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CASE ME/6752/18

PARTIES' RESPONSE TO PROVISIONAL FINDINGS REPORT

Sainsbury's

J Sainsbury plc

ASDA

ASDA Group Limited

15 March 2019

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EXECUTIVE SUMMARY

I. Introduction

(1) Asda and Sainsbury's operate in a rapidly changing and competitive market, where customers have more choice than ever in where and how they shop for groceries. The driving force behind the Proposed Merger is to deliver lower prices, better quality and service for customers. The synergies generated by the Proposed Merger have been independently calculated and then independently sensitised by expert industry consultants, who have found that the Proposed Merger will unlock cost-savings that will enable the Parties to lower prices by £1 billion annually across the Asda and Sainsbury's businesses by the third year following completion of the Proposed Merger. These significant reductions in prices will also drive industry-wide improvements in rivalry. The Proposed Merger is therefore pro-competitive and will result in substantial benefits to customers across local markets in the UK.

(2) Despite this, the Provisional Findings ("**PFs**") conclude that the Proposed Merger will lead to a significant lessening of competition ("**SLC**") on a number of bases, as follows:

(i) At the national level, in relation to the supply of in-store and online delivered groceries for both Parties and in relation to convenience for Asda.

(ii) At the local level, in relation to the supply of: (i) in-store groceries in 629 local areas; (ii) online delivered groceries in 290 local areas; (iii) convenience in 65 local areas; and (iv) fuel in 132 local areas (subsequently corrected to 129 local areas).

(iii) On the basis of a coordinated effects theory of harm between the Parties and Tesco in relation to aspects of online delivery pricing in 108 local areas where Ocado is entirely absent.

(3) The PFs do not find an SLC in relation to the buyer power, general merchandise ("**GM**") or in-store coordinated effects theories of harm identified in the CMA's Issues Statement.

(4) Given the multitude of fundamental errors and flaws in the CMA's analysis, the Parties have focused their response on key issues. As a result, this response ("**Response**") addresses the CMA's provisional SLC findings only. For the avoidance of doubt, the Parties consider that no concerns can, on the evidence, arise in relation to any of buyer power, GM or coordinated effects in relation to in-store groceries. To the extent that the PFs contain any indications to the contrary, the Parties consider that these are incorrect. Further, to the extent that the Parties do not specifically address any particular findings or comments in any part of the PFs, this should not be read as indicating agreement with the CMA's position.

(5) The Parties consider that there is no credible basis for a significant majority of the SLC findings provisionally identified by the CMA. In the chapters below, this Response sets out in detail the errors and problems with the CMA's analysis in relation to the following areas: GUPPI threshold; national in-store groceries; local in-store groceries; online delivered groceries; convenience; fuel; and efficiencies.

(6) Before doing so, however, the Response highlights key defects that are prevalent throughout the CMA's approach to the substantive assessment and undermine the validity and robustness of the PFs. These key failings in approach are: (i) inadequacies and errors in the CMA's analysis; (ii) unjustified dismissal of relevant evidence; (iii) insufficiently robust investigation of third-party evidence; and (iv) failure to remedy previously identified defects. These lead the CMA to reach conclusions that are fundamentally incoherent and/or at odds with any real-world sense checks, as set out below. If the fundamental flaws in the CMA's provisional conclusions highlighted in this Response are not corrected, UK consumers will suffer directly as a result, as will business certainty and confidence in the UK's competition regime.

II. Inadequacies and errors in the CMA's analysis

(7) As set out in detail in the chapters below, the CMA's analysis is inadequate in many respects, and contains significant errors (including the key errors set out at **Annex_001V.0_001**). Examples of these can be seen in relation to the CMA's approach to GUPPI, fuel and convenience:

A. The CMA's approach to the GUPPI threshold fails to meet basic economic standards in relation to robustness checks and confidence intervals

(8) The Parties have fundamental concerns with the CMA's approach to the GUPPI threshold provisionally adopted, including its inconsistency with previous decisional norms and the CMA's misapplication of the legal standard of proof in light of the nature of the grocery market, all of which will be addressed in Chapter 1 below. For the purpose of this category of defect, however, the key inadequacy in the CMA's methodological approach is its failure to engage to any extent in robustness testing.

