PROPOSED MERGER BETWEEN TESCO PLC AND BOOKER GROUP PLC

RESPONSE TO THE CMA'S PROVISIONAL FINDINGS

1. Summary

1.1 Tesco and Booker welcome the CMA's provisional findings (***PFs***) that the Merger cannot be expected to result in a substantial lessening of competition (***SLC***) and that the Merger merits an unconditional clearance. The PFs rightly recognise that the wholesale and retail groceries markets are highly competitive and that the Merger does not raise concerns from a procurement perspective.

1.2 However, there are a few areas where the Parties consider that the PFs have understated the strong evidence presented by Tesco and Booker throughout the CMA's merger inquiry. More weight could be given to this evidence in the final decision in order to strengthen the CMA's conclusion even further that the Merger would not result in an SLC in any market. In particular:

(a) While the CMA is correct to focus on the Parties' low combined share of wholesaling as a whole (particularly in relation to procurement), it then goes on to define separate relevant product markets for delivered wholesale and cash and carry wholesale. The Parties consider that the CMA's evidence is sufficiently strong to allow it to reach a conclusion, not only that each channel exercises a significant constraint on the other, but that they represent two channels within a single product market. This is addressed below in **Section 2A**.

(b) If the CMA decides to maintain its distinction between the two channels, it may wish to do even more to underpin its correct conclusion that – within each channel, rather than just looking at wholesaling as a whole – the competitive dynamics preclude an SLC as a result of the Merger. This is considered further in **Section 2B**.

(c) The CMA is correct that the Merger will not result in the merged entity enjoying problematic buyer power and its assessment is supported to a greater extent than is stated in the PFs by standard competition law theory. This is addressed below in **Section 3**.

(d) The CMA may want more explicitly to address wholesaler concerns about implications of the Merger for the foodservice segment, as described in more detail in **Section 4**.

(e) The Parties agree that an SLC will not arise at a local level. However, the CMA has relied on a number of conservative inputs and assumptions in its vertical GUPPI analysis and, if it were to use more realistic inputs and assumptions, its conclusion would be even stronger. Similarly, although implicit in its analysis, the CMA may wish to outline in greater detail that the evidence shows that Booker does not exercise any meaningful control over its symbol group retailers. This is outlined in more detail in **Section 5**.

Finally, we address a number of miscellaneous issues in **Section 6**.

2. Wholesale market definition and competitive dynamics

A. Wholesaling is a single market

2.1 The Parties welcome the CMA's conclusion that the Merger will not give rise to an SLC in the wholesale market. However, the Parties consider that the evidence presented to the CMA supports a conclusion that cash and carry and delivered wholesale are part of one and the same relevant product market.

2.2 First, the CMA has ample evidence that there is *demand-side substitutability* between the two channels:

(a) Wholesalers and the ACS have adduced evidence that many retailers already multi-source, relying on both cash and carry and delivered services.[1] This is true also of Booker's symbol group customers and foodservice customers.[2]

(b) Many market players have confirmed that customers are highly price sensitive and will switch channels to secure lower prices.[3]

(c) Few independent retailers rely solely on cash and carry services.[4] This is supported by the CMA's retailer survey. When independent retailers were asked which other wholesalers could be used instead of Booker for their current purchases, only a minority stated cash and carry wholesalers only (27%) or delivered wholesalers only (15%).

(d) There is no evidence that minimum order quantities and/or spend requirements (which the CMA identified as possible barriers to switching channels) are preventing a sufficient number of retailers and foodservice customers from switching between cash and carry and delivered channels. In relation to volume switching, the CMA acknowledged that these barriers are not significant.[5]

2.3 On the basis of the evidence set out above, it is highly likely that, if faced with a SSNIP in cash and carry or delivered services, a sufficient number of retailers and foodservice customers would switch purchases to the other channel to defeat the price increase. This was recognised by the Competition Commission when assessing *Booker/Makro*.[6] Since then, as the CMA acknowledges in its PFs, substitutability between the cash and carry and delivered channels has increased

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[1] See paragraph 6.48 of the PFs report. Paragraph references in the PFs report relate to the version of the PFs published on the CMA's case page.

