Anticipated acquisition by Shell UK Limited of 253 petrol stations from Consortium Rontec Investments LLP

ME/5191/11

The OFT's decision on reference under section 22(1) given on 3 February 2012. Full text of decision published 13 February 2012.

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. **Shell UK Limited (Shell)** is a wholly owned subsidiary of the Royal Dutch Shell Group. The Group is active in the worldwide exploration, production and sale of oil and natural gas, the production and sale of oil products and chemicals, power generation and the production of energy from renewable sources. The Group's downstream business is active in the refining of crude oil into a range of refined products that are marketed around the world for domestic, industrial and transport use. Marketing activities include the retail of motor fuels and related products.

2. **Rontec Investments LLP** (Rontec) is a special purpose joint venture partnership between GMR Capital Limited (GMR), Investec plc (Investec), Grovepoint Capital LLP and others, set up to acquire the retail fuel network of Total in the UK, Isle of Man and Channel Islands made up of 810 Total branded sites.

3. **The Target Business** comprises 253 petrol stations; 241 previously owned and operated by Total which were acquired by Rontec Investments and sold on to Shell, nine previously owned by Total but operated by dealers, and the rights to supply three which are dealer owned and operated. The UK turnover of the target business in 2010 was approximately £[ ] million.

TRANSACTION

4. Shell acquired the target business from Rontec for approximately £252.4 million. The transaction completed on 1 November 2011 and Shell provided Initial Undertakings to the OFT pursuant to section 71 of the Enterprise Act 2002 (the Act) on 2 November 2011for the purpose of preventing pre-emptive action.

JURISDICTION

5. The transaction qualified for investigation under the EU Merger Regulation (EUMR).[1] Shell made a request under Article 4(4) of the EU Merger Regulation for the transaction to be referred in whole to the United Kingdom. The OFT informed the European Commission on 20 July 2011 that it agreed with the referral request. The Commission then referred the transaction for investigation to the OFT on 1 August 2011.[2] The statutory deadline for a decision, as extended, is 3 February 2012.[3]

6. The OFT believes that as a result of this transaction Shell and the target business have ceased to be distinct. The annual UK turnover associated with the target business exceeds £70 million so the turnover test in section 23(1)(b) of the Act is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RATIONALE

7. The stated rationale for the deal is that by providing Shell with the means to increase its network by a large number of sites, the transaction will allow Shell to:

   a. benefit from increased economies of scale, allowing it to profitably continue its low-price high–volume strategy

   b. increase its attractiveness for a convenience retail partnership with a major retailer, and

   c. offer a larger network for Shell loyalty card holders.

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[1] Council Regulation (EC) No. 139/2004
[2] COMP/M.6294 - Shell/Rontec Investments LLP — 01/08/11
[3] The OFT had a total of 45 working days, pursuant to section 34A (4) of the Act to take a decision in respect of matters referred under Article 4(4) EUMR.

MARKET DEFINITION

8. The purpose of market definition is to provide a framework for the OFT's analysis of the competitive effects of the merger. The OFT identifies the market within which the merger may give rise to a substantial lessening of competition (the relevant market). However, the boundaries of the market do not determine the outcome of the OFT's analysis of the competitive effects of the merger in any mechanistic way.

9. The OFT's recent decisional practice[4] in this area considered that the relevant product markets for the operation of retail petrol forecourts comprised:

   i) the supply of groceries through their respective service stations, and

   ii) the retail supply of fuel.

   In this case the parties' activities also overlapped in the supply of fuel cards.

   Shell's submissions on market definition and the results of the OFT's merger investigation, in this case, are considered below.

Supply of groceries at petrol station forecourts

10. Given that the parties are minor players in the supply of groceries and third parties did not raise any concerns about the proposed transaction in this area, the OFT does not consider that the parties' activities in the supply of groceries give rise to competition concerns. The rest of the OFT's analyses therefore focuses on the supply of fuel only.

[4] ME/5139/11 – Proposed acquisition by Rontec Investments LLP of petrol forecourts, stores and other assets from Total Downstream UK plc, Total UK Limited and their affiliates.

Supply of fuel cards

Product Scope

11. Fuel cards are offered to heavy goods vehicle (HGV) fleet operators and to car and van fleet operators to enable them to purchase fuel from a network of sites either at a discount from the advertised pump price and/or under a single purchasing account or, in the case of direct bunkering cards, to facilitate cardholders drawing their own fuel from a network of bunker sites.

12. Fuel cards are offered by various types of businesses: independent fuel card issuers who do not operate any sites (such as UTA, DKV and Arval); petrol forecourt operators (such as Shell, BP and Esso); pay as you go cards offered by bunker fuel card providers (such as Keyfuels and UK Fuels); direct bunkering fuel cards which allow customers to buy diesel in bulk, store it in the bunker site network and draw it using a fuel card (again this service is offered by the bunker card providers, Keyfuels and UK Fuels); and independent resellers of cards issued by other firms (such as The Fuel Card Company).

13. Shell submitted, and third parties confirmed, that HGV fleet operators have different needs from car and van fleet operators. These differences centre on the specific site requirements of HGV operators, such as a high (or no) canopy, fast flow pumps, and large forecourts for ease of access; these requirements restrict the number of sites HGV operators can access by comparison to car and van fleet operators. [ ]. In addition Shell offer two different fuel cards, one to CRT customers and one to other fleet operators. Overall the OFT has therefore proceeded on the basis of separate markets for the supply of fuel cards to HGV fleet operators and car and van fleet operators.

Supply of fuel cards to HGV fleet operators

14. Shell submitted that for HGV operators there are three types of refuelling method, namely, home base refuelling, bunkering, and fuel cards. The OFT notes that bunkering can be further separated in to direct bunkering and pay as you go (PAYG) bunkering:

i. With direct bunkering, a HGV operator purchases fuel in bulk from a fuel wholesaler and then stores this in a bunker site network and pays the operator of the network a per-litre management fee for withdrawing their fuel.

ii. With PAYG bunkering, a HGV operator uses a fuel card to draw fuel at bunker sites, but the fuel is purchased on a pay as you go basis from a fuel reseller, rather than in up-front bulk purchases from a fuel wholesaler.

15. Shell submitted that home base refuelling and bunkering or fuel cards were complementary rather than substitutable. Third parties confirmed that they would not consider home base refuelling as competing with bunkering or fuel cards. Third parties confirmed that they would consider switching between fuel cards operated at petrol forecourts and pay as you go bunkering following a five per cent price rise in fuel; however they also stated that there would be limited scope to switch to direct bunkering based on the technical requirements and large volumes required to make direct bunkering commercially viable. In addition the OFT notes that some fuel card operators such as Arval do not offer fuel cards with Platts-based pricing and as such could be considered limited competitors to Platts-based cards offered by pay as you go bunker cards and petrol forecourt operators' cards.

16. The OFT has assessed the merger on the basis of the narrower relevant product market of the supply of PAYG fuel cards (including PAYG bunker cards and all other types of fuel cards) to HGV fleet operators excluding direct bunkering services.

Geographic scope

Supply of PAYG fuel cards to HGV fleet operators

17. Shell submitted that the geographic market was likely to be national on the basis that HGV fuel cards operate Platts-based pricing on a national basis. With respect to non-price competition Shell submitted that HGV customers do value non-price factors and in particular network coverage. Third parties stated that network coverage is an important factor in their choice of fuel card provider and in some cases stated that they cannot use a single provider due to the need to provide full coverage of the UK. While this can

be taken as evidence of the need to provide national coverage it also points towards competition between fuel card providers at the regional level based on difference in network coverage by region.