(9) As will be explained in Chapter 1, whilst the CMA acknowledges that its assessment contains biases (either upward or downward), it makes no attempt to quantify the relative importance of these biases. Additionally, the CMA accepts the existence of uncertainty in its estimates, but makes no attempt to quantify these uncertainties or test its results in light of them. The CMA's failure to test its results for robustness is wholly unprecedented in UK decision-making and is entirely at odds with accepted economic practice.

(10) Had the CMA engaged in basic robustness checks on its local analysis, it would have become clear that there is a strong and systematic bias upwards in its estimate of diversion ratios for non-surveyed areas around the GUPPI threshold. This bias is significant enough that the number of grocery SLCs is likely to be overstated by around 370 areas. Further, the CMA's local diversion estimates used as the basis for its calculations have so much uncertainty around them, particularly at very low levels of GUPPI, that for significant numbers of them it is not possible to say that they are any different from zero. Similarly, the online predicted diversion measure provides almost no explanatory power, because there is almost no relationship between the survey diversion and the estimated proxy diversion rate for the same areas. Basic robustness checks would have shown that these uncertainties result in over 350 areas where it is impossible to say with sufficient confidence that the GUPPI threshold is exceeded.

(11) The CMA's failure to carry out these basic robustness checks, and to test its approach by reference to the evidence, means that the results cannot be presumed to be sufficiently strong to support the CMA's provisional conclusions.

B. The fuel assessment is driven by a basic coding error and biased decision rule

(12) The CMA's assessment for fuel does not follow the standard approach of using an initial filter and then carrying out a detailed analysis of all relevant local evidence in those areas that fail the filter. According to the CMA, that is not practicable in this case, because there are too many potential areas of concern. However, the CMA's analysis contains a basic coding error that more than doubles the number of areas caught by the filter. Had the CMA not made this basic error, the number of local areas remaining for review would be 49 SLC pairs which could be reviewed on 43 maps. That is considerably fewer than the 84 local areas that were caught by similar filters and 61 local areas investigated using the standard approach in the recent *MRH/MFG*[1] case – which was dealt with under the significantly shorter Phase I statutory timeframe of 40 working days. The present case is therefore entirely suited to a standard approach.

(13) Having made errors that led it to depart from the standard fuel assessment approach, the CMA then adopts an inappropriate decision rule. For its decision rule, the CMA uses two measures (a GUPPI-based

[1] CMA decision of 31 August 2018 in the *completed acquisition by CD&R Fund IX of MRH (GB) Limited*, Case No. ME/6750/18 ("***MFG/MRH***").

measure and a “Pricing Indicator” measure – each with its own threshold), both of which the CMA states are accurate and robust, and applies them in an “either/or” fashion. This means if either threshold is exceeded in a local area, the decision rule automatically generates an SLC finding. Despite the CMA’s claim that both measures are robust (which we dispute), the two generally disagree, with only 34 fuel sites exceeding both thresholds. For each local area where there is a disagreement between the two measures (i.e. one threshold is exceeded and the other is not), the evidence from the supposedly “robust” measure where the threshold is not exceeded is entirely disregarded.[2] This approach is illogical and plainly inappropriate, and does not constitute a proper assessment of the available evidence in the round.

(14) The CMA’s provisional SLC findings in relation to fuel retailing are thus substantially overestimated by virtue of the CMA’s underlying calculation errors and inappropriate approach to a decision rule.

C. The CMA’s local findings are undermined by significant counting errors

(15) The CMA provisionally finds that the Proposed Merger will result in 65 SLCs in relation to convenience retailing at the local level. It has reached this conclusion because it duplicated Asda’s stores in the analysis by adding them from two different datasets. It also incorrectly counted Asda Living stores (i.e. home stores of approximately 30,000 sqft) as convenience stores. Once these mistakes are corrected, the number of local SLCs reduces by more than half (to 32 local SLCs).