[2] See paragraph 2.30 of Annex 3 to the Parties' Initial Submission to the CMA for its Phase 2 review. See also IGD's report on UK Grocery Foodservice Wholesaling (February 2017) (slide 6) submitted as Appendix 2 to Annex 5 to the Parties' Initial Submission to the CMA for its Phase 2 review.

[3] See paragraph 6.48 of the PFs report.

[4] Survey evidence pointing to a lower reliance on delivered services by independent retailers is not necessarily representative of the wider market, as its universe is restricted to retailers which are currently supplied by Booker.

[5] See paragraph 7.93 of the PFs report.

[6] See paragraphs 7.30(a) and 8.29 of the *Booker/Makro* Final Report.

even further, and the appropriate conclusion is that these channels are part of the same product market.

2.4 Second, there is material *supply side substitutability* between the two channels. The CMA has received ample evidence that wholesalers are either already active in both channels or can easily enter or expand in the other channel in response to a price rise:

(a) The wholesale market has evolved since the Competition Commission's decision in *Booker/Makro*, which already acknowledged the growing importance of delivered services. Wholesalers are increasingly developing a multi-channel presence (i.e. providing both collect and delivered options),[7] particularly in response to greater customer demand for improved delivery services.[8] Wholesalers active in both channels are able to adapt quickly and easily shift capacity between channels to respond to customer demand. Wholesalers have also told the CMA that there is growing demand for delivered services.[9]

(b) Barriers to entry and expansion are low. Wholesalers can easily adapt existing warehouse facilities to provide wholesale operations of another type. Booker uses its cash and carry depots for a dual purpose: (i) to support collect sales to wholesale customers; and (ii) to load and operate vehicles that deliver goods to wholesale customers. As noted by other wholesalers,[10] dedicated distribution and picking centres are not necessary for delivered wholesaling and outsourcing of delivery is also an option (as evidenced by recent symbol group distribution partnerships).[11] Several wholesalers told the CMA that they have recently expanded into delivered services or that it was possible to do so.[12] Moreover, delivered wholesalers, such as Birchall Foodservice, continue to expand,[13] demonstrating that barriers to entry and expansion are low in delivered wholesaling.

(c) Although the CMA has suggested that barriers to entry might be more significant in relation to delivered wholesale (notwithstanding its overall conclusion that barriers to entry in wholesaling are low), the evidence demonstrates that barriers to entry in delivered wholesale are also not

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7 See paragraph 7 of the CMA's summary of interviews with third party wholesalers.

8 For example, Bestway has recently invested in a new chilled distribution centre and subsequently launched a new delivered service aimed at attracting multi-site customers (see: https://www.bestway.co.uk/news.php?id=990). See also: http://www.afblakemore.com/about-us/news-story/blakemore-wholesale-launches-new-bangor-depot.

9 See paragraph 6.50 of the PFs report and paragraph 7 of the CMA's summary of interviews with third party wholesalers.

10 See paragraph 11 of the CMA's summary of interviews with third party wholesalers.

11 See paragraph 7.60 of the PFs report.

12 The CMA mentions that expansion into other wholesale segments by existing wholesalers could take time (see paragraph 7.83 of the PFs report), but this statement is based on a submission by Parfetts in relation to entry into the symbol group segment of the wholesale market and, therefore, it is not applicable to the expansion from cash and carry services to delivered services (and vice versa).

13 http://www.wholesalenews.co.uk/news/birchall-continues-with-its-rapid-expansion.html.

material. Notable recent examples of entry in delivered wholesale include agreements by Morrisons and the Co-op to supply McColls stores and Costcutter stores across the UK respectively,[14] as well as DeeBee's new click and deliver service launched at its Hull cash & carry site.[15] This was confirmed by the CMA's market test. When asked about minimum efficient scale, one wholesaler mentioned a figure of £150,000 delivered per week. This is not a significant sum:[16] for example, a distribution centre or light industrial unit comprising two or three trucks with total deliveries of £150,000 per week would be in the [✂] of business centres by value of delivered goods in Booker's estate. Supply-side substitution between the two channels is therefore straightforward.

2.5 On this basis, it is highly likely that, if faced with a SSNIP in cash and carry or delivered services, a sufficient number of wholesalers operating in the other channel would enter and defeat any price increase. As a result, there is no reason to define the cash and carry and delivered channels as separate markets.