18. While the OFT notes the national based pricing for HGV fuel cards, based on the competition between providers on network coverage the OFT has assessed the effects of the merger on the supply of fuel cards to HGV fleet operators on both a national and regional level.

Supply of fuel cards to car and LCV [5] fleet operators

19. Shell submitted that two thirds of car and LCV fuel card customers are national fleets and one third are neighbourhood fleets (small companies fuelling at a single site). Shell therefore submitted that there is both a national and local geographic scope to the supply of fuel cards to car and LCV customers.

20. Third parties confirm both the national and local elements of competition with respect to the supply of fuel cards to car and LCV fleet operators and the OFT is minded to assess the effects of the merger on this basis.

Retail supply of fuel

Product Scope

Retail supply of petrol and diesel

21. The retail supply of fuel involves the sale of fuel (both petrol and diesel) to motorists via forecourts. These forecourts are typically owned either by the oil companies that supply the fuel (Company Owned Company Operated, COCO), by supermarkets, or by independent third parties (Dealer Owned Dealer Operated, DODO).

22. Shell has submitted that the relevant product market is the retail supply of fuel to motorists, in line with previous OFT and European Commission decisions,[6] and that no further segmentation is necessary between different

[5] Light Commercial Vehicle

[6] See, for example, ME/5139/11 Proposed acquisition by Rontec Investments LLP of petrol forecourts, stores and other assets from Total Downstream UK plc, Total UK Limited and their affiliates; ME/3933/08 — Cooperative Group/Lothian Borders & Angus Cooperative Society,

types of fuel, such as petrol and diesel or 'regular' and 'super', for reasons of supply-side substitutability even though petrol and diesel are self-evidently not demand-side substitutes. No evidence was found to contradict this market definition in this case.

23. The parties overlap in respect of the retail supply of liquefied petroleum autogas (auto-LPG) and in the retail supply of fuel at motorway sites. These additional overlaps are considered below.

Retail supply of auto-LPG

24. Shell has submitted that 24 out of the 253 acquired sites currently supply auto-LPG and that 215 of the 876 Shell branded sites currently supply auto-LPG.

25. Auto-LPG is not a demand-side substitute for petrol or diesel because vehicles have to be specially adapted to run on it; average miles per gallon for an auto-LPG car are around 20 per cent less than a comparable non-auto-LPG vehicle; and it is approximately 50 per cent cheaper than petrol. While, on the supply side, whereas all of the parties' sites supply petrol and diesel less than one third supply auto-LPG. Shell submitted that as with petrol and diesel the cost of LPG fluctuates in line with the price of oil, however Shell also submitted that unlike petrol and diesel the primary use of LPG is as a heating product and as such the price varies throughout the year and is highest in the winter months. Shell submitted that on the supply side, in contrast to petrol and diesel, there are a large number of non-forecourt retail suppliers of auto-LPG who act as a competitive constraint on forecourt sites and who do not supply petrol or diesel; this was supported by third party responses. Lastly, Shell submitted that auto-LPG requires specialist equipment to be installed at retail outlets including pressurised storage facilities and dedicated pumps, limiting the scope for supply-side substitution; this was also supported by third party responses.

26. For these reasons the OFT concludes that the retail supply of auto-LPG should be considered as a separate market from the retail supply of petrol and diesel.

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paragraph 111; Case COMP/M.5550 *BP/Du Pont*, paragraph 24; and Case IV/M.1383 *Exxon/Mobil*.

Retail supply of fuel at Motorway sites

27. With regard to the retail supply of fuel at motorway sites, previous European Commission decisions have noted the existence of market segmentation depending on whether a forecourt is located on or off a motorway. However the OFT notes that this distinction relates primarily to those countries in which motorways operate under a toll system and as such limits choice for consumers.

28. In this case the OFT has not needed to conclude on whether a separate market exists for the retail supply of fuel at motorway sites, but has considered this segmentation in the competitive assessment as it relates to local overlaps and the appropriate set of competing sites to be considered for motorway sites.

Geographic scope

29. Shell submitted that in line with previous Commission decisions in the sector, the geographic market was likely to be national.[7] However, Shell acknowledged that there were local elements to competition in the retail supply of fuels, with each site having its own 'catchment area'. Although Shell also submitted that these areas often overlapped, resulting in 'chains of substitution' and by implication geographic markets which were wider than local.

30. Third parties on the other hand consistently viewed the retail supply of fuel to be local, although the size of the appropriate 'catchment' varied by respondent. The OFT consider that the competitive effects of this merger in relation to the retail supply of fuel (including petrol, diesel, auto-LPG and at motorway sites) should be assessed on a local basis. The results of the investigation and the appropriate catchment area to consider the effect of the merger on a local basis are set out in the unilateral effects section below.

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[7] Case No IV/M.1383 *Exxon/Mobil*, paragraph 441 and Case COMP/M.4919 *Statoil/ConocoPhillips*, paragraph 29. However, the Commission also took into account that competition also takes place at the local level.

Conclusions on frame of reference in respect to retail supply of fuel

31. The OFT has therefore assessed the effects of the merger for the supply of retail fuels (petrol and diesel combined) both nationally and at a local level, and separately for the market for the supply of auto-LPG both nationally and at a local level.

COMPETITIVE ASSESSMENT: UNILATERAL EFFECTS

32. As stated in the Merger Assessment Guidelines,[8] 'theories of harm are drawn by the Authorities to provide the framework for assessing the effects of a merger and whether it would lead to a substantial lessening of competition. They describe possible changes arising from the merger, any impact on rivalry and expected harm to customers as compared with the situation likely to arise without the merger'.

33. The OFT's market investigation raised four theories of harm that were investigated:

    i. Unilateral effects in the supply of fuel cards to HGV, car and LCV fleet operators

    ii. Unilateral effects in the retail market for the supply of retail supply of fuel at non-motorway sites at a national and local level

    iii. Unilateral effects in the retail market for the supply of fuel at motorway sites, and

    iv. Unilateral effects in the retail market for the supply of auto-LPG at a national and local level.

    Each of these concerns is addressed in turn below.

Supply of fuel cards

34. Shell submitted that the Total fuel card business was not part of the transaction. It also confirmed that prior to the merger a fuel card cross-acceptance agreement existed between Total and Shell for car and LCV customers which will continue. [ ].

[8] OFT 1254 – Merger Assessment Guidelines paragraph 4.2

35. The OFT has therefore assessed the merger with respect to fuel cards on the basis of the additional sites added to the Shell network by the merger and as if the Total fuel card has been withdrawn and customers moved to using a Shell fuel card.

Supply of fuel cards to HGV fleet operators

Market shares

36. Shell estimated that the Shell and Total national market share would be around [10-20] per cent in the supply of fuel cards to HGV fleet operators. The OFT's market investigation indicated that the parties' combined share in the supply of fuel cards to HGV fleet operators may be somewhat higher at approximately [20-30] per cent by volume with an increment of less than [0-10] per cent. These shares are not at a level that would ordinarily give the OFT cause for concern over unilateral effects given the OFT has drawn the market narrowly.

37. The OFT also noted that third parties stated that there are a number of competing providers of fuel cards including oil majors such as BP and PAYG bunker card operators such as Keyfuels. Third parties also stated that whilst Shell and Total fuel cards were competitors, BP was regarded as the closest competitor to Shell.

Network competition

38. As discussed above at paragraph 13 a key factor of competition in the supply of fuel cards to HGV customers is the scope of the network of HGV accessible sites offered by a provider. The OFT therefore considered whether unilateral effects could arise in respect of a reduction of competition able to provide a network of sites with a HGV fuel card service offering.

