J Sainsbury PLC and Asda Group Ltd:

[REDACTED] Response to the CMA's provisional findings report and remedies notice (6 March 2019)

1. Introduction

1.1 [REDACTED] welcome the opportunity to submit comments on the CMA's Provisional Findings ("PFs") and its notice of possible remedies in relation to the proposed combination of J Sainsbury PLC ("JS") and ASDA Group Limited ("ASDA", and, together with JS, the "Parties") (the "Merger").

1.2 It is clear that the CMA has conducted a very thorough and detailed investigation, and the findings of an SLC on the downstream markets are compelling and well-reasoned.

1.3 Overall,[REDACTED] supports the PFs and the well-reasoned conclusions therein. However, there are some areas in which [REDACTED] believes that additional points can be made to support those conclusions. The purpose of this response is therefore to address specific points in the PFs, on which [REDACTED] is well-placed to comment.[REDACTED]

1.4 [REDACTED] notes that the CMA has provisionally concluded that there is insufficient evidence that the Merger would have a negative effect on suppliers. That finding implies that the Merger could indeed have such an effect, even if the CMA does not need to reach a definitive conclusion on the potential upstream issues raised by the Merger in this case, given the clear findings of an SLC at the retail level. [REDACTED] recognises that.

1.5 In addition, [REDACTED] suggests that, in its final report, the CMA should consider factors and further evidence that support an adverse finding on buyer power and its likely adverse effects on the supply chain and consumers. [REDACTED] notes that only 33 out of 110 smaller suppliers submitted responses to the CMA's questionnaire. This low response rate, compared to that of larger suppliers, may reflect smaller suppliers' real concerns about possible retaliation from the Parties if they make adverse comments. Although the CMA's processes are robust and ensure the anonymity and confidential nature of third party comments, smaller suppliers may not be aware of (or sufficiently confident in) this. Therefore, it is quite possible that many smaller suppliers did not submit answers for fear of retaliation by the Parties. As a result, the data collected by the CMA may not be fully representative of the whole supply chain and it would likely have received further evidence on the possible negative effects of increased buyer power had more supplier responses been submitted. [REDACTED] respectfully suggests that the final report should acknowledge that fact.

1.6 [REDACTED] agrees with the CMA that the Parties are likely to have overstated the potential efficiencies. The evidence available to the CMA suggests that procurement costs would, at best, potentially lead to a reduction of costs of 2%. [REDACTED] believes that the Parties have each already reached maximum procurement efficiencies as they already employ full pallets, trucks and central distribution centres. No additional efficiencies are available without rationalising the Parties' structures. The Parties claim that prices of "many of the products customers buy regularly" would be cut by 10%. There is no evidence to support this assertion, nor any indication as to what products would see prices cut by 10%. The claimed efficiencies are therefore not substantiated in any way, and should be dismissed – as the PFs appear to conclude.

1.7 Given the CMA's SLC findings on the downstream markets, [REDACTED] agrees that prohibition would be the most effective remedy. The only other alternative remedy would be a divestiture of a large number of stores including brand and related assets to a single buyer (all stores and assets would need to come from one brand, as mix and matching stores and assets would create additional issues for any potential buyer and risk undermining the effectiveness of the remedy). However we believe such an alternative remedy is highly problematic, given that the effectiveness of such a divestiture is difficult to predict, given the magnitude in scope and the possible issues in finding a single suitable buyer, who would need to be willing and able to buy all of the stores to be divested and operate them as full-service grocery stores. In particular, it will be difficult to ensure that the buyer would be able to restore the effective competition that would be lost by the Merger. The problems with divestment of a large number of stores is evident from a recent US case (see further details below), which failed.

2. Market definition

2.1 [REDACTED] agrees that discounters, such as Aldi and Lidl, do not exert the same competitive constraint on the Parties as the other two of the 'Big 4' (i.e. Tesco and Morrisons). [REDACTED] notes that the discounters generally stock a significantly lower number of SKUs and product lines, as well as far less branded products, compared to the big retailers.

2.2 As a result of the more limited selection of products stocked, consumers typically use stores such as Aldi and Lidl to complement their shopping at the 'Big 4', rather than see them as 'one-stop' shops for entire grocery purchases. Therefore, it is not surprising that consumers spend a significant share of their overall grocery spend with the 'Big 4', not in Aldi or Lidl.

