

PROPOSED MERGER BETWEEN SAINSBURY'S AND ASDA

RESPONSE TO ISSUES STATEMENT

1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1 This memorandum sets out comments by Wm Morrison Supermarkets plc ("**Morrisons**") in relation to:

- (a) the CMA's Issues Statement (dated 16 October 2018) in connection with the proposed merger between Sainsbury's and Asda; and
- (b) the Parties initial submission to the CMA (dated 10 October 2016).

1.2 Morrisons is broadly supportive of the areas of focus identified by the CMA in the Issues Statement, which extends significantly beyond the limited range of issues considered by the CMA in its reference decision.

1.3 Given the size of the transaction and the importance of the UK grocery market to UK consumers, it is important that the CMA has sufficient time to get to the bottom of all the issues raised by the proposed transaction. Even a very small price rise resulting from the merger can be expected to have a very significant adverse impact on UK consumers.

1.4 Whilst a key argument of the parties is that the UK grocery sector has fundamentally changed in recent years, and therefore they suggest that a fundamentally different approach to assessing the transaction is needed, Morrisons considers that such changes should not be overstated. The market structure at a national level has remained similar since 2008 with four large retailers that have actually increased market share. Moreover, despite the recent growth of Aldi and Lidl, the presence of Limited Assortment Discounters in the UK groceries market is not new and nor is their business model, and most consumers continue to rely on large grocery stores with a wide product selection for a weekly or fortnightly grocery shop.

National competition - groceries

1.5 In relation to national competition for groceries, Morrisons considers that:

- (a) the parties are two of the closest direct competitors nationally. This is reflected in the high degree of overlap between the parties' stores at the local level, which is higher than for any other grocery retailer (except Tesco), and there are few other competitors offering one-stop shops;
- (b) national competition concerns extend beyond the sum of the local overlap. In particular, the parties have opened stores in similar areas to each other [X], which is competition that will be lost as a result of the transaction;
- (c) the UK competition authorities have previously considered that the market is conducive to coordinated effects. The high market share between Tesco and the Parties, combined with high levels of transparency and competitor monitoring in the market, suggests that duopoly concerns need to be closely scrutinised in this case; and
- (d) it is important that the CMA looks closely at the impact of the transaction on online grocery retailing, which attracts a different cohort of consumers to in-store shopping. The combined share of the two largest retailers (Tesco and the merged entity) will be even higher for online groceries, and some competitors do not provide a national coverage.

- 1.6 In relation to competition from the Limited Assortment Discounters, [redacted] the Limited Assortment Discounters only compete across a limited product range, and mainly with own label products (which are generally in the form of brands created by the retailer itself and for its sole use, sometimes referred to as 'exclusive brands'. An example of this would be the Harvest Morn breakfast cereal brand in Aldi). [redacted] Accordingly, they provide no competition for the vast majority of SKUs in the large one-stop stores, which could be adversely affected as a result of the merger.
- 1.7 Bargain stores offer an even more limited range of products, and therefore do not provide an alternative for the one-stop shop type of customers that shop at the parties' stores.

Local competition - groceries

- 1.8 In relation to local competition for groceries, Morrisons supports the comments in the Issues Statement that the CMA will consider how the merger will impact on competition in each local area where the parties are present. Morrisons considers that:
- (a) the existing segmentation by store size and approach to catchment areas remains valid. The principal constraint on a one-stop store remains another one-stop store, and this was the approach recently adopted by the CMA in *Tesco/Booker* (late 2017). In this context, the existing 4-3 fascia count filter remains appropriate;
 - (b) Morrisons' core competitors for larger stores are Asda, Sainsbury's and Tesco, and these four retailers should continue to be the focus of the fascia count analysis; and
 - (c) [redacted].
- 1.9 Morrisons has significant concerns that the methodology proposed by the parties (i.e. based on a weighted share of shop) will overstate the degree of competition faced by the merging parties' stores, and therefore materially understate the number of areas where there could be competition concerns. A number of arguments raised by the parties to support a revised approach have been considered previously by the UK competition authorities and rejected.
- 1.10 The local filter should act as a screen to rule out non-problematic areas. It is risky and creates a false sense of precision to attempt to design a complex mathematical formula that tries to account for every variable, and therefore the CMA should err on the side of caution in applying the filter, as it has done in previous merger cases in the sector.
- 1.11 The Phase 1 decision and Morrisons own analysis indicates that there are many local areas that fail the local filter analysis, and therefore likely to raise local competition concerns.

Fuel and other non-grocery retailing

- 1.12 Morrisons considers that there are likely to be local areas which give rise to competition concerns in markets related to road fuel or non-food products even where there is sufficient grocery retail competition. Notwithstanding the scale of the issues in relation to groceries, it is important that the CMA conducts a detailed investigation into each of these areas.
- 1.13 In relation to fuel, Morrisons considers that the transaction should be scrutinised closely at both a national and local level. Previous work of the CMA indicates that the presence of supermarkets, and Asda in particular, generally leads to lower fuel prices in an area: competition that would be lost as a result of the merger.

- 1.14 There are a number of reasons why competition concerns may arise in relation to the retail supply of road fuel, even where those same areas do not give rise to competition concerns in relation to the retail supply of groceries:
- (a) the CMA has adopted a different approach to assessing competition in fuel retailing compared to grocery retailing, and should continue to do so;
 - (b) [~~3~~] Price markers are unique to the fuel retailing market, and reflect the importance of particular retailers in driving price competition;
 - (c) the CMA should consider how consumers that buy a combination of products, such as fuel and groceries in a single trip, will be affected by the merger, but also whether the parties have the incentive to price low on fuel to encourage more consumers in-store (an incentive that cannot be easily replicated by divestment to other independent fuel retailers); and
 - (d) the parties also operate a number of standalone petrol filling stations, which need to be considered separately.
- 1.15 Morrisons notes that the parties have not suggested that a similar weighting approach should be applied to assessing the overlaps for fuel. This is perhaps unsurprising given that the supermarkets would generally be expected to be much closer competitors (which would be reflected in a much higher weighting) than smaller independent filling stations. If the CMA considers using a weighting approach to assessing grocery retailing at the local level, it should also consider a similar weighting approach to fuel retailing.
- 1.16 Morrisons agrees with the statement in the Issues Statement that the CMA also intends to carry out a detailed analysis (at both a national and local level) in relation to general merchandise. Each of Sainsbury's and Asda are important suppliers of non-grocery products both nationally and locally, which could be adversely affected by the transaction.

Buyer power

- 1.17 The Parties have signalled that they intend to use the merger to secure procurement benefits from suppliers and that this will result in lower prices to consumers. However, a duopoly situation with approximately 60 per cent of grocery purchasing power in the hands of just two retailers (the parties and Tesco) is likely to be regarded as an unhealthy concentration of power in the supply chain.
- 1.18 It is not clear to Morrisons that the Parties will be able to obtain significantly better purchase prices or terms of supply from suppliers as a result of the transaction, and the CMA should remain sceptical about such claims.
- 1.19 To the extent that any procurement benefits can be obtained from the transaction:
- (a) this would be likely to involve harmonising ranges in order to gain additional scale, which will lead to a loss of choice for consumers;
 - (b) the loss of competition at both a national and regional level is likely to result in the parties not having the incentive to pass on any scale-based purchasing synergies to consumers; and
 - (c) it would be important for the CMA to consider the impact that this would have on (i) suppliers, which could react by cutting quality, investment etc., [~~3~~]

