**Divestment(s) - conclusion**

63. The OFT considers that the undertaking offered in respect of funeral services in Bideford is clearly capable of addressing the competition concerns identified.
64. The OFT considered whether it was appropriate in the circumstances of this case to require that the relevant divestment(s) be made to an up-front buyer or buyers. However, the OFT concluded that an up-front buyer requirement was not necessary in this case, as there are a number of large and smaller purchasers able to acquire the divested asset(s) and that might be expected to be interested in doing so.

**DECISION**

65. The OFT has therefore decided to refer the anticipated acquisition by CGL of PSW to the Competition Commission pursuant to section 33 of the Act. However, the OFT's duty to refer is suspended because the OFT is considering whether to accept undertakings in lieu of reference from CGL pursuant to section 73 of the Act.