2.3 Consequently, [REDACTED] agrees with the CMA's view that the Parties and Tesco/Morrisons are each other's closest competitors and, therefore, exert a more significant competitive pressure on each other than the discounters.

3. Coordinated effects (in-store groceries)

3.1 As concerns possible coordinated effects between the 'Big 4' in relation to in-store groceries, the CMA focused its investigation on coordination of consumer prices. However, it is important to note that retailers do not only compete on prices, but on a number of factors such as brand image, range of products, and service level (e.g. opening hours, staffing levels, availability of tills operated by staff vs. self-checkout tills, etc.). As such, it is possible that the Merger could also lead to increased coordinated effects for non-price related factors.

3.2 The PFs state that the coordinated effects analysis has focussed on price "*due to the greater transparency around price*". [REDACTED] considers that there are other PQRS factors that are as transparent as price, if not more so. One such factor is store opening hours, number of staffed tills vs self-checkout tills and number of in-store cheese, meat and deli counters (which is easier to monitor than price, given that they are only single factors that needs monitoring).

3.3 The PFs indicate that there was insufficient evidence regarding the potential for pre-existing coordinated effects. However, it was not apparent to [REDACTED] whether the CMA had investigated the motivation as regards the similar timing surrounding the withdrawal of the "low price guarantee" pledges by certain retailers.

3.4 As such, [REDACTED] submits that the final report should acknowledge that coordinated effects are possible today and post-Merger in respect of non-price factors – even if the final report concludes it has not been necessary to do a detailed analysis of the issue given the CMA's findings on unilateral effects.

4. Buyer Power

(a) Effects on suppliers and evidence

4.2 [REDACTED] recognises that the CMA has focused on the extent to which the impact of the Merger on suppliers can harm consumers. Nonetheless, it shares the view of Neil Parish MP "*While I commend the CMA's thorough investigation into the merger, I'm disappointed the report was unable to reflect the impact this merger could have on businesses in the food supply chain, other than how it would affect competition at a customer level*".[1] The impact on the wider food supply chain has a direct impact on consumer choice (range, innovation and quality) and so [REDACTED] respectfully suggests this should be addressed in the final report.

4.3 Whilst the PFs assessment on buyer power is limited to the possible effects on innovation and waterbed effects, no account has been taken of the Parties' ability to delist and rationalise ranges, which deprives consumers of product choice. These are topics that [REDACTED] believes should be addressed in the final report.

4.4 Although [REDACTED] recognises that the CMA does not need to reach a definitive conclusion on possible negative effects on suppliers (given the clear SLC at the retail level as described in the PFs), it considers there to be ample evidence to support a finding that increased buyer power would have a negative effect on suppliers, which would in turn affect consumers.

4.5 For example, [REDACTED]

(b) Third party comments

4.6 [REDACTED] notes that c. 90% of larger suppliers responded to the CMA's questionnaire, compared to only 30% of smaller suppliers.[2] The large discrepancy in response rates is likely due to the particular concerns of smaller supplier about possible retaliation by the Parties, should their views be known. The Parties' comment that "*suppliers more concerned about the Merger might have been more likely to respond*".[3] However, this is contradicted by the fact that half of the large suppliers and more than two-thirds of the small suppliers that responded to the questionnaire said that the Merger would not have an impact on the innovation. As such, finds it more credible that those suppliers who are most likely to have been concerned about the impact of the Merger did not respond for fear of retaliation (which is consistent with surveys by the Groceries Code Adjudicator in relation to GSCOP). This is especially so for smaller suppliers, where the response rated was materially lower than for large suppliers.

4.7 Since smaller suppliers are more likely to be concerned about retaliation if they make their views known and less likely to have responded to the CMA's questionnaires, the information received during the CMA's investigation is not likely to be representative of the whole supply chain. Therefore, considers it is important for the CMA to contact these smaller suppliers and stress the fact that their views will be anonymous and confidential, especially since smaller suppliers are often among the most innovative (see further below).