39. Shell submitted national market shares based on the 1,718 HGV accessible forecourt sites operated by Shell, the Target Business and its competitors; which estimate the combined market share of the acquired sites and Shell to be approximately [20-30] per cent with an increment of less than [0-10] per cent.

40. The OFT's market investigation indicated a number of competitors with a sufficient network of accessible sites for HGV fuel card customers. These include Keyfuels which offers access to a network of 1,550 bunker sites which include forecourt and non-forecourt sites. This indicates that there will be a proportion of dealer owned and dealer operated branded forecourts that also offer bunkering services as well as other operators of non-forecourt bunker sites. Third party evidence on market shares of HGV accessible sites including bunker sites, indicate that the combined market share of Shell and the target business would be below [20-30] per cent and it should be noted that these estimates do not include HGV accessible sites of smaller forecourt-suppliers such as Pace, Jet and Murco.

41. Shell also submitted regional market shares based on the number of HGV accessible forecourt sites. There are four regions where the combined share of HGV accessible forecourt sites for the acquired sites and Shell sites exceeds 25 per cent. These regions are the East of England (combined [30-40] per cent, increment [0-10] per cent), the North West (combined [20-30] per cent, increment less than [0-10] per cent), the South East (combined [30-40] per cent, increment [0-10] per cent), and the South West (combined [20-30] per cent, increment less than [0-10] per cent). These shares are not at a level that would ordinarily give the OFT cause for concern over unilateral effects as there is no evidence of the parties being particularly close competitors. The OFT also notes that in each region the parties will face a degree of competition from one or more other forecourt brands which operate HGV accessible sites such as, BP which operates 15 per cent of all HGV accessible forecourts nationally.

42. The OFT received no third party concerns with respect to the competitive effects of the merger in the supply of fuel cards to HGV fleets.

43. On the basis of the evidence above the OFT does not believe there is a realistic prospect of a substantial lessening of competition with respect to the national or regional supply of fuel cards to HGV customers.

Supply of fuel cards to car and LCV fleet operators

Market Shares - National

44. The OFT's market investigation estimates the parties' combined national share of supply of fuel cards Supply of fuel cards to car and LCV fleet

operators of around [10-20] per cent with an increment of less than [0-10] per cent. The merged entity will face competition in the supply of fuel cards to car and LCV fleet operators from a range of competitors including Arval with an estimated market share of over [45-55] per cent and other oil majors such as BP.

45. Third party responses note that for the majority of customers the pricing mechanism is centred on pump prices[9] and apart from cost the main rationale for using a fuel card is the management of fuel purchases under a single account and the management data supplied by the fuel card provider. On this basis third parties consider the Arval fuel card (and other similar offerings) as a direct competitor to those operated by the oil majors. In addition, competing fuel card suppliers, such as Keyfuels, also act as resellers for fuel cards from Shell and the other oil majors, with resale arrangements based on a negotiated volume-dependant price to the reseller from the fuel card supplier and then independent price setting by the reseller.

46. Third parties highlighted the network of sites at which a fuel card is accepted as a key element of competition for car and LCV fuel cards. To ensure maximum coverage many of the oil majors enter into cross-acceptance agreements with respect to fuel cards. For example Shell has cross-acceptance agreements with Total and Esso. In addition, the Arval fuel card has the greatest network coverage with agreements for use at 95 per cent of petrol forecourts. The merger increases the number of sites under the Shell brand to over a thousand; however BP, Texaco and Esso have a similar number of sites, with BP remaining the largest brand in the UK. Third parties confirmed that the addition of 253 forecourts to the Shell network would not negatively affect the national balance of networks or provide Shell with an excessive advantage in terms of site numbers.

47. The OFT therefore does not consider that the merger has led to a realistic prospect of a substantial lessening of competition with respect to the national supply of fuel cards to car and LCV customers.

48. The OFT considers that the competitive effect of the merger on the price paid by car and LCV fuel card holders at individual sites is best assessed under the competition assessment for the retail supply of fuel at the local

[9] As explained above, Shell submitted that [ ] per cent of their non-HGV fuel card customers pay the pump price.

level given that third parties told the OFT that the primary parameter of competition is the variation of pump price locally.

Retail supply of fuel at a national level — excluding the supply of auto-LPG

National market shares

49. The parties' combined share of supply on the basis of the number of Shell sites and the target business is around [10-20] per cent, with an increment of less than [0-10] per cent. The corresponding share of supply by volume would be around [10-20] per cent, with an increment of less than [0-10] per cent. Neither is at a level that would ordinarily give the OFT cause for concern over unilateral effects as the evidence does not indicate that the parties are close competitors on a national level.

50. Shell submits that the shares of supply on a branded basis overstate fuel retailers' share of supply given the large number of the Shell sites (approximately [20-30] per cent) which are dealer owned and operated and as such are not subject to price control by the oil company suppliers, and are subject to an exclusive supply agreement limited to a maximum five-year duration (and as such have the ability to rebrand at least every five years).

51. Third parties confirmed these arrangements both for the Shell network and other branded forecourts.

National competitive conditions

52. Shell submitted that the merger would not raise a realistic prospect of a substantial lessening of competition nationally, since post-merger there remained a significant number of strong competitors, not least the supermarkets. Supermarkets are considered to be price-setters in the market and have achieved significant growth at the expense of standalone fuel retailers. Shell also noted that the supermarkets traded in high volume transactions, which meant that their share of supply is significantly higher than their share of sites.

53. Shell provided, as evidence of the constraint that supermarkets posed in the market, the fact that the prices of at least one supermarket supplier at [

]. This contrasts to the target business, where the acquired forecourts are only monitored by [ ].

54. Shell also submitted evidence from internal [ ] pricing reports which showed that [ ].

55. Consistent with this, the OFT noted that Forecourt Trader (a trade publication) has discussed the constraint from supermarkets, and states that the recent price rises have caused greater switching towards the hypermarkets, which have seen growth in volumes, while other retailers have seen falling or stagnating sales.[10] Likewise, a report by Wood MacKenzie (WM), a research and consultancy service provider, into downstream oil services also notes that the supermarkets are the price-setters in the sector, since they have the lowest acceptable margins in the market at around four to five pence per litre.[11] Margins for other retailers are higher given their higher cost structures, that is, since they operate as stand-alone retailers focusing on fuel retail.

56. Third parties generally agreed with Shell in relation to competitive conditions at the national level. All stated that they had some form of price monitoring, which included supermarkets. The supermarket respondents typically stated that they competed most closely with other supermarket suppliers in the local area, since they were also competing for a share of the customer grocery spend.

57. The OFT's market investigation has therefore indicated that supermarkets and other branded forecourts will provide a constraint on the merged entity on a national basis (and where present, in local areas). At the national level, therefore, the OFT does not consider there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel, and this is not considered further.

Retail supply of fuel at local level (not including Auto LPG)

Competition, pricing, and marker sites

58. Shell told the OFT that pricing was the main parameter of competition in the retail supply of fuel at a local level, and that both Shell and the target

[10] Forecourt Trader, June 2010.
[11] Wood MacKenzie, Downstream oil services report, July 2010, page 8.

business undertook regular price monitoring, with prices at individual sites revised frequently as a result.

59. The target business, when trading as Total, set its prices on a site by site basis depending on a range of factors, including set margins/volumes, reference to a set of competitors and overall pricing strategies for a particular site. [ ].

60. [ ].