B. Even considering the cash and carry and delivered channels in isolation, there would be no SLC as a result of the Merger

2.6 The CMA is correct to conclude that there will be no SLC stemming from the hypothetical procurement advantages accruing to the merged entity regardless of the wholesale channel being analysed (see also **Section 3** below). However, given that Booker has a higher share of cash and carry wholesale than delivered wholesale, the CMA could be more explicit in its final decision that the Merger would not lead to an SLC in the cash and carry channel taken in isolation.

2.7 In addition to the arguments that apply to all of wholesaling (e.g. that achieving procurement synergies will depend on negotiations with suppliers, that the Parties' share of procurement is insufficient to result in an SLC, that there is ample downstream competition and that suppliers will wish to retain competition downstream), the CMA in its final decision may want to point to the evidence showing that this is as true of each channel as it is of all wholesaling.

2.8 In particular, any ability to exploit hypothetical procurement gains in the cash and carry channel would be undermined by the level of competition in the delivered channel. The CMA may also wish to emphasise that, while low across all wholesaling, barriers to entry and expansion within the cash and carry channel are particularly low, as evidenced by the dynamism of the sector.[17] As explained

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14 Morrisons announced a long-term wholesale supply arrangement with McColls in August 2017 (https://www.mccolls.co.uk/media/29026096/20170801_mccolls_rns_final.pdf), while the Co-op and Costcutter have recently announced that the Co-op will become the exclusive wholesale supplier to Costcutter stores (https://www.co-operative.coop/media/news-releases/csg).

15 https://www.deebee.co.uk/media-and-events/media/16.

16 See paragraph 9 of the CMA's summary of interviews with third party wholesalers.

17 For example (among many others): (i) Dhamecha's steady long-term growth over the past twenty years (from a single depot operation which has expanded incrementally over time); (ii) Costco's recent opening of new stores in Stevenage and Maidstone; (iii) Holland Bazaar's opening of a new store in south London; (iv) recent new entry by Abra Wholesale (opening a cash and carry in Luton); and (v) recent new entry by Plymouth Cash and Carry opening in Plymouth.

in the Parties' buyer power submission of 29 September 2017: (i) there are very limited (if any) sunk costs of entry or expansion as all the major assets (e.g. depots and delivery vehicles) can readily be leased; (ii) there is no shortage of the necessary assets as wholesalers operate on readily available industrial land and do not face onerous planning requirements; and (iii) the short run fixed costs of operation are a small proportion of total costs, and even these can be scaled with volume as the wholesale business grows.

3. The CMA's approach to buyer power is underpinned by competition law theory

3.1 The Parties welcome the CMA's conclusion that the Merger will not result in an SLC due to any advantages in procurement. The Parties agree with the approach taken by the CMA in its assessment of the buyer power theory of harm, in particular: (i) the cumulative conditions outlined in paragraph 8.11 of the PFs report to determine whether the Merger would raise any concerns in the wholesale market due to potential procurement advantages; and (ii) the confirmation that buyer power concerns could potentially arise only if procurement shares exceed the threshold of 30% post-merger and there is a significant increment.[18]

3.2 In relation to the latter, the Parties agree that a threshold of a 30% combined procurement share and a 5% increment is the appropriate one to identify whether there may begin to be buyer power concerns. Given the concern expressed by third parties in this regard, the CMA may wish to remind readers in its final decision that use of this threshold is widely accepted:

(a) The European Commission's Non-Horizontal Merger Guidelines make clear that a non-horizontal merger is unlikely to raise concerns where the new entity's market share post-merger in each of the markets concerned is below 30%.[19] The same threshold is referenced in the CMA's Merger Assessment Guidelines.[20]

(b) In an OFT-commissioned study on the competitive effect of buying groups, economics experts concluded that a buyer group's share of upstream purchases is moderate if it does not exceed 30%.[21]

(c) Similarly, under the Vertical Block Exemption Regulation, the block exemption applies if the undertakings' market shares do not exceed 30%.[22] The European Commission presumes that, below that threshold, vertical agreements would generally be pro-competitive.[23]

(d) In the absence of a significant increment in procurement shares, a merger would not have a sufficiently significant impact on the upstream markets

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18 See paragraph 8.44 of the PFs report.