(c) Innovation and New Product Development

(i) [REDACTED] Innovation and NDP

4.8 [REDACTED] respectfully suggests that the CMA should take the opportunity to consider further the impact of the Merger on innovation in new product development

[1] See e.g. article in The Grocer "*Suppliers celebrate CMA's Sainsbury's-Asda findings*" (22 February 2019). Available at: https://www.thegrocer.co.uk/home/topics/sainsburys-asda-merger/suppliers-celebrate-cmas-sainsburys-asda-findings/576943.article.

[2] See PFs (paras. 15.6 to 15.7).

[3] See PFs (para. 15.20).

("NDP"). [REDACTED] has provided information, which contrary to the views shared by the Parties, show that products are especially developed for the UK.

[REDACT PICTURES]

4.9 In addition, now that [REDACTED] has seen in the PFs the approach the CMA has taken to assessing whether the Merger may lead to an SLC in respect of supplier innovation (e.g. paras. 15.12-15.19), it can address these points directly.

[REDACT PICTURES]

4.10 Given the costs associated with many NPD projects, the merged entity's ability to force prices of new products down towards marginal cost of supply, could make NDP less attractive for suppliers and, as such, ultimately result in less product choice for consumers.

(i) Smaller suppliers' innovation and NDP

4.11 So far as innovation is concerned, a distinction also needs to be made between branded and own-label manufacturers. Most innovation comes from branded suppliers, and own-label manufacturers often free-ride on innovation by branded manufacturers.[4] As both the initial innovation and the subsequent free-riding by own-label manufacturers ultimately benefits consumers, it is in this context, important to note that amongst large branded suppliers, half thought the Merger may have adverse effects on innovation.[5] The proportion of smaller branded suppliers with the same view is not stated in the PFs, although should it be higher this would be particularly relevant to the impact of the Merger on consumers, as a result of reduced incentives to invest and innovate. The impact of small manufacturers in product innovation should not be underestimated. An example of a small supplier that has been on the forefront of innovation is [REDACTED]: it started out as a small company but its innovative development/marketing [REDACTED]. Other examples of smaller suppliers who have been successful in recent years thanks to their innovative products are the two London-based [REDACTED]producers [REDACTED]As a 'small producer', [REDACTED]has received support from Sainsburys. Images of new products developed by smaller suppliers which may be adversely impacted by the Merger are shown below.

[REDACT PICTURES]

(i) Range harmonisation and retailers' NDP support

4.12 Innovation is also likely to be reduced as a result of range harmonisation. Even if the Parties post-Merger would continue to run as separate brands, they would inevitably cut down on the number of suppliers and SKUs sourced across the business. This is evidenced by the fact that the Parties themselves predicate claimed efficiencies on securing better terms, meaning a coordinated buying strategy.[6] This concern of range harmonisation and rationalisation leading to reduced opportunities to have products stocked in the Parties' stores has been set out by the British Brand Group's members.[7]

4.13 Further, the evidence suggests that the Parties are particularly important to suppliers' innovation, representing c. 37 % of revenues for NPD projects over three years, compared to their grocery market share of less than 30%.[8] Moreover, the Parties

[4] This is an important reason why prices of branded products tend to be higher than own-label.

[5] See PFs (para. 15.6).

[6] See PFs (para. 16.12).

[7] See PFs (para. 15.9).

[8] See PFs (para. 15.13).

account for more than 50% of the NPD revenues for almost one-fifth of projects.[9] Even though the PFs state that NPD costs account for a small proportion of expected revenues, projects with a higher proportion relate to the most innovative products, which may be denied to consumers as a result of the Merger. This is particularly relevant in this case, as the evidence shows that the Parties are the "*two retailers most likely to offer commitments in support of NPD*".[10] Consequently, loss of competition between the Parties means that consumers may end up with less new products.

4.14 In addition, even if retailers do provide some form of commitment to support NPD, the loss of a major retailer means that the terms of such support may suffer, be it from unilateral and/or coordinated effects. The reduced competition between the retailers to showcase a new product will be lost by the Merger. Although this has not been addressed in the PFs, it may have material adverse effects on consumers.