2. MARKET CONTEXT

Changes in the market dynamics are overstated

- 2.1 The UK grocery market is valued at £184 billion.¹ The maintenance of effective competition is therefore imperative in order for millions of consumers to continue to benefit through lower prices and better quality, range and service. The Proposed Merger would represent a very significant shift in the structure of the market, and raises a number of potential serious competition concerns.
- 2.2 A key argument being made by the Parties to address these concerns is that "*the UK grocery sector has fundamentally changed since the 2003 Competition Commission Safeway report and the 2008 Groceries Market Investigation*".² However, whilst there have been some changes in the UK groceries sector in recent years, the effect of such changes on the way in which the CMA should examine competition in the market should not be overstated:
- (a) at a national level, the market structure has remained similar. The largest four retailers have a greater share of the market today (69.5 per cent) than they did in 2007 when the Competition Commission examined the market (65.4 per cent);³
 - (b) the Parties have both increased their market share since the Groceries market investigation, with Sainsbury's increasing market share by 2.1 percentage points to 15.9 per cent, and Asda by 1.4 percentage points to 15.5 per cent;
 - (c) the presence of Limited Assortment Discounters in the UK groceries market is not new, and nor is their business model:
 - (A) whilst Aldi and Lidl have opened stores and gained share in recent years, previous discounter brands such as KwikSave and Netto (acquired by Asda) have disappeared;
 - (B) in 2010 Asda's view was that Netto, which operated a similar business model to Aldi and Lidl, "*is not in the same product market as Asda*";⁴
 - (C) the current market share of Aldi and Lidl (12 per cent) is similar to the market share of three Limited Assortment Discounters as far back as 1993, which suggests that there is a relatively defined role for the discounters in the UK groceries sector and that this is not a novel development; and
 - (d) whilst customers' shopping habits continue to evolve, such as through the introduction of online food retailing, many customers still carry out a weekly or fortnightly grocery shop in a large grocery store with a wide product selection. The importance of the large one-stop shop format has therefore not fundamentally changed since the Groceries Market Investigation.
- 2.3 Accordingly, whilst it is right for the CMA to examine the changes that have taken place in the UK groceries sector in recent years, Morrisons does not consider that the market has fundamentally changed since 2008 such that there are now a much broader range of competitive constraints on their core business in operating large format grocery stores

¹ <https://www.igd.com/about-us/media/press-releases/press-release/t/igd-uk-food-and-grocery-forecast-to-grow-by-15-by-2022/i/16927>

² Page 1 of the Parties initial submission to the CMA, dated 10 October 2018 (the "**initial submission**").

³ See Figure 3.1 of the Groceries Market Investigation Report, and Kantar Worldpanel market share data for the 12 weeks ending 22 April 2018, available at <https://www.kantarworldpanel.com/en/grocery-market-share/great-britain/snapshot/22.04.18/>.

⁴ OFT Decision "Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited", 23 September 2010.

(and therefore a fundamentally different approach to the competition assessment is not required).

Maintaining separate brands does not address the concerns

- 2.4 The Parties have stated in their announcement of the Proposed Merger that they will continue to maintain separate Asda and Sainsbury's brands post-merger.
- 2.5 However, despite the intention to continue operating two separate brands, it is clear that the transaction will result in the parties having a "single controlling mind". This will impact on how, post-merger, the parties allocate investment in the grocery retailing proposition (e.g. on factors such as price and people) between the two brands. It will also impact how they allocate capital between the two brands.
- 2.6 Morrisons notes that the CMA will in any event assess the Proposed Merger on the basis of the fact that full control over Asda is being acquired by Sainsbury's. Morrisons agrees with this approach for the following reasons:
- (a) the Parties will be able to change any elements of competition that do not pertain to brand, e.g. changing prices, store refurbishment, making ranging decisions, choosing promotions, etc. As a result, this intention does not provide any comfort from the perspective of maintaining competition in the market;
 - (b) although they have stated that there are no planned store closures, the Parties have not committed to maintaining any individual stores with the current brand and there are likely to be local areas where changing the fascia is attractive to the Parties;
 - (c) the reported management structure, with a Group Operating Board and a management team led by the Sainsbury's Chairman, CEO and CFO suggest that the Parties intend to coordinate both brands centrally;
 - (d) the expected £350m of buying synergies resulting from harmonised buying terms suggests that the merged company will procure products centrally through one buying team; and
 - (e) in any event, the statements contained in the announcement are not binding on the Parties, and the CMA will need to assume that, if a profitable opportunity presents itself, the Parties will change their strategy.
- 2.7 Accordingly, Morrisons considers that little comfort can be taken from the parties' announcement that they intend to continue operating both brands post-merger.

3. NATIONAL COMPETITION ISSUES FOR GROCERIES

Introduction

- 3.1 As all of the major supermarket chains told the Competition Commission during the Groceries Market Investigation, a number of the most important parameters of competition are determined at the national level, including prices, promotions, range, own-label supply, and product quality. In setting these elements of the competitive offering, Morrisons, like the other major supermarkets, is influenced by the competition it faces from other supermarket chains.
- 3.2 This section sets out a number of factors which Morrisons considers are relevant to the assessment of national competition:

- (a) the degree of local overlap between the parties as an indicator of the closeness of national competition;
- (b) the extent to which national competition extends beyond the sum of the local overlaps in this case;
- (c) factors that point to the transaction giving rise to duopoly (coordinated effects) concerns;
- (d) the extent of competition between (i) the Parties; (ii) the discounters; and (iii) other competitors; and
- (e) the online grocery retailing market.

National issues as a function of the degree of local overlap

3.3 In assessing national competition, the CMA explained in the *Coral/Ladbroke*s report that any loss of competition at the national level is likely to arise as a result of the aggregated loss of competition in the various local areas in which the two retailers operate. In particular, the CMA explained that

"if the Transaction may be expected to result in competition concerns in local areas representing a significant proportion of the Parties' overall business, the Transaction may create an incentive to worsen any of the aspects of the Parties' offerings that are set centrally and applied uniformly on a national basis".⁵

3.4 If the same approach is applied in this case, it is clear that the Parties are two of the closest competitors at a national level due to the extent of the local overlap between their respective estates. In particular:

- (a) 91% of Asda's one-stop stores have a Sainsbury's one-stop store nearby (i.e. within the maximum reach isochrone), and
- (b) 88% of Sainsbury's one-stop stores have a Asda nearby.

3.5 On this basis, the degree of overlap between the parties' estates at the local level is higher than for any other grocery retailer, with the exception of Tesco.

3.6 Accordingly, to the extent that there are parameters of competition that are set centrally, and which are reflective of competition at the local level, the evidence points to the Parties being two of the closest direct competitors at a national level.

3.7 The extent of the local overlap between Sainsbury's and Asda is also much higher than was identified between the parties in the *Coral/Ladbroke*s report (i.e. which identified overlaps between 30% and 40% of their respective estates). Accordingly, even if the CMA were to apply a similar approach in this case, the evidence points to national competition concerns being significantly more acute than were identified in the *Coral/Ladbroke*s report. Grocery retailing is also more strategically important for the country than gambling, with very different underlying economics (e.g. no equivalent minimum £40, or delivery charge etc, for a bet), and therefore the CMA should be cautious in relying on the *Coral/Ladbroke*s decision to inform its assessment in this case.

National issues extend beyond the sum of local overlaps

3.8 Notwithstanding the very high degree of local overlap between the Parties, the CMA also set out in *Coral/Ladbroke*s that national concerns may extend beyond the aggregated loss

⁵ Paragraph 8.2. <https://assets.publishing.service.gov.uk/media/5797818ce5274a27b2000004/ladbroke-s-coral-final-report.pdf>

of competition at a local level (e.g. where retail mergers result in the loss of potential competition or innovation between the parties that goes beyond their respective estates).⁶

3.9 [X]

3.10 Moreover, the extent of the local overlap between the Parties indicates that their commercial strategies have been targeting very similar areas for store trading, which would have been expected to continue if they remained as two separate entities. However, the merger will remove this incentive to open stores in competition with each other, thereby eliminating an important competitive dynamic in the market.