(16) In addition, the CMA’s local analysis fails to take account of the presence of over 500 competing Co-Op Midcounties stores. Whilst the Parties have not had sufficient time to correct for this error and re-run the CMA’s local analysis on a proper basis, it is clear that the impact of the omissions could be significant. For example, in the [✂] local area, the CMA’s analysis misses two sizeable Co-op Midcounties stores, one of 20,000 sq ft and the other of 16,000 sq ft. The constraint posed by those stores in that local area is therefore sizeable.

III. Unjustified dismissal of relevant evidence

(17) The PFs emphasise, at paragraphs 9 and 6.7, the extensive and wide-ranging nature of the CMA’s investigation, and the range of qualitative and quantitative evidence that the CMA has reviewed. Despite this, the PFs are based on a very limited selection of evidence. In particular, the CMA places by far the most weight on its own survey evidence in relation to both in-store and online groceries. In so doing, the CMA discounts and ignores a multitude of sources of relevant evidence submitted by the Parties. The chapters below examine why the CMA has no basis on which to discount these pieces of evidence. For purposes of this executive summary, it suffices to highlight key pieces of relevant evidence dismissed by the CMA.

A. The CMA dismisses key evidence from the Parties and third parties demonstrating that online and in-store groceries compete in the same market

(18) The PFs conclude that online and in-store groceries do not compete in the same market. The CMA can reach this conclusion only by dismissing a raft of the Parties’ evidence and the evidence of third parties. In particular, the CMA dismisses:

- Evidence of the consistency of category mix across in-store and online, and the commonality of competitive parameters (such as price and quality) across in-store and online.
- Kantar switching data which shows that close to 75% of online customers switch to in-store and that only around 30% of online customers bought at least half or more of their groceries online.

[2] Thus, sites are problematic if they fail either of the GUPPI test (1.5%) or the PI test (0.75ppl). Thus, if the PI for an area is only 0.2ppl but the GUPPI is 1.6%, the PI is ignored and the GUPPI is used to determine an SLC, whereas if the PI is 0.8ppl and the GUPPI is only 0.8% the GUPPI is ignored and the PI is used to determine an SLC.

- ABA online lapser survey data showing that over half to two thirds of the Parties' online customers that lapsed or reduced spend online did so because they spend more in-store.
- Internal documents from the Parties demonstrating that customers switch from online to in-store when they are dissatisfied with online service.
- An analysis of the Parties' customer-order level data for online orders placed over a two-year period (the Parties' "transactional data"). This data, which reflects actual shopper behaviour, shows that the diversions rates between the Parties' online services are far below the levels one would expect if in-store was not a substantially stronger constraint than indicated by the CMA survey.
- The evidence of third-party online providers (Ocado and Amazon) that they compete in an overall market for groceries, comprising both online and in-store.

(19) An in-depth Phase II analysis that discounts all of the above evidence in favour of a single survey that cannot be considered to be robust.

B. The CMA dismisses key evidence relating to in-store groceries

(20) The PFs similarly dismiss key pieces of evidence demonstrating that (a) the Parties are not particularly close competitors; (b) the shorthand "Big 4" label is a misnomer that fails to capture the reality of consumer preferences in UK grocery shopping today; and (c) the extent of the constraint from the discounters. In particular, the CMA dismisses:

- Third party data cited in the Parties' internal documents and third party reports (such as Global Data) that are informative of the competitive dynamics in the UK grocery industry, including demographic and customer perception data.
- Empirical entry/exit and impact analysis showing the extent to which the Parties lose customers to the discounters. In this respect, whilst the CMA states that its approach to the local in-store groceries analysis takes account of the entry/exit data, the information provided to the Parties shows that it has done so in an unsystematic and *ad hoc* way that uplifts, in particular, the diversions between the Parties.
- The Parties' internal "gravity models" which demonstrate the extent of competitive constraints faced by the Parties. As with the transaction data and lapser surveys discussed above, the gravity models are used and frequently relied on by the Parties in their day-to-day business to assess local conditions of competition and produce local market forecasts, thus capturing the essential inputs of a proper local assessment. Despite the Parties offering to provide the dataset (plus a member of staff to explain it) to the CMA on multiple occasions, the CMA has declined to even review it. This failure to investigate a key piece of evidence is particularly unsupportable as the data shows that the gravity models are, not only accurate in their own right, but are also more accurate at predicting the CMA's own survey diversions than the WSS model on which the CMA bases its local SLC findings.