61. Shell has submitted that its territory managers are responsible for pricing at sites in their allocated area. For each Shell site associated marker sites are selected by these managers and approved by the central pricing team based on their price of fuel and non-price factors such as location, opening hours, access, traffic flow, etc. [ ].

62. [ ].

63. Shell submitted that while price markers are an important tool in setting prices at the local level, [ ].

64. Shell further submitted that sites face effective competition from sites other than those considered 'marker sites'. This is because the marker sites are a very narrow list of competitors, since the parties are only able to monitor a limited number of sites and the recognition that those sites will in turn mark other sites and as such any large price differentials 'will be felt throughout the interlocking marker system.'

65. Shell undertook econometric analysis to understand the level of constraint placed on their sites [ ]. In particular the analysis concentrated on whether for Shell sites, supermarkets or Total sites provide a different level of constraint to other sites; and conversely for Total sites whether Shell has a different level of constraint to other sites. Shell submits that the results of the analysis show that prices at Shell sites react to a greater extent to [ ], and supermarkets in particular, and there is no greater response to Total sites than any other marker sites. While, on the other hand, the target business does not respond more [ ], or when marker sites are Shell branded.

66. Shell presented this analysis as demonstrating the reaction of a sites' price to another sites' price, with controls for geographic and site specific characteristics. However the OFT notes that this analysis is based on cross-sectional data rather than time series data and as such the 'reaction' interpretation, though consistent with the results, is not the only one admissible: put differently, a finding that (say) prices in two adjacent petrol stations happen both to be low on average over an extended period of time (a year in the case of Shell's analysis) is not sufficient to conclude that one low price caused the other through competition.

67. The OFT has considered Shell's econometric analysis which was put forward to demonstrate that the supermarkets may provide a greater constraint than other petrol forecourts and that this should be reflected in the filtering methodology. However, the OFT does not consider this appropriate or necessary. First, as set out above, the OFT has concerns around the methodology adopted for the econometric analysis. Second, in any event, the OFT considers that in adopting a filtering methodology, it is important to establish the competitor set and apply a consistent value to each competitor in the filter. Third, if following the application of filtering it turns out that a particular competitor or type of competitor is stronger than another, this will be highlighted by the level of diversion in a local area from either of the merging parties to that competitor. As such, the strength or otherwise of supermarkets will be identified in the diversion ratios calculated following the application of the filter.

68. As a consequence, the local area filtering methodology discussed below doe not place any additional weight on the presence of certain brands within a given site's marker set. In doing so, it recognises that any additional competitive effect from a given site's market set will be captured in subsequent analysis (also discussed below).[12]

69. Shell also submitted that not all Shell or Total branded sites should be considered under the same fascia. This is due to the fact that some sites are owned by Shell and Shell has retail price setting controls (COCOs), while other sites are owned by a dealer with a fuel supply and branding contract with Shell under which the dealer sets the retail price of the fuel (DODOs).

[12] For example in lower-than-average incremental profit margins earned by sites facing lots of competition [ ], or in low diversion ratios between Shell and Total in areas where they face lots of competition from [ ].

70. Shell submitted contracts between Shell and dealer sites which show the level of price setting control Shell has over dealer site retail prices. [ ].

71. In spite of this there remains a potential theory of harm whereby following a price rise at an acquired site the value of diverted sales to dealer-owned Shell sites would be internalised to some degree through increased wholesale sales by Shell. The OFT therefore considers that on a cautious basis dealer-owned sites branded as either of the parties should be considered under a single fascia in any filtering exercise. That said, those overlaps which fail the filtering process and include dealer owned sites with wholesale supply from the parties are discussed further below with consideration of the control of retail fuel pricing and internalisation of diverted sales.

Filtering methodology

72. Shell submitted that in order to identify overlaps which merit further analysis at a local level, it was appropriate to undertake a filtering exercise:

i. on the basis of drive-time isochrones, and
ii. with regard to Shell's and Total's price marker lists.

(i) Drive-time isochrones – non motorway sites

73. Shell submitted to the OFT that an appropriate filter for capturing local overlaps would be through the use of drive-time isochrones, since the vast majority of customers would drive to the petrol stations. Shell submitted that the catchment areas used in the OFT's earlier Rontec/Total investigation, a 10-minute drive time in urban areas, and a 20-minute drive time in rural areas, were appropriate for the initial screen of the overlaps in this case.

74. Shell submitted additional evidence which corroborated these 10- and 20-minute drive time isochrones. In particular survey results at Shell and Total sites[13] showed 70 per cent of customers travelled less than 10 minutes to urban sites (compared to 49 per cent at less than five minutes), and 60 per cent of customers travelled less than 20 minutes to rural sites (compared

[13] Surveys were undertaken by Accent on behalf of RBB at areas captured by the filtering methodology to provide evidence of closeness of competition between sites through diversion ratios. Further discussion of these surveys is set out below.

to 45 per cent at less than five minutes). For those sites marked by urban Shell sites, 90 per cent of marker sites are less than [ ] minutes from the 'marking' Shell site, and 80 per cent are less than [ ] minutes. While for those sites marked by rural Shell sites, 90 per cent of marker sites are less than [ ] minutes from the corresponding Shell site, and 80 per cent are less than [ ] minutes.

75. Third party views in relation to the appropriate methodology for analysing the local elements of competition were mixed. One noted that the typical catchment analysis employed in other sectors such as groceries was not appropriate, since fuel purchases are not typical shopping missions (where the customer sets off from their location specifically for the purpose of buying, say, groceries) but instead petrol stations attract a high degree of passing trade. Therefore the 10/20-minute isochrones were far too narrow and strict for assessing competition. Another third party said that they monitored competitors on the basis of one-mile radii for sites within the M25 and three-mile radii for sites outside the M25. However they noted that at times they also included competitors outside these radii. While a third suggested that the 10/20-minute isochrones were sufficient as a starting point, but a more detailed analysis would typically be required to capture other elements which influence the geographic market, such as topographical features around sites.

76. Overall while third parties used various local measures for their pricing methods the OFT considers that the isochronal analysis submitted by Shell is a reasonable starting point for the local analysis of the unilateral effects arising from the merger.

(ii) Drive-time isochrones – motorway sites

77. Shell submitted that the appropriate drive time isochrone for a motorway site is 30 minutes. As evidence for this view Shell submitted that 90 per cent of motorway marker sites are less than [ ] minutes from the 'marking' Shell motorway site and 80 per cent are less than [ ] minutes.

78. Shell also submitted that, on a cautious basis, off-motorway sites should not be considered within the analysis (although they would be considered in the price marker analysis set out below). The survey results for the acquired motorway sites indicated that only 25 per cent of those customers interviewed would have gone to a petrol station off the

motorway, suggesting a narrow market satisfying the hypothetical monopolist test likely would exclude non-motorway sites.

79. Despite this, the OFT has not needed to conclude on whether the 30-minute drive time isochrone for motorway sites or the exclusion of off-motorway sites is appropriate for a cautious first filter as all acquired sites and their overlapping Shell sites were caught by this or the marker site filters discussed below.

(iii) Filtering based on price markers (all sites)

80. Shell submitted that price-marker data is an important indicator on its own. As a result it proposed the following secondary (additive) filter, where:

a) any area where an acquired site identifies a Shell site as a [ ] marker

b) any area where a Shell site or an acquired site identifies the other as one of three or fewer competing sites, and

c) any area where there is a reduction in competing brands from four to three or fewer (that is any areas where the Shell or Total brand is one of only three brands or fewer on the marker list)

would be considered further. [ ].