3.11 [X]

3.12 The impact on national competition also extends to online grocery retailing, with Sainsbury's and Asda being two of the largest online providers. As set out below, Morrisons notes that the combined share of the two largest retailers (Tesco and the merged entity) will be even larger in online groceries, with Tesco having a market share of 39.7 per cent and the Parties combined with 34.9 per cent (Sainsbury's 17.6 per cent, Asda 17.3 per cent). Moreover, a number of the major market players, [X], do not provide national coverage, which means that many consumers will face a more limited choice.

3.13 Accordingly, Morrisons considers that there are important aspects to national competition in grocery retailing which extend beyond the sum of the local overlaps, and which would be adversely impacted by the merger.

Duopoly concerns for a large range of products

3.14 Morrisons agrees with the CMA that it is also relevant to consider whether the proposed transaction gives rise to any coordinated effects concerns in relation to the supply of groceries (either through retail supply or online/delivered sales).

3.15 The transaction will leave two very large retailers at the national level (accounting for approximately 61 per cent of all grocery sales), [X] (i.e. the combined market share of the two largest retailers is likely to be much higher across certain product ranges that are not supplied in discounters or smaller stores). As set out further below, the combined market share of the largest retailers will be even higher in Northern Ireland (approximately 70 per cent).

3.16 In this regard, it will be important for the CMA to assess the degree of competition between the Parties and third parties across the entire product ranges of the Parties. To the extent that there is competition from other retailers and national multiples, this tends to be limited to a narrow (core) product range, leaving greater concentration in relation to a large number of products.

3.17 [X], until recently, Asda offered a price guarantee whereby it would refund the difference if prices were not at least 10 per cent cheaper than for the equivalent shop against Tesco, Morrisons and Sainsbury's (this scheme has now been withdrawn). The other grocery retailers, including Sainsbury's, Morrisons and Tesco have also operated similar schemes in the past. The retailers are also able to use a combination of price tracking and Kantar market switching data to check the prices offered by competitors, and if they are losing customers, they are able to see to whom.

3.18 The possibility of coordinated effects in relation to a merger in the groceries sector has also been considered in the past. In particular, the CMA identified concerns in relation to

⁶ Paragraph 9.1. <https://assets.publishing.service.gov.uk/media/5797818ce5274a27b2000004/ladbroses-coral-final-report.pdf>

the possibility of coordinated effects in relation to the acquisition of Safeway by each of Asda, Sainsbury's or Tesco in the Safeway report. The CMA concluded that:

"At the national level, we found that the change in market dynamics brought about by the acquisition of Safeway by any of Asda, Sainsbury's or Tesco might be expected, given the conditions facilitating coordinated behaviour, over time to lead to such coordinated behaviour".

- 3.19 More specifically, the CMA was concerned that a number of conditions existing in the one-stop grocery market were conducive to coordinated behaviour, and that this would be intensified by a merger with each of Asda, Sainsbury's or Tesco. Such conditions are also likely to be relevant in relation to the proposed transaction.
- 3.20 [3<] To the extent that such duopoly concerns are identified (i.e. between the parties and Tesco), they could not be remedied through store divestments that are acquired by Tesco, which would exacerbate those concerns.

Competition in the groceries market

(i) Extent of competition between Sainsbury's and Asda

- 3.21 There are a limited number of grocery retailers operating large one-stop shops, which comprise the Parties, Tesco and Morrisons (Waitrose has a very limited presence outside the south of England).
- 3.22 As noted above, many customers still carry out a weekly or fortnightly grocery shop in a large grocery store with a wide product selection. The importance of the large one-stop shop format has therefore not fundamentally changed since the Groceries Market Investigation in 2008. The transaction is therefore a 4-3 at the national level, [3<].
- 3.23 The effect of the transaction will also be felt particularly strongly in certain regions, notably Northern Ireland, where both parties are present, but fewer competitors are active overall (for example, Morrisons is not active in Northern Ireland). Kantar market share data, as set out in Table 1 below shows that even using the most generous approach to market definition (e.g. including symbol groups, Boots, greengrocers and butchers, etc) the Parties and Tesco will be the only significant supermarket multiples in Northern Ireland with the next largest retailer, Lidl, a distant third with a 5.6 per cent share (and, moreover, as noted below, only offering a limited range of products).

Table 1 – Estimate of the parties market shares in Northern Ireland

Retailer	Market share (%)
Tesco	35.2%
Sainsbury's	17.3%
Asda	17.0%
Combined Sainsbury's/Asda	34.3%
Lidl	5.6%
Other multiples	8.7%
Symbol groups	8.1%
Other outlets (including Boots,	8.0%

greengrocers, butchers)	
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Source: Kantar Worldpanel including spend across food, beverages, alcohol, household and health & beauty.

- 3.24 It is not the case that the Parties' store networks are largely complementary, as the Parties' announcement of the Proposed Merger on 30 April suggests. In fact, there is a very high degree of geographic overlap between the Parties' estates at the local level, with the Parties competing with one another in the vast majority of areas where their large stores are situated. Accordingly, Morrisons considers that the parties are direct competitors to each other, and not complementary.
- 3.25 In particular, Morrisons' analysis of local overlaps between Sainsbury's and Asda indicates that:
- (a) 385 one-stop Asda stores have a one-stop Sainsbury's store within the maximum reach isochrone⁷ centred on the store (i.e. 91 per cent of Asda's 423 one-stop stores); and
 - (b) 438 one-stop Sainsbury's stores have a one-stop Asda store within the maximum reach isochrone around the store (i.e. 88 per cent of Sainsbury's 499 one-stop stores).
- 3.26 Following the Proposed Merger, it is likely that Tesco and the merged entity will be present in the vast majority of areas, [REDACTED].
- 3.27 [REDACTED]
- 3.28 Morrisons also notes that Sainsbury's pays particularly close attention to Asda's offering – Sainsbury's Brand Match, which was in place between 2011 until 2016 offered customers vouchers if their shopping would have been cheaper at Asda. Between 2014 and 2016, the scheme only benchmarked Asda, and not any other competitor. As noted above, Asda's price guarantee scheme also benchmarked prices against Sainsbury's (and other retailers with large store formats, but excluded Aldi and Lidl).
- (ii) Competition from discounters**
- 3.29 The Parties state in their initial submission to the CMA that "*Aldi and Lidl have had the most profound impact. Their rapid expansion both in store numbers and product range and quality, have changed customer perceptions of "value" and "convenience" and they are now mainstream grocery competitors*".
- 3.30 [REDACTED] the Limited Assortment Discounters only compete across a limited product range, and mainly with own label products (which are generally in the form of brands created by the retailer itself and for its sole use, sometimes referred to as 'exclusive brands'. An example of this would be the Harvest Morn breakfast cereal brand in Aldi). Accordingly, their product offering is limited in terms of the number of SKUs and choice within particular product categories, and there is a general lack of branded goods that customers may wish to purchase on a weekly basis. This is no different to the position that existed previously with Limited Assortment Discounters such as KwikSave and Netto.
- 3.31 The Limited Assortment Discounters also do not offer the full range of amenities (such as cafes, food counters, pharmacies, ATM machines, petrol filling stations etc) that are

⁷ i.e. the isochrone that is twice the size of the relevant primary isochrone, which indicates that there is some overlap in the catchments of the Parties.

available at the large one-stop shops. Accordingly, they provide a far less attractive shopping proposition for many customers that value these additional services.⁸

- 3.32 It is of note that in 2010, Asda's view was that Netto, which operated a similar business model to Aldi and Lidl, *"is not in the same product market as Asda."*⁹ Roger Burnley, Asda CEO confirmed in his evidence before the Environment, Food and Rural Affairs Select Committee on 20 June 2018 that this view of discounters also applies to Aldi and Lidl:

*"They are examples of very different models to us. They typically offer a much much smaller and narrower number of lines which greater volumes go through."*¹⁰

- 3.33 The analysis of discounters as offering a limited competitive constraint is also consistent with the CMA's (and its predecessor organisations) findings in relation to market definition in the groceries market. [X]

- 3.34 Moreover, independent third parties have also reached the same conclusion. In its UK Food Retail report on 30 May 2018, HSBC Global Research considered the impact of discounters on the food retail market in the context of the Proposed Merger, observing that discounters did not compete with large supermarkets because:

- (a) most consumers cannot meet all their needs in a discounter (90 per cent of shoppers at discounters also shop elsewhere);
- (b) most consumers buy some branded goods that are typically not available in discounters;
- (c) large stores offer choice within their range, discounters do not; and
- (d) most consumers buy more than the limited range on offer at discounters.¹¹

- 3.35 [X] Applying a "weighting" to Aldi and Lidl in the competition analysis would therefore suggest that a competitive constraint from the Limited Assortment Discounters applies across the full product range of a large supermarket, even though this is not the case. The CMA should, therefore, for the same reason also be extremely cautious of relying on averages (e.g. in relation to any switching data presented by the Parties).

Limited range, limited competition

- 3.36 As mentioned in paragraph 3.30, discounters only compete with the large store format retailers in relation to a narrow range of products. In this regard, the table below sets out Morrisons' average number of products (SKUs) stocked in stores of various sizes.

[X]

- 3.37 [X]

- 3.38 [X]

⁸ Store amenities were considered an important differentiating factor in the Groceries Market Investigation. In particular, the Competition Commission stated (at paragraph 4.25) that *"In the same way that product range can be expected to influence customers' willingness to substitute between stores of different sizes, we also thought that the availability of different food counters and other store amenities might be expected to influence customers' willingness to substitute between stores of different sizes"*.

⁹ OFT Decision "Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited", 23 September 2010.

¹⁰ See Mr Burnley's evidence, at 10.49am: <https://parliamentlive.tv/Event/Index/d9ccc033-59d1-4189-b3b2-e9aa827502af>

¹¹ HSBC Global Research: "UK Food Retail" 30 May 2018.

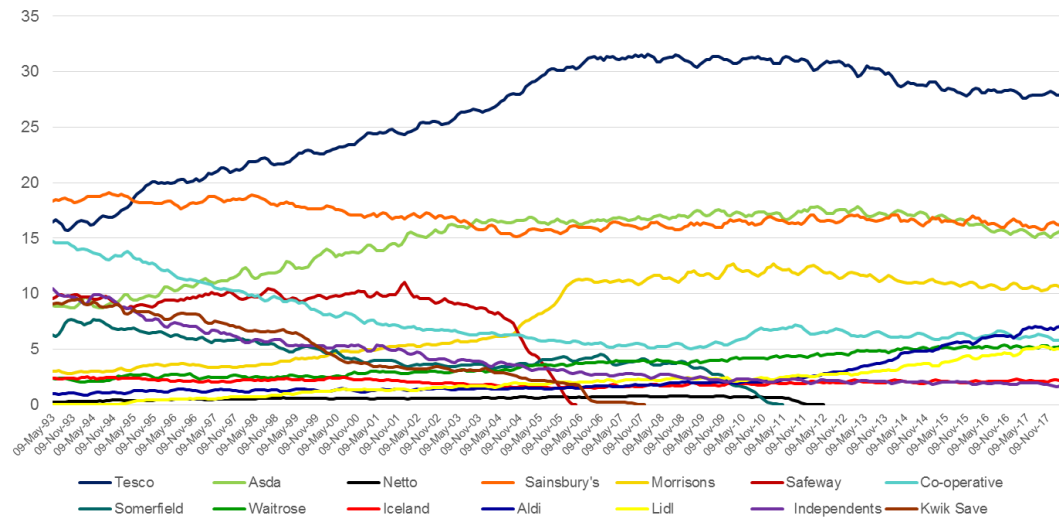
- 3.39 [X] the Limited Assortment Discounters do not compete for a very large proportion of the products in these stores.
- 3.40 In addition, even within this limited range of products, the discounters' range is extremely limited in the provision of brands. This has been a long standing feature of their business model, which focuses on providing a SKU at the lowest price, whether or not it is the brand or product most customers would wish to buy. [X] less attractive to those customers that place value in brands (or a combination of brands and own label products).
- 3.41 In this context, Kantar Worldpanel data indicates that:
- (a) Aldi sales of branded products account for just **7.6** per cent of their sales; and
 - (b) Lidl's sales of branded products account for just **10.6** per cent of their sales.
- 3.42 This contrasts with Sainbury's sales of branded goods at 47.6 per cent and Asda's branded good sales at 53.7 per cent.¹² Accordingly, the Limited Assortment Discounters do not provide effective competition to the Parties across the full range of branded products in their stores.
- 3.43 [X]
- 3.44 Given the limited range of products stocked by discounters, and the absence of branded products, to the extent that there is competition between the full-service supermarkets and discounters, this only takes place across a limited part of their product range. [X]
- 3.45 Accordingly, Morrisons considers that it would be inappropriate to adopt the approach suggested by the Parties in their Initial Submission by applying a weight to account for the competitive constraint provided by Aldi and Lidl that implicitly assumes that the constraint applies across the entire product range, when it does not. For similar reasons, the CMA should also be cautious of aggregating together any assumed competitive constraint provided by Aldi and Lidl (at both a national and local level), given that they both tend to focus on similar narrow product ranges, and therefore do not compete with the large store format stores for a very large proportion of the products in these stores.

Market presence of discounters

- 3.46 As noted above, in their description of the changes to the grocery market that are relevant to the assessment of the Proposed Merger, the Parties have identified the recent growth of Aldi and Lidl in the UK as a key development. However, a discounter segment within the UK grocery market is not a new development. The UK has had a discount sector for over 25 years, with brands such as Kwik Save, Iceland and Netto historically being the discount brands that provided the discount offering that Aldi and Lidl now provide.
- 3.47 As the chart below shows, in 1993, the three discount brands, Kwik Save, Iceland and Netto had a market share in the UK of approximately 11.5 per cent, which is similar to the market share currently enjoyed by Aldi and Lidl at approximately 12 per cent. Iceland's business model has changed over time (i.e. since 1993). Whilst it still specialises in frozen food, it now sells a wide selection of brands and operates a high/low promotional model, which is very different to the business models of the discounters.

¹² Based on Kantar Worldpanel Total Grocery data for 52 weeks ending 25 March 2018.

Chart 1 – Grocery market shares over time



3.48 [X]

3.49 [X]

(iii) Other competitors

3.50 In contrast to the competition provided by Sainsbury's, Asda and Tesco, Morrisons considers that the presence of other grocery retailers has a more limited impact.

3.51 Morrisons considers that the constraint from Waitrose at the national level is relatively limited. Whilst Waitrose has expanded the number of stores it operates in recent years to around 350, this is insignificant in comparison to the number of Tesco (in excess of 6,000) and the Parties' stores (more than 2,800). Moreover, these stores are largely concentrated in the South East and, to a lesser extent, the Midlands, with only a small number of stores in other parts of the country.

3.52 Similar to the discounters, Marks & Spencer's food offering is limited, with a particular focus on ready-to-eat meals (28.6 per cent, compared to approximately 5 per cent for most supermarkets), and almost entirely own-label products (only 0.8 per cent of products sold in Marks & Spencer are branded). Marks & Spencer's current operational plans as a whole business, coupled with the planned closure of up to 100 stores, many of which have significant food sales areas, mean that it will be further diminished as a national competitor over the next three to five years.