19 See paragraph 25 of the guidelines.

20 See paragraph 5.3.5 of the guidelines.

21 OFT Economic Discussion paper on the competitive effects of buyer groups (2007), paragraph 1.86.

22 http://ec.europa.eu/competition/antitrust/legislation/guidelines_vertical_en.pdf.

23 See recital 8 of the Vertical Block Exemption Regulation.

to warrant investigation.[24] A 5% threshold is appropriate, in line with the CMA's usual assessment in horizontal mergers (which is more conservative than in non-horizontal mergers).[25]

4. There will not be an SLC in the foodservice segment

4.1 The Parties note that there have been complaints from some wholesalers about the merged entity's ability to leverage any hypothetical procurement benefits from Tesco's buying power to improve its competitive position in the foodservice segment. It would be straightforward for the CMA to address this concern more explicitly in its final decision by citing the following factors to show that the concern is not sustainable:

(a) Booker's share in the foodservice segment of the wholesale market is only 16%,[26] which is well below any reasonable threshold for concern.

(b) Given that Tesco is not active in the wholesale market, the Merger will not result in any structural changes to the wholesale market and no increment in Booker's market share. There is no increment in procurement shares arising from the Merger in the foodservice segment, as Tesco has no meaningful activities in this segment of the market. As the CMA notes, there are differences between products procured for catering and those procured for retailing. As a result, the Merger is highly unlikely to give Booker a meaningful procurement advantage in the foodservice segment.

(c) The market is very competitive and competitors include large players (such as Brakes and Bidfood). As the CMA was told, wholesalers can and would respond to increased competition.[27] It is not plausible to consider that Booker would be able substantially to weaken its competitors.

(d) As the CMA recognises, specialist wholesalers and buying groups act as a further constraint over larger cash and carry and delivered wholesalers.[28] The presence and strength of these players make it even less plausible that merged entity would be able to harm competition.

(e) Foodservice customers have countervailing buyer power. Customers are always looking for the most attractive price/quality ratio and re-tender their business very frequently; as a result, wholesalers typically earn low margins in these contracts. While larger (i.e. national) foodservice customers may have contracts lasting a year or more, smaller independent foodservice customers often switch wholesalers on a weekly basis. This

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24 See OFT Economic Discussion paper on the competitive effects of buyer groups (2007), paragraph 1.86.

25 See, for example, the Competition Commission's decision in *Booker/Makro* (paragraph 8.57) and the CMA's decision in *Heineken/Diageo* (paragraphs 37 and 43).

26 See IGD's report on UK Grocery Foodservice Wholesaling (February 2017) submitted as Appendix 2 to Annex 5 to the Parties' Initial Submission to the CMA for its Phase 2 review.

27 See paragraph 8.26 of the PFs report.

28 See paragraph 6.36 of the PFs report.

frequent switching and re-tendering of business is driven in part by the fact that consumers at foodservice businesses are unlikely to have strong preferences for (or even knowledge of) a given supplier or product. Many foodservice customers may also switch wholesalers at various times of the year to maximise their use of local produce.

(f) Barriers to entry and expansion in foodservice are low (for the same reasons as outlined above).

4.2 In any event, the Merger is expected to bring significant benefits to the foodservice segment, which are likely to outweigh any hypothetical negative impact on competition. For example, Tesco's skill in the fresh supply chain will enable Booker to provide a better quality offer with an attractive value proposition, thereby raising the quality standards in the foodservice segment.

5. The CMA has adopted very conservative assumptions in its vGUPPI analysis and the CMA's conclusions could therefore be strengthened

5.1 The Parties welcome the CMA's conclusion that the merged entity has neither the ability nor the incentive to worsen Booker's wholesale offer or Tesco's retail offer for the various reasons set out in the PFs report.