(iv) Geographic closeness of competition (all sites)

81. The OFT also considered the geographic proximity of the parties' competing sites. However, no additional local overlaps were highlighted as potential areas of concern on the basis of them being each others closest geographic competitors.

Outcome of filtering methodology

82. The filtering methodology outlined above captured 68 local areas which include 48 acquired Total sites which fail one or more filters and 70 Shell branded sites which fail one or more filters. Of these 118 sites in local areas that that fail the filtering methodology, 101 are company owned sites and 17 dealer owned sites.

Local areas of concern

83. Shell submitted that the number of local areas that may raise the prospect of a substantial lessening of competition could be narrowed through the calculation of a Gross Upward Pricing Pressure Index (GUPPI) on a site-by-site basis for each of the 68 areas caught by the above filters.

84. Shell first submitted evidence on GUPPI for each site based on diversion between sites approximated by the volume share of supply of the parties' sites within the drive-time isochrone catchment areas discussed above. However, lacking evidence that volume market shares are a good approximation for diversion, and lacking evidence on the degree of diversion outside of the markets for which shares were calculated, the weight that the OFT felt able to attach to this analysis was limited. Shell, consequently, undertook a series of surveys at the sites failing one or more of the filters detailed above to measure (rather than proxy) diversion.

Measuring diversion

85. Shell engaged in discussions with the OFT on the design of its survey in order to ensure that the OFT would be able to place a high degree of weight on the diversion ratios. This gives the OFT a high degree of comfort in the quality of available evidence with regards to diversion between the parties' sites.

86. The survey design allowed diversion between sites to be captured in two ways. The first through naming specific sites which consumers would divert to, and the second by diversion to a particular brand should a consumer be unable to name a specific site.

Measuring profit margins

87. Shell submitted evidence on the retail variable profit margin (the profit margin of revenue over costs that vary with sales) for each site (Shell and the target business) in the 68 local overlap areas caught by the filtering outlined above. The OFT has assessed the basis for the calculation of the margin for both Shell and the target business, and in particular the variable costs included in the calculation and the possibility of the 'retail' margin not accurately reflecting the full margin obtained on each litre of fuel sold at the retail level given the vertical integration between Shell retail sites and the Shell distribution division.

88. With respect to the variable costs included in the calculation the OFT recognises that Shell has restricted these to short term costs and that medium to long term costs such as staff have been excluded. In relation to the calculation of the retail fuel margin and the recognition of the vertically integrated nature of the parties' business, Shell provided the OFT with a paper on the formulation of transfer prices and allocation of margin. The methodology is based on input prices paid by Shell upstream and as such avoids issues of cost allocation within Shell.

Pass through

89. Historically the OFT has combined evidence on diversion ratios and variable profit margins with assumptions over demand curvature to calculate simple measures of the value of business internalised by a merger calibrated as a potential percentage price increase. While these measures are only illustrative of Shell's incentive to raise prices; they have been used in numerous retail merger cases to identify local overlaps of potential concern.[14]

90. The value of business internalised by the merger in percentage terms is known as the gross upward pricing pressure index (GUPPI). To calibrate GUPPI as a potential percentage price increase, a rate at which this price pressure is translated into potential price rises is needed. The rate of pass through depends on two main elements: the extent to which a given firm will pass through cost changes into prices; and the extent to which an incentive for one of the merging parties to increase prices in turn increases the incentive for the other to do so, resulting in a feedback effect between them that can magnify the potential price increase.

91. In economic theory a working assumption for the rate of firm-specific cost pass-through depends on the nature of the relationship between the amount demanded and price (specifically, the curvature of the demand function). For example linear demand is consistent with firm-specific pass through of 50 per cent and isoelastic demand is consistent with firm-specific pass through of greater than 100 per cent. In this particular case, as set out in paragraphs 83 to 88, Shell has provided a substantial analysis relating to this point.

[14] See chapter 4 of the Retail Merger Commentary

92. As regards the feedback effect, in past cases our approach has made allowance for a feedback effect between the parties, described above, and we see no reason to depart from that in this case. Other things being equal, the higher is the diversion between merging parties, the larger this effect becomes. Moreover, the higher the diversion between parties the more the potential there is for competition between the parties themselves to be constraining the margins of each of them in a particular local area. On both counts a potential price rise measured only by GUPPI times cost pass-through risks underestimating the potential harm by ignoring the potential feedback effect. To take account of this we have therefore looked particularly closely at areas where the diversion ratio is relatively high in order to ensure that the diversion has suitable weight in the overall assessment.

93. The OFT recognises that any measure that we adopt in relation to our assessment of a particular merger has to be consistent with the OFT's role as a first phase competition authority. In this case, the parties provided information which enabled the OFT to have confidence in the use of this measure without having to make a conservative assumption (as has been the case in a number of supermarket mergers[15] and other cases) around the shape of the demand curve.

94. Shell submitted an analysis of pass through at Shell sites based on Shell's input cost and price movements over a 22 month period. The input cost movements over this period were largely due to changes in underlying Platts prices or duty and therefore industry-wide. It argued that this analysis shows that the pass through rate for these industry-wide cost changes is close to 100 per cent, but no more, in the long run and that there is evidence of short term 'smoothing' of price responses to cost variations which could as such pass through in the short term 'may well be significantly less than 100 per cent'.

95. Further to this Shell submits that given the above estimates are based on pass through rates for industry-wide cost changes; any measure of pass

[15] For example: Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited www.oft.gov.uk/shared_oft/mergers_ea02/2010/Asda-Netto.pdf, and Anticipated acquisition by Co-operative Group Limited of Somerfield Limited www.oft.gov.uk/shared_oft/mergers_ea02/2008/CGL.pdf

through for firm-specific cost increases would be lower, and therefore no more than 100 per cent.

96. The OFT has considered the methodology used by Shell to reach their conclusions and carried out analysis to test the robustness of the pass through estimates. The OFT's analysis was consistent with Shell's argument that generally costs are passed through at a level around 100 per cent in the long run, though in more than half the observations the rate of pass through was above 100 per cent (albeit not above by as much as if demand was isoelastic). Shell responded that:

- pass through in excess of 100 per cent is not consistent with industry facts as variable costs (in particular oil) have significantly increased over time but variable profit margins have stayed flat

- the OFT's results may be a product of the OFT having assumed a constant lag between changes in price and the changes in variable cost that caused them (a one week lag between cost shocks and price changes, for example) because the true relationship between a shock to variable cost and its impact on price is more complex than can be allowed for by any constant lag structure.

In view of this, the OFT does not consider that Shell's evidence provides much of a basis, if any, for thinking that pass through may exceed 100 per cent, on average, by much.

97. Neither does the OFT consider that the fact that Shell's evidence on pass through is based on national average prices provides much evidence for thinking that pass through may be greater than 100 per cent at any sub-national level, given Shell submitted evidence that pass through is no greater for local areas where Shell has 'market power' than for local areas where it does not.

Multiple sites as multiple products

98. The OFT notes that in many of the local overlap areas identified by the filtering methodology above there are multiple sites of both parties. Further to this the parties' sites in an area can be company owned or dealer owned. This means that the margin estimate for each site can be

significantly different and as such any consideration of pricing pressure should take account of these differences as previously undertaken by the OFT in the Unilever/Alberto Culver investigation.[16]

Conclusion on retail supply of fuel at local level (not including auto-LPG)

99. The parties overlap in 68 local areas that are not obviously unproblematic based on a cautious filtering methodology. In these areas, surveys were carried out by Shell to generate estimated diversion ratios and pricing pressure estimates. The OFT then considered Shell's estimates of pricing pressure and the calibration of these estimates as a potential price increases in each of these 68 local areas in the context of other evidence such as fascia analysis, as well as the site operating model, and diversion between the parties. The OFT considers that evidence on diversion between the parties provides an indication of the closeness of competition between the parties above and beyond that provided by pricing pressure analysis as it suggests that post merger pass through may be higher than pre merger. For those areas where diversion ratios were over 40 per cent, the OFT also reviewed marker evidence and maps of the local area to consider the nature of local competition in the round.