4.15 [REDACTED] notes that around one-fifth of suppliers said that the Merger would make their business less likely to engage in product innovation (with c. 60% saying it would not change their incentives).[11] However it is not only the number of suppliers, but the nature of the suppliers, that is important – in particular whether those concerned about the Merger are amongst the most innovative [REDACTED]. In addition, as noted above, it is possible that the statistics presented in the PFs understate the proportion of suppliers concerned about the Merger, given that a significant number of smaller suppliers may have chosen not to respond to the CMA's questionnaire out of fear of possible retaliation from the Parties.

5. Efficiencies

5.1 [REDACTED] agrees with the PFs that the Parties have overstated the likely efficiencies that may arise from the Merger and any possible positive effects on consumers.

5.2 The Parties claim that efficiencies will be achieved from 'harmonised' purchasing synergies from suppliers, e.g. as suppliers will be dealing with one retailer instead of two. However, as stated by the Food and Drinks Federation ("FDF"), such harmonisation is "*highly questionable*", as many suppliers do not serve both Parties, which makes such harmonisation unlikely, or at least vastly overstated. Even if a supplier serves both Parties, there may be a big difference in the product supplied. Therefore the Parties' modelling on harmonisation appears to be very much exaggerated (as the CMA appears to recognise – Appendix M, para. 78).

5.3 Further, the scale of such harmonisation can also be questioned as the Parties are planning to retain both brands post-Merger. As noted by a number of larger branded suppliers in the PFs, the Parties' operations already benefit from scale. For example, they are both individually able to achieve efficiencies, e.g. in transport, storage and discounts.[12] As a result, [REDACTED] supports the conclusions in the PFs that any increment in scale, particularly absent brand integration, would be limited at best.

5.4 As a general note, the scale efficiencies appear to have been calculated based on the assumption that the merged entity will retain the vast majority, it not all, of the Parties' stores. As such, the alleged efficiencies would have to be adjusted for store divestments. This means that even in the best-case scenario for the Parties, their combined volumes would not amount to the sum of their purchases pre-Merger, on which the efficiencies were calculated. [REDACTED] notes the CMA's conclusions that procurement costs would fall by c. 2% for a retailer increasing its share of supply from

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9 See PFs (para. 15.13).

10 See PFs (para. 15.10).

11 See PFs (para. 15.10).

[REDACTED]

15% to 30%, but given the need for stores divestments the Parties' combined share would not be 30% and so the procurement benefits would be lower than 2%.

5.5 Finally, [REDACTED] notes that the CMA has considered a number of alternative non-Merger specific approaches for the Parties to achieve synergies. For example, buying alliances and purchasing groups are mentioned as alternatives. However, as recognised by the Parties and the CMA, such alternatives raise serious potential competition concerns (which is why the CMA states that any claimed efficiencies would be Merger-specific). Indeed, a number of European authorities are investigating or considering investigating the potential anti-competitive effects of retail alliances on suppliers and customers. See for example the investigation by the French Competition Authority, which includes the Carrefour/Tesco alliance in its review.[13] [14].

6. Remedies

6.1 Given the CMA's compelling and well-reasoned SLC findings on the downstream markets, [REDACTED] agrees that prohibition is the only appropriate remedy to ensure that the current level of competition remains largely preserved (even leaving aside the comments above on the supplier issues). It is, in fact, the most effective remedy and would be easy to implement.

6.2 [REDACTED] supports the CMA's notion that a divestiture "*carries a significant risk of being an ineffective remedy*"[15] and that "*it is not clear […] that a suitable package of assets could be found to provide an effective and comprehensive remedy*"[16]. There is a recent example of a failed divestment involving a large number of grocery stores in a recent US case – *Albertsons/Safeway*. Despite a detailed investigation following a "second request" and the approval of an upfront buyer for 146 of 168 stores that the Federal Trade Commission ("FTC") required to be divested, the remedy failed when the buyer (which operated grocery stores in other areas) went into administration.[17] As a result, Albertsons bought back some of the divested 'problematic' stores and the issues were, therefore, not solved by the remedy.

6.3 Notwithstanding the comments above which highlight the serious risks associated with the divestment of a large number of stores, should a divestiture be considered, [REDACTED] agrees with the CMA that the complexities of the remedy require a "buyer up-front" remedy. However, [REDACTED] notes that despite a "fix-it first" remedy in *Albertsons/Safeway* in which the purchaser were approved as part of the FTC's settlement, the remedy still failed.