3.53 The Parties also state in their initial submission that "*our stores face increased competition from bargain stores including B&M (which recently acquired Heron Foods), Home Bargains and Poundland*". Whilst these non-food discounters include some food products in their product ranges, their product ranges are extremely limited. Accordingly, they do not compete for a very wide proportion of the Parties' product range, and they do not provide a similar shopping experience for customers that value the convenience of a one stop shop.

3.54 [X]

3.55 [X]

Concentration in online grocery

- 3.56 Morrisons considers that the Proposed Merger will also affect competition at the national level in online grocery retailing, and therefore it is a relevant factor for the CMA to consider (as set out in the Issues Statement).
- 3.57 Morrisons notes that the combined share of the two largest retailers (Tesco and the merged entity) will be even larger in online groceries, with Tesco having a market share of 39.7 per cent and the Parties a combined share of 34.9 per cent (Sainsbury's 17.6 per cent, Asda 17.3 per cent). This will result in a highly concentrated market with the two largest retailers having a combined market share of 74.6 per cent.
- 3.58 Moreover, [redacted] the CMA should investigate whether there are areas of the country where competition is reduced from three players to two following the merger where the merged entity would be able to flex parameters of competition, for example cost and availability of delivery slots.
- 3.59 In their Initial Submission, the parties have suggested that online grocery retailing is all part of a single market along with grocery retailing in bricks and mortar stores. Similar issues were also considered by the CMA in its *Coral/Ladbroke's* report (which is referred to by the parties in a number of places in their Initial Submission). It is of note that in that case, the CMA considered that "*the evidence indicated that the constraint from the online channel on the retail channel is not sufficiently strong for these channels to form part of the same relevant product market*".¹³
- 3.60 Morrisons considers that the CMA will reach a similar conclusion in this case. Online shopping for groceries has different characteristics to shopping in-store, it attracts a different cohort of consumers (e.g. consumers that value the convenience of the delivery), and consumers have to pay a delivery fee to access the online market. This is also reflected in the different level of spend per online shop compared to a shop in-store. Moreover, for a large proportion of customers that shop in-store, they have not considered switching to shopping online as an alternative, given factors such as the delivery fee and minimum spend requirement.
- 3.61 [redacted]
- 3.62 The highly concentrated nature of the online grocery retailing market if the proposed merger proceeds, together with the two largest market players being the same as in bricks-and-mortar retailing (i.e. Tesco and the Parties), with a higher combined share than in bricks-and-mortar also contributes to the national competition concerns.

Barriers to entry

- 3.63 As set out in Morrisons' response to the CMA's Preliminary Invitation to Comment, Morrisons considers that there are significant barriers to entry and expansion in grocery retailing. At a national level, new entry into the UK groceries market is very costly [redacted]. The barriers to entry at a national level include:
- (a) the requirement to establish and build a recognised brand in grocery retailing;
 - (b) the need to establish a property estate of grocery stores;
 - (c) the need to establish supply relationships with a large number of suppliers, which is particularly difficult to establish for fresh food categories; and
 - (d) the difficulties in operating an efficient distribution network.

¹³ Paragraph 12. <https://assets.publishing.service.gov.uk/media/5797818ce5274a27b2000004/ladbroke's-coral-final-report.pdf>

3.64 The UK competition authorities have consistently found that there are significant barriers to entry in relation to large and mid-sized grocery stores, such that new entry cannot be expected to resolve any competition concerns resulting from a merger between grocery retailers. For example, in its Groceries market investigation, the Competition Commission identified the planning system as representing a significant barrier to entry in respect of large grocery stores.¹⁴ The OFT has subsequently applied these findings in a number of merger cases, for example *Co-op/Somerfield*¹⁵ and *Asda/Netto*¹⁶.

3.65 [X]

3.66 By contrast, there have been a number of examples of companies finding significant expansion in the grocery market to be difficult, [X]

3.67 Accordingly, Morrisons considers that it is highly unlikely that entry could be considered sufficiently timely, likely or sufficient to offset any national competition concerns identified by the CMA during its Phase 2 investigation.

4. **LOCAL COMPETITION ISSUES FOR GROCERIES**

Introduction

4.1 Many parameters of competition are determined at the local level [X]. Morrisons also stocks locally-sourced products which vary from store to store, [X]. Morrisons therefore supports the comments made by the CMA in the Issues Statement that it will consider how the merger will impact on competition in each local area where the parties are present.

4.2 Whilst the groceries market has continued to evolve since the Groceries Market Investigation in 2008 (as set out above), Morrisons does not consider that the changes warrant the CMA to adopt a materially different approach to assessing local competition.

4.3 Although the local analysis conducted by the CMA at Phase 1 is not explained in detail in the Phase 1 decision, Morrisons considers that the approach taken to apply the local filters developed in previous merger cases remains the right one. Morrisons notes, however, that there are elements of the local filter that were not conducted in Phase 1, which are important factors to assessing local competition. In particular:

- (a) the CMA did not apply output area re-centring, but only centred isochrones on each of the merging parties. This re-centring is designed to capture more accurately the choices faced by customers from their homes, rather than focusing on the location of the stores; and
- (b) the CMA did not consider the extent to which any of Sainsbury's convenience stores would fail the local filter due to an overlap with an Asda mid-size or one-stop store.

4.4 Morrisons expects these omissions will be rectified in the CMA's Phase 2 analysis.

4.5 Given the level of concentration at the national level (i.e. reduction from 4-3, and two players each with a 30 per cent market share), the CMA should be cautious in applying its local analysis (even if it ultimately finds no national issue). If competition is weaker at the national level, sufficient rivalry can only be sustained by competitive local markets.

¹⁴ Competition Commission Groceries Market Investigation report, paragraphs 7.114-7.122.

¹⁵ OFT decision on Anticipated acquisition by Co-operative Group Limited of Somerfield Limited, 20 October 2008, paragraphs 143-151.

¹⁶ OFT decision on Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited, 23 September 2010, paragraphs 113-115.

Appropriate framework for local analysis

Segmentation by store size

- 4.6 In a number of previous merger cases in the groceries sector, the CMA has developed a framework for assessing local competition, which is designed to identify stores where there is clearly no potential for competition issues. This allows the competition analysis to be more focused on those areas most likely to give rise to competition concerns.
- 4.7 This analytical framework was applied by the CMA as recently as late 2017 in the *Tesco/Booker* Phase 2 inquiry. In that case, the CMA concluded that it remained appropriate to distinguish between:
- (a) one-stop stores (>1,400 sq metres net sales area), which are only constrained by other one-stop stores;
 - (b) mid-sized stores (280-1,400 sq metres) which are constrained by other mid-sized and by one-stop stores; and
 - (c) convenience stores (<280 sq metres), although the CMA did not consider a further split between large and small convenience stores (<100 sq m).¹⁷ The CMA found that convenience stores are constrained by convenience, mid-size and one-stop stores.
- 4.8 The relevance of the *Tesco/Booker* case is that the CMA has considered these issues in the context of a detailed Phase 2 investigation in the recent past (i.e. within the last 12 months) and considered that the previous analytical approach remains valid. This conclusion was reached notwithstanding the changes to the UK groceries market that have taken place since the Groceries Market Investigation. Accordingly, the CMA has taken the view that changes in shopping patterns do not justify moving away from the previous categorisation of stores by size.
- 4.9 Morrisons notes that the Parties have argued in their Initial Submission that there is no "step change" in constraint of stores at 1,400 sq metres, and there is no strict delineation at 280 sq metres and 1,400 sq metres. The Parties have argued that this should be reflected by all stores (of any size) being included in the filter analysis, with appropriate weighting, in a weighted share of stores ("**WSS**").
- 4.10 This argument is not a new one, and was considered when the local analysis was conducted in the *Safeway* report. As the Competition Commission noted in the *Safeway* report:
- "we believe that one-stop grocery shopping is a separate market from other, secondary, forms of grocery shopping. As a result, there is likely to be some size of store, below which it would be very difficult to provide the range and depth of goods in order for consumers to fulfil their main shopping needs in one visit. However, we recognise that any such threshold will have some element of arbitrariness and there will be some exceptions around the threshold level."*¹⁸
- 4.11 The Competition Commission went on to note that there may be certain examples, such as remote areas, where smaller stores could act as one-stop shops, notwithstanding their smaller size. The Competition Commission concluded that ultimately these instances were not enough to widen the market definition.¹⁹ However, in designing the local "4-3" filter,

¹⁷ CMA Report on the anticipated acquisition by Tesco PLC of Booker Group plc, paragraph 6.13).