100. **TCS Brenzett** — The Shell site at New Romney is a [ ] marker for the Target Business at Brenzett [ ]. The GUPPI for this area calibrated as a potential price increase with 100 per cent pass through is [five-10] per cent. In the 10-minute drive-time isochrone centred on the Shell site, there is a reduction in fascia of four to three and the diversion ratio from Shell to the Target Business is [60-70] per cent. Therefore the OFT considers that there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel in this area.

101. **TCS Demon and TCS Stoughton** — These two target business sites are in the same catchment with three Shell sites — Shell Ladymead, Shell Meadows, and Shell Woodbridge Hill. Both of the Target Business sites

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[16] Unilever/Alberto Culver —
This extension simply considers the separate GUPPI terms cumulatively. For example, if we introduce a product C, which is supplied by the same firm as supplies product B:

$$\text{GUPPI (product A)} = \frac{\text{(Value of sales diverted to product B) + (Value of sales diverted to product C)}}{\text{Revenues on volumes lost by product A}}$$

which gives a cumulative or composite GUPPI of:

$$GUPPI_A = \left[D_{AB}\frac{p_B - c_B}{p_B} \times \frac{p_B}{p_A}\right] + \left[D_{AC}\frac{p_C - c_C}{p_C} \times \frac{p_C}{p_A}\right]$$

mark all three Shell sites, [ ]. The GUPPI for these two areas calibrated as a potential price increase with 100 per cent pass through is estimated as [five-10] per cent.

102. The overall diversion ratios from TCS Stoughton to Shell is [60-70] per cent (comprising [30-40] per cent to Shell Woodbridge, [10-20] per cent to Shell Ladymead and [0-10] per cent to Shell Meadows), while the diversion ratios from Shell Woodbridge to the target businesses are [50-60] per cent to TCS Stoughton and [0-10] per cent to TCS Demon. The diversion ratios from Shell Meadows to the Target Business sites are [10-20] per cent to TCS Stoughton and [10-20] per cent to TCS Demon, while at Shell Ladymead the diversion ratios to the Target Business sites are [50-60] per cent to TCS Demon and [0-10] per cent to TCS Stoughton.

103. Overall the OFT has considers that there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel here in these areas.

104. **TCS Ewood** —Shell Blackburn Service Station and Savoy Service Area are [ ] markers for the Target Business at Ewood [ ]. Centered on TCS Ewood, the GUPPI for this area calibrated as a potential price increase with 100 per cent pass through is [0-five] per cent. The diversion ratio from M65 Darwen to TCS Ewood is [60-70] per cent, therefore the OFT considers that there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel in this area.

105. **TCS Ickenham** — Shell Swakeleys is a [ ] marker for the Target Business site at Ickenham [ ]. Centered on TCS Swakeleys the GUPPI for this area calibrated as a potential price increase with 100 per cent pass through is [0-five] per cent. The diversion ratio from TCS Ickenham to Shell Swakeleys is [60-70] per cent, while from Shell Swakeleys to TCS Ickenham the diversion ratio is [50-60] per cent, therefore the OFT considers that there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel in this area.

106. **TCS Great Barr** — Shell Great Barr is one of two markers for the Target Business site at Great Barr [ ]. While the estimated GUPPI of [0-five] per cent is not as high as in some areas, diversion ratios are very high. The diversion ratios for TCS Great Barr to Shell is [60-70] per cent (comprising [30-40] per cent to Shell Great Barr, [20-30] per cent to Shell Bluecoats,

[0-10] per cent to Shell Aqueduct, and [0-10] per cent to Excelsior SS), while the diversion ratio from Shell Great Barr to TCS Great Barr is [30-40] per cent. The very high diversion ratio towards Shell and the relatively high diversion ratio towards the Target Business give cause for concern and indicate that the post merger potential price rise may be an order of magnitude higher than the estimated GUPPI. Overall the OFT therefore considers that there is a realistic prospect of a substantial lessening of competition with respect to the supply of retail fuel in this area.

107. There were other local areas where the diversion ratios were greater than 40 per cent, but, on the basis of all the evidence considered in the round, the OFT has concluded that these areas raise no concerns.

Retail supply of auto-LPG

108. Following its conclusion above that the retail supply of auto-LPG should be considered as a separate market from the retail supply of petrol and diesel, the OFT has considered whether the merger raises a realistic prospect of a substantial lessening of competition in relation to the retail supply of auto-LPG on both a national and local level.

National supply of auto-LPG

109. On a national basis the combined share of supply by the number of Shell sites and those of the target business that supply auto-LPG is around [20-30] per cent, with an increment of [0-10] per cent.[17] Shell estimate that there are currently 160,000 dual-fuel cars (around 0.5 per cent of all registered vehicles).

110. Shell submitted that nationally the merger did not raise a realistic prospect of a substantial lessening of competition since there would be a significant number of strong competitors, including non-forecourt suppliers, post merger. It also submitted that BP operated a similar sized network and that the other oil majors also operated networks of sites supplying auto-LPG. Further, non-forecourt suppliers provided an equal constraint to forecourt suppliers, highlighting gas suppliers such as Flogas and Calor as non-forecourt suppliers at their gas depots; and specialists who convert cars to auto-LPG and maintain a storage unit to supply customers.

[17] Based on Experian Catalist data and www.drivelpg.co.uk data.

111. Third parties confirmed the competitive constraint on forecourt sites by non-forecourt sites, providing evidence that over 30 per cent of sites supplying auto-LPG were non-forecourt sites, and that auto-LPG customers were fully aware of the location of non-forecourt sites through various websites including www.drivelpg.co.uk. Third parties did not raise any concerns with regards to the retail supply of auto-LPG at the national level.

112. The OFT therefore does not consider that the merger raises a realistic prospect of a substantial lessening of competition at the national level for the retail supply of auto-LPG, and therefore this is not considered further.

Local supply of auto-LPG

113. Shell submitted that competition at the local level for the retail supply of auto-LPG is very similar to that for other retail fuels in that suppliers compete primarily on price. It proposed a similar filtering methodology to that used for other retail fuels in order to identify local overlaps of potential concern. The OFT received no evidence from third parties to suggest that this was not appropriate for auto-LPG, however there were some variations based on evidence from third parties discussed below.

114. As with petrol and diesel forecourts, Shell initially carried out a filtering exercise based on the 10-, 20-, and 30-minute isochrones; however it argued that customers of auto-LPG were highly price sensitive and that these isochrones should be wider. Third party evidence suggested that a customer may travel further to purchase auto-LPG given the limited number of retail suppliers in comparison to other fuels. However the OFT notes that the broad consensus amongst third parties was that a 20- to 30-minute isochrone was most appropriate.

115. Following discussions with the OFT Shell undertook sensitivity analysis on the outputs from the filtering exercise by increasing the drive time isochrones in increments to a maximum of 40 minutes for urban, rural and motorway sites. However, this analysis did not increase the number of local overlap areas which failed the filtering exercise.