5.2 Although the CMA's conclusion that there will be no SLC is correct, the Parties consider that some of the inputs and assumptions used in the vertical GUPPI framework remain too conservative. If the CMA were to use more realistic and reasonable assumptions for these inputs (in line with the usual approach taken at Phase 2), no areas would be identified under the vertical GUPPI framework as requiring further consideration. For example:

(a) The use of a 5% GUPPI threshold (even on a cautious basis) does not reflect the fact that the Merger is a vertical transaction, that this is a Phase 2 analysis and that there would be significant "dilution" of any wholesale GUPPI between the wholesale and retail levels. In addition, when considering a Tesco price increase, a large price gap already exists between Tesco stores and Booker-supplied stores (c.[✂]%), which means marginal customers would still pay more by switching to Booker-supplied stores in response to a small Tesco price increase. Therefore, a 5% GUPPI threshold is too conservative and a GUPPI threshold of at least 10% should be used.[29]

(b) The CMA has reduced the weighting of Aldi and Lidl to 80% in its weighted share of shops (***WSS***) model. However, there is strong evidence demonstrating that Aldi and Lidl are equally as strong and effective competitors as the multiples in the convenience segment, including the

[29] See, for example, the CMA's Phase 2 decision for *Ladbrokes plc / Gala Coral Group Limited* (footnote 118).

CMA's own entry-exit analysis,[30] Tesco's entry analysis[31] and Kantar customer switching data.[32] This means that when considering the incentive to worsen Tesco's offer, Aldi and Lidl have been given the same weighting as Booker-supplied symbol retailers in the PFs, even though the evidence demonstrates clearly that Tesco stores are significantly more constrained by Aldi and Lidl than by Booker-supplied symbol stores (indeed, [✂]). As such, the weighting attributed to Aldi and Lidl stores should be 100% in the WSS model.

(c) Using a 10% assumption for out-of-market diversion is overly cautious. For example: (i) Tesco's analysis of its Clubcard data for the Express format shows that [✂]; and (ii) an analysis from past One Stop store acquisitions shows out-of-catchment leakage of [✂].[33]

(d) Using a pass-through rate of 75% is highly conservative, as Booker has no meaningful degree of influence over the pricing of branded goods sold as price-marked packs (which accounts for c.[✂]% of Booker's sales to Premier retailers) or under a promotion. For these types of sales, there is typically no scope for a wholesaler price increase to be passed-through by retailer customers.

5.3 Separately, the CMA's overall approach to analysing local competition is supported by the fact that Booker operates a highly flexible symbol group model and does not exercise any meaningful degree of control over its symbol group retailers.[34] This point was confirmed by the CMA in its review of the *Booker/Musgrave* transaction,[35] but it is not assessed in any detail in the PFs. Given the significant analysis undertaken on this point by the CMA, it may be useful to explain more explicitly in the final decision that the evidence in this case is entirely consistent with the CMA's conclusions in *Booker/Musgrave*. In particular, any attempt to deteriorate Booker's offer would be defeated by retailer customers switching at the wholesale level (either by switching symbol group fascia or switching wholesale purchases to competing wholesalers).[36]

5.4 Finally, the Parties agree with the CMA's conclusion that engaging in a targeted deterioration strategy at specific local areas would entail costs, operational

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[30] The CMA's entry-exit analysis indicates that the entry of a discounter has a similar (indeed slightly greater) impact on Booker's sales to its retailer customers as the entry of a multiple.

[31] Tesco's entry analysis demonstrates that Aldi and Lidl store openings have a comparable impact on the sales of Tesco Express stores as the opening of [✂]. Furthermore, the impact of Aldi and Lidl store openings is not statistically different to the impact of [✂].

[32] Customer switching data shows that Express stores lost more (net) customers to Aldi and Lidl than to any other competitors - including the multiples, symbol stores and convenience specialists – between June 2016 and June 2017.

[33] See Section 2A of the Parties' response to the CMA's working papers submitted on 13 October 2017.

[34] For further detail, see Section 8B of the Merger Notice and Annex 3 to the Parties' Initial Submission for the CMA's Phase 2 review.

[35] Booker's relationship with its symbol group customers has become even more flexible since the *Booker / Musgrave* transaction. For example, [✂].

[36] As rightly recognised in the PFs, Booker's contractual arrangements do not pose a barrier to Booker's retailer customers switching at the wholesale level. See paragraphs 7.89 and 7.102 of the PFs report.

complexities and reputational risks, which would be disproportionately high relative to the very small number of areas identified under the vertical GUPPI framework (using the CMA's conservative inputs).[37] This is in line with established precedent, as the lack of incentive to engage in a bespoke local strategy where there are only a small number of areas involved was recognised by the CMA in *Booker/Musgrave*.[38] Recognising that quantification of such costs is not straightforward (particularly since the Parties set their respective offers on a national basis and any local variation is very limited and not based on local competition), the CMA is right both to exercise its margin of discretion in this respect and to place these costs in context as one of a number of reasons why any incentives to pursue a targeted deterioration strategy are insufficient to result in an SLC.