6.4 Furthermore, it would be important that a single buyer is found for all of the stores and that the stores are the same as the brand to be divested (see below) – both to restore the loss of competition caused by the Merger and to ensure any remedy has any chance of being effective. In addition, the scope of the divestiture would need to include a brand and other assets such as distribution centres, IT systems, central operation, purchasing teams, e-commerce functions etc. A mix and match divestment of stores between brands (as was the case in the *Albertsons/Safeway* merger) would make a divestiture less efficient, as the stores would not have the same IT systems, logistics systems etc. Trying to create one effective competitor from a mix-and-match divestment would materially complicate the remedy (as it would effectively require a separate merger of the divestment stores from each Party) and raise the likelihood of

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[13] See press release from the French Competition Authority on "*Joint purchasing agreements in the food retail market sector*" (16 July 2018). Available at:
http://www.autoritedelaconcurrence.fr/user/standard.php?lang=fr&id_rub=684&id_article=3226.

[REDACTED]

[15] See the CMA's notice on possible remedies (para. 19).

[16] See the CMA's notice on possible remedies (para. 19).

[17] See for example: https://www.oregonlive.com/window-shop/2015/11/albertsons_bids_on_36_haggen_s.html; and https://www.ftc.gov/news-events/press-releases/2015/01/ftc-requires-albertsons-safeway-sell-168-stores-condition-merger.

the remedy being ineffective. Therefore, [REDACTED] agrees that it is difficult to envisage that a mix and match divestment of stores (and associated assets/infrastructure) could be an effective remedy.

6.5 [REDACTED] also notes that, given the expertise of the Parties in operating complex supply chains and the logistics of a grocery business with presence across the UK, there is likely to be a very limited pool of suitable purchasers that can demonstrate that they would be able to make a success of the divested business.

7. Summary/Conclusion

7.1 The CMA's findings of an SLC on the downstream retail markets are convincing and well-reasoned. [REDACTED] notes that the CMA has implicitly acknowledged that the Merger could have a negative effect on suppliers. Whilst the CMA states that it has not found sufficient evidence of such effects in this particular case, [REDACTED] considers that there is sufficient evidence to show that the Merger would lead to negative effects on suppliers that would result in less innovation and product choice for consumers. [REDACTED] considers that one reason why there may be "insufficient evidence" is due to (smaller) suppliers' concerns about expressing their views. If the CMA were to reiterate the confidential nature of its processes and require smaller suppliers who had not responded to the CMA's questionnaire to respond (e.g. by issuing s109 notices)[REDACTED] believes this would produce sufficient evidence to conclude an SLC based on buyer power. However, given the clear findings of an SLC downstream, [REDACTED] recognises that the CMA does not need to conclude on the Merger's possible negative effects on suppliers. [REDACTED] respectfully requests that the CMA clarify in its decision that the fact that the CMA has not had to rule on current retailer behaviour towards suppliers (which could be exacerbated by the Merger), does not imply any endorsement of the current functioning of the relationship between suppliers and customers.

7.2 [REDACTED] agrees with the PFs that the Parties have overestimated any possible efficiencies of the Merger, especially since they plan to keep their two brands separate post-Merger and any increase in scale as concerns synergies with suppliers would be limited, due to the fact that a large number of suppliers currently do not supply products, or at least not the same products, to both Parties.

7.3 [REDACTED] also considers that although the remedies proposed are the only ones potentially available to the address the SLCs identified in the PFs, anything other than prohibition is fundamentally problematic. Prohibition of the Merger is the only effective way to ensure that the Merger will not lead to adverse effects on consumers in the UK. The alternative divestiture of a significant number of stores (from one of the Parties) together with a brand and assets to a single buyer carries the significant risk of failing to restore current levels of competition, as highlighted by the failed divestment remedy in the recent *Albertsons/Safeway* case in the US. In addition, this remedy faces additional challenges in terms of ensure sufficient scope of a divestiture package, finding a single suitable buyer and the complexities involved in ensuring the purchaser's ability to successfully operate the package of divested stores.