116. While Shell included price marker site analysis consistent with the filtering method for other fuels, the OFT notes that there are no non-forecourt price marker sites identified for these areas and it was not clear whether these price marker sites exclude non-forecourt competitors per se or whether

non-forecourt sites are not deemed to be a competitive constraint in these areas. [ ].

117. Based on the narrow drive time isochrones and the potential exclusion of non-forecourts suppliers, the OFT had a more cautious view of the filtering exercise than of the parallel exercise for the retail supply of other fuels. The filtering exercise identified 20 local overlaps of potential concern. In some areas these are identified as two-to-one (one area) or three-to-two reductions (eight areas) in competing fascia.

118. As with the supply of other retail fuels Shell undertook surveys at sites included in the local overlap areas identified by the filtering exercise. However due to the low response rate from the surveys (no areas had more than 65 responses and most sites had fewer than 30 responses) the OFT was not able to attach any significant weight to the estimated diversion ratios from these surveys beyond them being directionally helpful as to the sites individuals would divert to (if not the extent to which they would divert). Consequently, these areas gave the OFT prima facie concerns over a realistic prospect of a substantial lessening of competition in the retail supply of auto-LPG, which required a closer analysis of the individual areas.

119. Shell provided additional fascia counts for the overlapping areas, including non-forecourt sites. Shell submits that these non-forecourt suppliers are rigorous competitors who are an effective constraint on competition, since they are typically the cheapest auto LPG supplier in a local area and therefore tend to capture a high percentage of the most marginal customers.

120. The OFT considered local overlaps based on the inclusion of non-forecourt sites, narrow catchment areas of 10, 20, and 30 minutes for urban, rural, and motorway, and for motorway sites only including sites on the motorway. On this basis there is one area with a two to one reduction — M4 Cardiff Gateway, four areas with a three to two reduction — TCS Addlestone, TCS Beacon Hill, TCS Broughton, and TCS Stopsley, one area with a four to three reduction — A40 Monmouth East, and three areas with a five to four reduction — A50/M6 Lymm Services, TCS New York Road, and Expressway. These areas were therefore considered in more detail.

121. From considering the maps alongside the marker and survey data provided the OFT was able to allay its prima facie concerns with regard to the following Target Business sites: M4 Cardiff Gateway, TCS Beacon Hill, A40 Monmouth East, A50/M6 Lymm Services, TCS New York Road, and Expressway.

122. However, the following sites continue to raise concerns:

123. **TCS Addlestone** — A higher number of survey results were gathered in respect of this area (20 at the Target Business, TCS Addlestone and 65 at the Shell Ottershaw site) which gives a higher degree of confidence than would otherwise occur. From the maps provided it is clear that TCS Addlestone and Shell Ottershaw are closest geographically, and this is borne out by high diversion ratios — [90-100] per cent from TCS Addlestone to the Shell site and [70-80] per cent from the Shell Ottershaw site to the Target.

124. **TCS Broughton and TCS Grovebury** — On a narrow 10-minute catchment, the area around TCS Broughton is a three to two with no non-forecourt suppliers to act as a competitive constraint. [ ] and the limited survey evidence supports the three to two. From 45 responses at the Shell Leadenhall site, there is a [40-50] per cent diversion to the Target Business, TCS Broughton. In addition, through expanding the catchment area to 20 minutes based on TCS Broughton an additional Target Business site, **TCS Grovebury**, is brought in. From the maps provided it would appear that there are no non-forecourt sites in this enlarged catchment area and it results in a three to two. Although TCS Grovebury monitors Shell Leadenhall, [ ]. Nevertheless, as before, the diversion ratio from Shell to TCS Grovebury calculated from 45 responses at the Shell site is [40-50] per cent, and therefore the OFT on a cautious basis considers that this site also may raise prima facie concerns.

125. **TCS Stopsley** — On a narrow 10-minute catchment this is a three to two with the parties' sites the closest geographically. TCS Stopsley monitors two Shell sites — Shell Luton Airport and Shell Flamstead, [ ]. Survey responses were comparatively low, 30 at the Target site, TCS Stopsley, which gave a diversion ratio of [80-90] per cent to Shell, while at Shell Luton Airport survey responses of 16 gave a diversion ratio of [90-100] per cent. From the map provided there is a BP just within the catchment to the north west and a non-forecourt site just outside the catchment to the west.

126. The OFT also scrutinised those local areas that had high diversion ratios based on the limited survey evidence available. This exercise identified a further two sites, TSC Fleet, and TCS Ducklington that raised concerns.

127. **TCS Fleet** — The parties' sites are the closest geographically, albeit that the Shell sites are motorway service stations on the north and southbound carriage ways. However, TCS Fleet is sufficiently near Junction 4a of the M3 as to provide a realistic alternative. [ ] and the fact that they are considered as realistic alternatives by consumers is borne out by the survey evidence. Although responses to the survey were relatively low, from 34 surveys at TCS Fleet, the diversion ratio was calculated as [60-70] per cent, while from the 34 respondents at M3 Fleet Southbound the diversion to TCS Fleet was [50-60] per cent, and at the northbound services from 23 respondents the diversion was [60-70] per cent.

128. **TCS Ducklington** — In the 10-minute catchment area centred on TCS Ducklington, the transaction results in a two to two including non-forecourt sites. However, TCS Ducklington monitors two Shell sites in nearby Oxford, outside the 10-minute catchment, but within 20 minutes, Shell Peartree and Shell Holywell. Responses to the survey were limited, 14 respondents, but for this limited set of respondents the Shell sites were considered to be close competitors with a diversion ratio of [60-70] per cent.

129. **Barriers to entry and expansion in auto-LPG** — Shell has argued that even if local overlaps raise the realistic prospect of a substantial lessening of competition there would be sufficient entry to mitigate these concerns. Shell submitted that entry for an existing fuel retailer would cost below £100,000 and take less than 12 months; this is based on previous entry by the parties at their forecourt sites. Shell submits that because of the low cost of entry firms would be able to recoup any costs over a short time period and as such would be incentivised to enter following a small price rise.

130. Third parties submitted evidence that while the installation of equipment may not cost more than £100,000 and can be achieved in a short time span (under six months) obtaining planning permission for the installation of an auto-LPG storage tank often takes longer than the two years which the OFT generally considers to be timely.

131. In addition third parties submitted that for forecourt sites there are frequently space constraints with respect to the location of an additional storage tank and safety restrictions around its site. Finally one third party commented that the demand for auto-LPG has been declining and as such forecourt owners were unlikely to invest in new facilities following a small but significant price rise.

132. The OFT has therefore concluded that in relation to the retail supply of auto-LPG there is a realistic prospect of a substantial lessening of competition in a number of local overlaps, listed above, and that there is evidence that entry would not be sufficiently timely to constrain the merged firm in these areas.

COORDINATED EFFECTS

133. Having previously considered coordinated effects in this market in the recent Rontec/Total case, where the OFT concluded that the proposed transaction did not give rise to any coordinated effects concerns; the OFT did not consider coordinated effects arising from this case. The OFT notes that following this transaction there will continue to be at least six major independent fuel suppliers in the UK. It also considers that the supermarkets serve as an additional competitive constraint in the retail supply of fuel.

THIRD PARTY VIEWS

134. Third-party comments have been discussed above where relevant.

ASSESSMENT

135. The assessment concerns the completed acquisition by Shell of 253 petrol stations, 241 of which were previously owned and operated by Total. The UK turnover of the target business in 2010 was approximately £[ ] million.