6. Other issues

6.1 There are two other areas where the Parties consider that there is additional evidence that would strengthen the CMA's findings:

(a) **Counterfactual**: as noted in the PFs, an agreement has been reached for the Co-op to acquire Nisa.[39] The Parties agree with the CMA's conclusion that if the transaction were to go ahead, it would not affect the SLC assessment of the Merger, as the Co-op / Nisa transaction is conditional on CMA approval and any such approval "*may include remedial action to address competition concerns found at that time*".[40] Moreover, when assessing the Parties' post-merger incentives under the vertical GUPPI framework, the CMA has used a WSS approach (under its 'base scenario') to proxy diversion ratios between Tesco stores and Booker-supplied stores. Under this WSS approach, diversion is estimated to be in proportion to the Parties' weighted share of *stores* in the local catchment. The Co-op / Nisa transaction would not affect the number of competing *stores* in each local catchment and therefore would not impact the incentives analysis (and SLC assessment) under the vertical GUPPI framework.

(b) **SSNIP test**: as part of the retailer survey, the CMA assessed the likely actions of retailers in response to a small but significant non-transitory increase in Booker's wholesale price. In line with established precedent, the CMA used 5% as its measure of a small price rise, which the Parties consider is appropriate.[41] Even if the CMA were to consider the likely actions of retailers in response to an even smaller rise in Booker's wholesale prices (i.e. less than 5%), it is reasonable to conclude that there would still be significant switching at the wholesale level. This is because retailers operate on low margins and are highly price-sensitive (as

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37 This is recognised in the PFs report (see paragraphs 9.56 and 10.23). For further detail, see Sections 5 and 6 of the Parties' response to the CMA's working papers submitted on 13 October 2017.

38 See paragraphs 5 and 59 of the *Booker / Musgrave* decision.

39 Since the publication of the PFs, the terms of the acquisition have been approved by Nisa's shareholders.

40 See paragraph 5.9 of the PFs report.

41 See footnote 79 of the PFs report.

acknowledged by all of the wholesalers interviewed by the CMA),[42] which means even a very small increase in wholesale prices would likely cause them to source their requirements from other suppliers. As such, the Parties consider that the CMA should revisit its conclusion that using a 5% SSNIP measure could overstate retailer reactions.

(c) **P&H**: since the publication of the PFs, P&H has entered into administration and is no longer able to supply delivered wholesale services to Tesco. This illustrates that any impact on competition from Tesco potentially choosing not to buy from P&H is not merger-specific, as P&H is now unable to provide delivered wholesale services to Tesco irrespective of the Merger.[43]

In any event, the CMA's conclusion that there would be no SLC in the supply of delivered (and other) wholesale services as "*sufficient options and competitive constraints will remain*" for each of P&H's customer groups and for the wholesale supply of tobacco products still stands. Likewise, existing players will be able to maintain the high degree of rivalry in the supply of wholesale services irrespective of any changes in P&H's competitiveness.[44] While it is premature to evaluate the impact of P&H's collapse, the strong and dynamic nature of competition in the wholesale market is demonstrated by the measures already being taken by wholesalers to support P&H's customers, including: (i) Costcutter (a major customer of P&H) quickly being able to find alternative supply arrangements whereby the Co-op will supply products to Costcutter stores;[45] (ii) [✂]; and (iii) Bestway reportedly picking up the contract to supply the Central Convenience chain owned by P&H.[46]

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42 See paragraph 17 of the CMA's summary of interviews with third party wholesalers.

43 [✂]

44 See paragraph 58 of the summary of the PFs and paragraphs 11.22 to 11.53 of the PFs report.

45 The Co-op and Costcutter have entered into an agreement that will see the Co-op become the exclusive wholesale supplier to Costcutter stores from Spring 2018. The Co-op is also looking at short-term interim arrangements to support Costcutter retailers until the formal agreement begins (see: https://www.co-operative.coop/media/news-releases/csg).

46 https://www.thegrocer.co.uk/channels/wholesalers/retailers-race-to-plug-supply-gaps-in-wake-of-ph-demise/560792.article.