¹⁸ Safeway report, paragraph 5.11.

¹⁹ Safeway report, paragraph 5.23.

the Competition Commission did include this point as one of the reasons for adopting a "4-3" rule over the more conservative "5-4" rule it was considering.²⁰

4.12 [REDACTED]

Geographic market

4.13 In relation to the relevant geographic market, the CMA has previously concluded that the relevant set of nearby retailers should be based on:

- (a) One-stop stores – 10 minute drive-time in urban areas, 15-minute drive-time in rural areas;
- (b) Mid-sized stores – 5 minute drive-time in urban areas, 10-minute drive-time in rural areas;
- (c) Convenience stores – 1 mile catchment in both urban and rural areas, with more proximate competitors being stronger competitors.²¹ The CMA decided this was more appropriate than the 5 minute drive time previously used in some cases.

4.14 The CMA recently concluded in *Tesco/Booker* that it had not received any submissions from the Parties, or any other strong evidence that supports moving away from this approach, and therefore adopted it again in that case. Accordingly, Morrisons considers that it remains appropriate, as the CMA and its predecessor organisations have done in grocery cases, to conduct an initial analysis within this geographic market framework based on a "4-3" fascia count.

4.15 Morrisons notes that the CMA mentions in the Issues Statement that "*the Parties also submitted that the available evidence supports wider geographic catchment areas (i.e. longer drive times) than those used by the UK competition authorities in previous cases*".²² Morrisons finds this counter-intuitive. On the one hand, the Parties are trying to argue that consumer shopping patterns are changing with more regular and smaller shops, but on the other that they are also travelling further. This suggests a significant amount of additional time is now being incurred by consumers in doing their weekly shop.

4.16 To the extent that the CMA considers refining the approach previously used, the approach should reflect the high level of close geographic proximity between the Parties' stores (as competitor stores are often more distant). [REDACTED] for example Monks Cross shopping centre in York. In this regard,

- (a) [REDACTED];²³ and
- (b) [REDACTED]

4.17 [REDACTED]

4.18 In order to analyse this, Morrisons considers that the CMA should, in addition to the local competition tests used in previous cases, conduct a more detailed analysis in relation to those local areas where the Parties are each other's closest geographic competitor, even if there are other, more distant, fascia within the catchment area.

Fascia filter

²⁰ Safeway report, paragraph 5.284.

²¹ Ibid, paragraph 6.24.

²² Paragraph 26 of the Issues Statement.

²³ <https://www.egi.co.uk/news/what-sasda-deal-may-mean-for-landlords/>

- 4.19 Morrisons recognises that the CMA has conducted a very recent investigation into which retail fascia are appropriate to include in relation to the convenience sector in the *Tesco/Booker* merger case. [redacted] many customers use Morrisons' larger stores to conduct top-up and convenience shopping missions.
- 4.20 In relation to mid-sized and one-stop stores, Morrisons considers that the fascia identified as effective competitors in previous analysis by the CMA and its predecessors, remains appropriate for the filtering exercise.
- 4.21 In particular, as noted in relation to the analysis of national competition above, the following should continue to be excluded from the fascia count analysis:
- (a) [redacted]
 - (b) [redacted]
 - (c) [redacted]

4.22 [redacted]

Weighted share of stores

- 4.23 In their Initial Submission the merging parties have argued that the CMA should move away from a fascia count filter to a filter based on the weighted share of shops ("**WSS**"). The merging parties have suggested that all competitors should be included in this methodology (including stores outside the geographic catchment area, a wide pool of competitors such as bargain stores, and across stores of all sizes).
- 4.24 Morrisons has significant concerns that this proposed methodology will significantly overstate the degree of competition faced by the merging parties' stores and therefore understate the number of areas where there could be competition concerns.
- 4.25 As noted above, the Parties' arguments that purport to justify the use of a weighted share of stores are not new. Indeed, a number of the points were made during the 2008 Market Investigation and 2003 Safeway merger inquiry, and the existing local analysis framework takes account of them, including through the choice of a "4-3" filter, rather than the initially considered "5-4" filter.²⁴
- 4.26 Morrisons notes that the local filter should act as a screen to rule out non-problematic areas. It is risky and creates a false sense of precision to attempt to design a complex mathematical formula that tries to account for every variable. The more types of store, store sizes and distances that are included at the filtering stage, the greater the risk of a Type II error (i.e. failing to identify areas of competition concern). Given the importance of the grocery market to consumers, the CMA should err on the side of caution, as it has done in previous merger cases in the sector. Competitors that act as a limited constraint (e.g. discounters, bargain stores, and stores outside the catchment area) can be readily taken into account during the site-by-site analysis of areas that fail the initial filter, through impact assessments, surveys, switching data, etc.
- 4.27 As regards the proposal to use a WSS, Morrisons considers this would be inappropriate for the following reasons:
- (a) in each area, aggregating together a large number of competitors that exert only a limited competitive constraint (e.g. due to their smaller or more limited range) is not the same as having one close competitor in the area. [redacted];

²⁴ Safeway Report, paragraph 5.284.

- (b) applying a weight does not address the fact that stores that offer a much more limited range of products [X] do not compete for a very wide range of products in the Parties' stores, which could result in consumers of those products being adversely affected through higher prices as a result of the merger;
- (c) it is not obvious that a filter based on the number of stores in an area (as suggested by the parties) more accurately reflects competition in the grocery market compared to a fascia count filter. The CMA's retail merger commentary notes that "*fascia count is likely to be the appropriate measure if brand is important to customers and customers choose between the fascias in their local area, irrespective of the number of stores that they have.*"²⁵ Brand is clearly important to customers in the grocery market, and the grocery market is one of the examples listed by the CMA in the guidance. In comparison, the guidance notes that "*Store count is a good measure of concentration if the brand is not very important or visible to the customer*",²⁶ which is clearly not the case in the grocery market. There is a significant risk that a filter based on number of stores will significantly overstate the competitive constraint on the merging parties;
- (d) it is not clear from the Phase 1 decision how the Parties propose that the CMA should determine the weights to be applied to each competitor. This problem is particularly pronounced given that the merging parties appear to be arguing for the inclusion of a wide pool of competitors including Limited Assortment Discounters, bargain stores and online operators. In comparison, the CMA's four to three filter has been tried and tested in a large number of merger decisions and a market investigation. Moreover, as noted above, a number of the Parties' reasons for moving away from this filter have been previously considered and either incorporated into the filter (or via flexing the filter), or addressed in detail for any sites that fail the initial filter; and
- (e) weighting stores by distance also raises issues as it is unlikely to reflect the choices facing customers. If stores are weighted relative to the distance from the focal store this may understate the degree of competition between two sites. For example, a Sainsbury's that is the other side of a town may receive a low weighting even though from the perspective of consumers living in the town it is a direct competitor.