136. Shell and Total overlap in the supply of a range of services to UK customers including the supply of groceries through service stations, the supply of fuel cards; and the supply of retail fuel. The OFT considers that the relevant markets for an assessment of this transaction are the retail supply of groceries through petrol forecourts at a national and local level;

the supply of fuel cards to HGV and car and LCV customers at a national and regional level; and the retail supply of fuel split between supply of petrol and diesel together, supply of auto-LPG and the supply of all types of fuel at motorway service stations at a national and local level.

137. In relation to the supply of groceries, the supply of the national or regional supply of fuel cards to HGV customers, the national supply of retail fuel (petrol, diesel and auto-LPG) the OFT did not consider the completed merger had led to a realistic prospect of a substantial lessening of competition on the basis that the parties were not each others' closest competitors and the parties' combined market share and/or the increment to it were not large enough to give the OFT cause for concern over unilateral effects. Third parties were also unconcerned by the impact of this merger in all of these markets.

138. The parties' principal area of overlap concerns the supply of retail fuel in the UK. In assessing local aspects in relation to retail supply of petrol and diesel [and motorway service stations], Shell adopted a filtering methodology to identify prima facie areas of concern on the basis of drive-time isochrones (10-, 20- and 30-minute drive times), and with regard to Shell's and Total's price marker lists and then carried out a survey exercise at the sites that failed this initial filter.

139. The OFT then considered a variety of evidence including estimates of upward pricing pressure, diversion ratios, marker sites, business models and reviewed maps. On the basis of this in the round assessment, the OFT considers that with respect of six local areas of overlap, TCS Brenzett, TCS Demon, TCS Stoughton, TCS Ewood, TCS Ickenham and TCS Great Barr the proposed transaction gives rise to a realistic prospect of a substantial lessening of competition. The OFT notes that in each case the parties mark each other's sites and that there are high levels of diversion from Shell's sites to the Target Businesses sites and/or vice versa.

140. The parties also overlap in the retail supply of auto-LPG. Shell again adopted a filtering methodology to identify prima facie areas of concern on the basis of drive-time isochrones (10-, 20- and 30-minute drive times), and with regard to Shell's and Total's price marker lists. Shell again carried out a survey exercise at the identified overlap sites, however, given the small number of auto-LPG users in the UK no areas had more than 65 responses and most sites had fewer than 30 responses. Consequently, the

OFT was cautious in respect of the weight placed in the estimated diversion ratios from these surveys. They were, however, directionally helpful as to the sites individuals would divert to.

141. On the basis of the filtering methodology, survey results, and fascia counts (including non-forecourt suppliers, the transaction gives rise to 12 prima facie local areas of concern with regard to the retail supply of auto-LPG.

142. The OFT considers that with respect of six auto-LPG Target Businesses, TCS Stopsley, TCS Fleet, TCS Addlestone, TCS Ducklington, TCS Broughton and TCS Grovebury the proposed transaction gives rise to a realistic prospect of a substantial lessening of competition. The OFT notes that in each case the parties either mark each other's sites or are the closest geographically. In addition, although survey responses were limited, there are high levels of diversion from Shell's sites to the Target Businesses sites and vice versa.

143. In respect to barriers to entry and expansion for auto-LPG, Shell argued that there would be sufficient entry to mitigate any concerns, citing comparatively low costs and entry. However, third parties while agreeing that the installation of equipment may not cost more than £100,000 and can be achieved in a short time span (under six months) submitted that obtaining planning permission for the installation of an auto-LPG storage tank often takes longer than the two years which the OFT generally considers to be timely. One third party also commented that the demand for auto-LPG has been declining and as such forecourt owners were unlikely to invest in new facilities following a small but significant price rise. The OFT therefore concluded that there is evidence that entry would not be sufficiently timely to constrain the merged firm.

144. Consequently, the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

UNDERTAKINGS IN LIEU

145. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which

has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

146. The OFT has therefore considered whether there may be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's *Exceptions and Undertakings Guidance* states that undertakings in lieu of reference are appropriate only where the remedies proposed to address any competition concerns raised by the merger are clear cut and capable of ready implementation.[18]

147. Shell indicated that in order to remedy any competition concerns identified by the OFT, and to avoid a reference to the Competition Commission, they would be prepared to offer undertakings in lieu. Shell offered UILs in relation to the concerns identified in the retail supply of fuel in local areas and in the retail supply of auto-LPG in local areas.

UIL in auto-LPG

148. In respect of auto-LPG, Shell has offered to divest its auto-LPG interest in relation to the relevant Target Business LPG Site in every local overlap area (the SLC auto-LPG sites) for which the OFT had identified an SLC concern in auto-LPG.

149. Under its proposed UILs, Shell would sell Shell's interest in the SLC auto-LPG sites assets to [a suitable purchaser]. The OFT has considered Shell's auto-LPG UIL offer carefully. The offer, Shell submits, would represent a structural divestment of all of the physical LPG assets related to the SLC auto-LPG sites. These assets would include all of the physical assets on each of the sites, including the LPG tanks and related equipment. [ ].

150. [ ].

151. The OFT has considered whether this offer amounts to a sufficiently clear-cut remedy capable of ready implementation in line with its established guidelines and role as a first phase merger authority. The OFT considers that it is appropriate, given the size of the auto-LPG component at an individual petrol forecourt site, and the ability of Shell to carve-out the

[18] See OFT Mergers – *Exceptions to the duty to refer and undertakings in lieu of reference guidance* OFT1122, paragraph 5.7.

physical assets and any related business, including any goodwill, of the retail of auto-LPG to a purchaser and, for that purchaser to carry on the business in its own name. This is sufficient for the OFT to suspend its duty to refer, subject to consultation on this proposed UIL.

UIL in retail supply of fuel

152. Shell also offered to divest to a suitable purchaser either the Target Business site or one or more of the Shell sites in local area where the OFT has concluded that the completed merger gives rise to a realistic prospect of a substantial lessening of competition (Local Retail Fuel SLC). Shell further proposed that as an alternative to the divestment of one or more sites to a third party purchaser, Shell would be able to swap either the Target Business site or one or more of the Shell sites in any of the above-listed areas with a third party on the basis that this swap would not give rise to any competition concerns either in terms of any overlap created with the third party or any overlap created as a result of any site(s) that Shell received in lieu of the site(s) swapped with the third party.

153. The OFT considers that the Local Retail Fuel SLC offer is capable of clearly addressing the competition concerns identified above in accordance with the Act and the OFT's guidance and decisional practice. This includes both the divestment to a purchaser or a swap with a third party.

Upfront Buyer

154. The OFT considered whether it would be appropriate in this case to require that the relevant divestment be made to an up-front buyer.

155. With regard to its offer in respect of auto-LPG Shell acknowledges that there are relatively fewer candidate buyers than in retail fuels, [ ], given the relatively fewer potential purchasers, the OFT considers that an upfront buyer for the SLC auto-LPG sites is appropriate in this case.

156. [ ] there are a significant number of suitable candidate purchasers for petrol forecourts, and the OFT has no reason to doubt the commercial attractiveness of the divestment businesses. For these reasons, the OFT does not consider that an upfront buyer is necessary for those areas identified above for the retail supply of fuel.

DECISION

157. The OFT's duty to refer the completed acquisition by Shell UK Limited of 253 petrol stations from Consortium Rontec Investments LLP to the Competition Commission pursuant to section 22 of the Act is suspended because the OFT is considering whether to accept undertakings in lieu of reference under section 73 of the Act. However, pursuant to section 34A(3) of the Act this decision does not prevent the OFT from making a reference in the event of no such undertakings being offered or accepted.