Application of local filters

4.28 [X]

4.29 The Phase 1 decision also applies the local filter analysis as developed in previous cases, and identifies 463 total stores (235 Asda and 225 Sainsbury's stores) that fail the analysis. Morrisons expects that if the output area re-centring and Sainsbury's convenience store analysis is conducted, there will be additional stores that fail the initial filter analysis.

5. NON-GROCERY COMPETITION ISSUES

Introduction

5.1 The Issues Statement also sets out that the CMA will consider whether there are competition concerns that arise with regards to:

- (a) retail supply of road fuel; and

²⁵ CMA Retail merger commentary, paragraph 3.23.

²⁶ CMA Retail merger commentary, paragraph 3.24.

- (b) retail supply of non-food products (e.g. toys, homewares, electrical items, etc.)
- 5.2 Based on previous decisions of the CMA, it is clear that if the Transaction only related to overlaps in one of these markets the CMA would undertake a detailed local analysis (e.g. *Celesio/Sainsbury's* pharmacy investigation or the *MRH/MFG* retail fuel merger).
- 5.3 The scale of the issues with regards to the overlaps between the Parties in the grocery retail market is not a reason to ignore or downplay local issues in other markets. Morrisons considers that there are likely to be local areas which give rise to competition concerns in markets related to road fuel or non-food products even where there is sufficient grocery retail competition.

Retail supply of road fuel

- 5.4 Morrisons believes that the CMA should carefully examine the effect of the Proposed Merger on the retail supply of road fuel, as it has done in relation to the *MFG/MRH* acquisition. In this regard it is important that the CMA considers both:
- (a) local competition, as there are likely to be local areas which give rise to competition concerns in relation to the retail supply of road fuel, even where those same areas do not give rise to competition concerns in relation to the retail supply of groceries; and
 - (b) national competition, given the importance of supermarkets, [S&A], in driving competition in the retail supply of road fuel.
- 5.5 As noted in the CMA's Phase 1 decision, Sainsbury's has 311 petrol filling stations and Asda has 317 petrol filling stations. As such, the importance of the CMA's assessment of the retail supply of road fuel is extremely important.

Local competition in the retail supply of road fuel

- 5.6 As the Office of Fair Trading ("**OFT**") found when it investigated the operation of the UK petrol and diesel fuels markets in January 2013, the level of retail competition in an area is (amongst other factors) a key driver of regional and local variations in road fuel prices.
- 5.7 In that study, the OFT found that the following three factors impacted on fuel prices in local areas:
- (a) the number of competitors within the area. Local areas with more competitors tend to have lower pump prices;
 - (b) the presence of a supermarket in a local area constrains the prices that rival retailers are able to charge. The OFT found that *"Controlling for all other factors, the presence of at least one supermarket in a local area is associated with pump prices that are 0.5p per litre lower for diesel and 0.7p per litre lower for petrol, compared to an area with no supermarket fuel retailing presence"*;²⁷ and
 - (c) whether or not there is an Asda situated in the area. The OFT found that *"the presence of at least one Asda forecourt, is associated with lower pump prices within a local area, with the scale of this effect being much greater than the effects associated with any other retailer"*.²⁸

²⁷ "UK petrol and diesel sector, An OFT call for information", January 2013, paragraph 4.9.

²⁸ "UK petrol and diesel sector, An OFT call for information", January 2013, paragraph 4.13.

- 5.8 Morrisons considers that the retail supply of road fuel therefore requires separate examination from the examination of competition in the grocery market. There are a number of reasons why competition concerns may arise in local areas in relation to the retail supply of road fuel, even where those same areas do not give rise to competition concerns in relation to the retail supply of groceries.
- 5.9 First, the CMA adopts a different approach to assessing local competition in fuel retailing compared to grocery retailing. As set out in *MFG/MRH*, in previous fuel retailing mergers the CMA has applied the following filters to identify area which warrant further assessment:
- (a) Price marker filters, where:
 - (A) either Party identifies a site of the other Party as its main price marker; or
 - (B) either Party identifies a site of the other Party as one of three or fewer competing (i.e. price-marked) sites; or
 - (C) the merger would lead to a reduction in competing brands in the price marker list from four to three or fewer.
 - (b) Geographic competitors: the Parties' sites are the closest in terms of drive-time; or
 - (c) Fascia count: the Merger would lead to a reduction in fascia from 4-to-3 or fewer (by brand or owner) within the relevant drive-time isochrones.
- 5.10 Only the fascia count filter is applied in relation to both the grocery retailing and fuel retailing assessments, but even though the same filter is applied, it is unlikely to identify identical areas of concern as (i) the competitor set differs between the grocery retailing and fuel retailing markets, e.g. there will be some local areas where there are three competing grocery fascia but only two competing fuel fascia; and (ii) the geographic area over which the filter is applied is different and will therefore produce different results. The relevant drive-time isochrones for fuel retailing is 20 minutes in rural areas which is wider than the isochrones for grocery retailing (at most 15 minutes). As such there may be areas where the Parties overlap in fuel retailing but not in grocery retailing.
- 5.11 The price marker filters and geographic competitors filter are specific to fuel retailing. Morrisons expects that these filters will therefore identify local areas of concern that are not identified in relation to grocery retailing.
- 5.12 Second, the importance of both parties [§<] in acting as a price marker in local areas will be a key determinant of local competition. The price marker filters are unique to the fuel retailing market, and reflect the importance of particular retailers in driving price competition. [§<]. This is consistent with the *MFG/MRH* decision which noted that:²⁹
- "Evidence from the Parties' price marker data indicates that supermarkets are particularly influential on the Parties' pricing. For both Parties, supermarket sites are disproportionately more likely to be price markers than other sites in the local area."*
- 5.13 Third, the CMA mentions in the Issues Statement that it will also consider how consumers that buy a combination of products from the parties in a single trip, such as fuel and groceries, will be affected by the merger. It is also relevant for the CMA to consider the extent to which the Parties are able to (and do) offer low prices on fuel in order to benefit from sales in-store, which cannot be replicated by smaller independent filling stations. In

²⁹ *Motor Fuel Group (MFG) / MRH*, paragraph 66(b).

this regard, as noted in the OFT's investigation, supermarket's *"business model tends to allow supermarkets to offer road fuel cheaper than oil company owned sites and independent dealers. To some extent this approach may be aimed at attracting road fuel consumers into their attached superstores"*.³⁰

- 5.14 This factor will also be important when considering any remedies offered by the merging parties to address competition concerns in relation to fuel retailing. If there are petrol filling stations that give rise to standalone competition concerns (i.e. the co-located grocery store does not give rise to concerns), it is not obvious that divesting the petrol station to an independent dealer or oil company will address the competition concern, as the incentive for a grocery retailer with co-located petrol filling stations to offer low fuel prices to encourage more customers in-store is no longer present.
- 5.15 Fourth, both Sainsbury's and Asda operate a number of standalone petrol filling stations. For example, the CMA's Phase 1 decision notes that Asda operates 18 petrol filling stations which are not co-located with an Asda grocery store. These sites will not be considered as part of the local analysis of grocery retailing and therefore it is important that they are assessed separately.
- 5.16 Finally, Morrisons also notes that whilst the parties have suggested that a weighting approach to competitors should be applied to assessing grocery retailing at the local level, it has not suggested that a similar weighting approach should be applied to fuel. This is perhaps unsurprising given that the supermarkets would generally be expected to be much closer competitors (which would be reflected in a much higher weighting) than smaller independent filling stations (which would face a much lower weighting). To the extent that the CMA considers using a weighting approach to assessing grocery retailing at the local level, it should also consider applying a similar weighting to fuel retailing.

National competition in the retail supply of road fuel

- 5.17 Tesco, Sainsbury's, Asda and Morrisons together account for between 40 and 50 per cent of total road fuel sales by volume.³¹ Morrisons considers that this may understate the supermarkets market position at a national level as it includes a large number of independent dealers which play a very limited role in determining national pricing. Whilst the big four supermarkets are important for driving price competition in the market, the demand for independents tends to be based on convenience and loyalty led, thereby targeting a different cohort of users.
- 5.18 Morrisons believes that it is important that the CMA assesses the potential for a loss of national competition given the importance of supermarkets [3<], in driving price competition in road fuel. The loss of a key driver of price competition could have a very significant impact on the road fuels market, which would not be offset by competition from the independent providers.
- 5.19 As explained above, the OFT's investigation into road fuel found that the presence of an Asda forecourt in a local area had a disproportionate effect on retail prices relative to other retailers, including the other supermarkets. The OFT found that the presence of an Asda forecourt in a local area pushed down competitor's pump prices by 0.7 pence per litre (ppl) for diesel and 0.8 ppl for petrol, this compares to 0.3 ppl (diesel) and 0.4 ppl (petrol) for Morrisons and 0.1 ppl (diesel) and 0.2 ppl (petrol) for Sainsbury's.³²
- 5.20 Although Asda sets fuel prices at a local level, a number of its pricing decisions are taken nationally. For example, in September 2018 Asda announced plans to cut the price of petrol by 2 ppl across its forecourts. At the time, AA fuel price spokesperson Luke Bosdet

³⁰ *"UK petrol and diesel sector, An OFT call for information"*, January 2013, paragraph 3.40.

³¹ *Motor Fuel Group (MFG) / MRH*, paragraph 64.

³² *"UK petrol and diesel sector, An OFT call for information"*, January 2013, figure 4.4.

said: "Once again, Asda has to take the lead in passing on fuel savings to drivers".³³ This strategy of being a price leader in relation to road fuel is consistent with Asda's overall strategy in grocery retailing of "Everyday Low Prices".

- 5.21 The following charts are also consistent [X]. The charts show the national average price of Morrisons' retail sales of unleaded fuel relative to the national average price for each of Asda, Sainsbury's and Tesco in 2017/18, and 2018 year to date (based on Catalyst (Experian) data).³⁴

[X]

[X]

- 5.22 [X] Chart 2 also shows that Sainsbury's unleaded fuel prices moved to be much more closely aligned with Asda's prices during that period, which further suggests that they are two of the closest competitors in the retail supply of road fuel.

- 5.23 It is important that the CMA considers whether the Proposed Merger will reduce Asda's incentive to act as a price leader and what impact this will have on national competition in the retail supply of road fuel.

- 5.24 In addition, the CMA should consider whether the interaction of fuel and grocery retailing will have an impact on national competition in either market. As paragraph 34 of the CMA's Phase 1 decision notes: "the prices offered at the Parties' petrol filling stations can be used as one way to attract customers to do their grocery shopping at a supermarket on the same site".

- 5.25 If there is a lessening of competition in relation to grocery retailing at a national level, this may affect national competition for fuel retailing. In particular, if there is evidence that the merging parties may compete less vigorously in grocery retailing as a result of the Proposed Merger, they may also have less incentive to price fuel aggressively to attract customers to do their grocery shopping at a supermarket at the same site.

Other non-food products

- 5.26 Morrisons agrees with the statement in the Issues Statement that the CMA also intends to carry out a detailed analysis (at both a national and local level) in relation to general merchandise.

- 5.27 Each of Sainsbury's and Asda are important suppliers of non-grocery products both nationally and locally, with the extent of this being likely to vary according to the product categories.³⁵

- 5.28 Morrisons notes that, if the Proposed Merger only related to non-grocery products, the CMA would examine the national and local effects in these markets, as it did in *Celesio/Sainsbury's* and *Sainsbury's/Home Retail Group*. Whilst it may be tempting in the CMA's limited timescale for review to truncate such an analysis, the scale and complexity of the competition issues to be examined in groceries and fuel should not be a reason to examine the other non-grocery overlaps in any less detail.

³³ <https://www.independent.co.uk/news/business/news/asda-petrol-price-cuts-2p-litre-fuel-costs-diesel-a8555486.html>

³⁴ The date ranges are based on the financial years for Morrisons (i.e. 5 Feb 2017 to 10 Feb 2018 for 2017/18, and 11 Feb 2018 to October 2018 for 2018/19 ytd).

³⁵ For example, in *Sainsbury's/Home Retail Group*, the CMA found a higher share in small domestic appliances.

6. INCREASED BUYER POWER

- 6.1 The Parties have signalled that they intend to use the merger as an opportunity to reduce the prices they pay to suppliers. In particular, this not only includes the identified £350 million of net procurement benefits which will arise from harmonisation of buying terms, but also an as yet unspecified amount of "*further volume benefits that might be accreted from the combination of the two buying books*".³⁶ In other words, the Parties will seek not simply to purchase at the lower of the price on which either of them purchase, but will be looking to negotiate an even lower price with suppliers to reflect their larger scale.
- 6.2 [§<]
- 6.3 Morrisons considers that cost price harmonisation will be difficult to achieve if the parties are simply seeking to merge volumes:
- (a) suppliers will only tend to invest in offering lower prices in exchange for growth in volumes, which unlocks additional production efficiencies. Simply merging Sainsbury's and Asda's volumes with a particular supplier that was previously supplying both does not deliver any additional volume to that supplier over the pre-merger situation. It also seems unlikely that, post-merger, the parties will be able to commit future growth to suppliers (if anything, they may even lose volumes as they seek to combine supplier volumes and consolidate supply);
 - (b) the parties will also need to harmonise the respective supply chains (e.g. to deliver into the same depots), the products (design, quality, packaging etc.) and the range (otherwise volumes may be compromised). All of which will lead to reduced choice for customers; and
 - (c) branded promotional activity may also need to be harmonised, effectively reducing overall promotional activity between one-stop stores. For example, brands tend to rotate promotional activity around the four large one-stop retailers (i.e. promotions mostly run consecutively). By removing a competitor and harmonising this promotional activity across the merged parties, customers will potentially lose a significant period of lower prices through promotional activity that would have otherwise been available.
- 6.4 To the extent that discounts are volume related, then such discounts are only likely to occur if Asda and Sainsbury's are purchasing (and stocking) the same product ranges, and therefore are direct competitors with each other in the sale of those products. Due to the loss of competition that may be expected to result from the transaction at the retail level, the parties are unlikely to have the incentive to pass on any scale-based purchasing synergies to consumers. Any such volume related synergies would also be reduced in the event that a large number of divestments are required to address the competition concerns raised by the transaction.
- 6.5 It is also of note that both Parties' chief executives have confirmed that the expected purchasing benefits will result from a degree of harmonisation of product ranges between Sainsbury's and Asda (where they do not purchase the same SKU), and this will presumably extend to alignment of, for example, promotions. The Parties have confirmed that the focus of this will be on the large branded suppliers whose products the discounters generally do not sell. Morrisons considers that this alignment may lead to reduced choice for consumers as the two Parties harmonise their product lines.

³⁶ Transcript of analyst call on 30 April 2018, "Full year unaudited results & combination of J Sainsbury's plc and Asda Group", page 8.

- 6.6 In addition, if the Parties are able to drive purchase prices down and squeeze suppliers further, those suppliers are likely to react and to seek to recover the loss in profitability through other means (e.g. through consolidation, reductions in quality, price increases on other products/to other retailers, or by exiting the market). This has the potential to change the nature of the overall supply base in the UK. [X].
- 6.7 Moreover, if as a result of the merger, the Parties are seen as being an important trading partner for suppliers, it could mean that other grocery retailers [X] are disadvantaged in other ways as a result (e.g. through supply shortages during periods of high demand as suppliers focus on serving the largest retailers first). The fact that there would be two grocery retailers of approximately the same size as Tesco is now, could exacerbate this issue for smaller supermarkets.