(21) As above, the failure to rely on, and even examine, key pieces of evidence concerning the supply of in-store groceries (particularly evidence that casts doubt upon the CMA's PFs) is plainly inadequate.

C. The CMA's unwarranted dismissal of the Parties' quantified synergies case

(22) The PFs reject the Parties' quantified synergy case, which reflects an extensive empirical exercise compiled by retail industry specialists ([a consultant]), and has been sensitised by [a third party] to provide a highly conservative view on the synergies (using the methodologies and standards which would apply if the announcement of synergies was covered by Rule 28 of the Takeover Code). In contrast, the CMA's use of simple comparators to calculate an efficiencies credit of £400 million is vague, opaque and far less robust than [a consultant's] analysis and [a third party's] sensitised figures. The CMA does not explain

why it is better placed than Sainsbury's, Asda and two highly-experienced consultancies to ascertain the level of synergies to be expected in a significant deal of this kind.[3]

IV. Insufficiently robust investigation of third-party evidence

(23) The third key defect in the CMA's provisional assessment is one of process; the CMA has, on the face of the PFs, failed to carry out a sufficiently robust investigation of third-party evidence.

(24) This is most apparent in relation to online delivered groceries, where the CMA states (at paragraph 12.81) that it was told that M&S has no definitive plans to enter online delivered groceries. Just a week after the PFs were issued, M&S announced that it is entering into a £750 million joint venture arrangement with Ocado, which will result in M&S products being available for online delivery (alongside a wide range of branded products) within 18 months. According to the materials published by the parties on announcement, the "*JV will work as a true partnership aiming to create the UK's leading online grocery business.*" The failure of the CMA to identify this upcoming entry indicates that its investigative steps were clearly deficient (as a transaction of this size and nature must have been in contemplation and negotiation for some time).

(25) Similar statements downplaying or denying entry/expansion plans by other competitors also appear to have been taken at face value by the CMA and not investigated properly. For example, the PFs state at paragraph 12.81 [✂] and that [✂]. Both of these statements are plainly at odds with publicly available information relating to the expansion plans of these competitors.

(26) With respect to third-party views regarding the constraint from in-store groceries on online, the PFs cite Morrisons' submission that competition between online and in-store channels may be limited. The CMA does not appear to have attempted to validate this submission. Had it done so, it would have been clear that the statistic Morrisons submitted does not support that submission. The statistic quoted by Morrisons (and relied on by the CMA) is based on net-switching, which the CMA rejects elsewhere as uninformative. Using the CMA's preferred measure (switching losses), it is clear that only 22% (rather than 99.6%) of losses from Morrisons' online came from other online competitors, with the remaining 78% coming from in-store.

V. Failure to correct previously identified defects

(27) The Parties provided detailed submissions to the CMA in response to its annotated Issues Statement and WPs. In these submissions, the Parties highlighted a number of defects in the CMA's assessment, as it then stood. The analysis and findings in the PFs show that the CMA has failed to remedy these defects and that, as a result, they continue to compromise the CMA's conclusions.

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[3] The Parties propose appointing an independent third party to verify the price investment commitment. Specifically, this third party would independently review a statement made in the combined group's annual report and accounts that the group had reduced prices for customers in Sainsbury's and Asda by £1bn per annum, by the third year post-completion. This is similar to Sainsbury's approach to its Corporate Social Responsibility targets and reporting. The Parties have had preliminary conversations with a large accountancy firm that expects that any of the large accountancy firms would be able to perform this role.

Sainsbury's already has a SKU by SKU methodology for measuring price investment today, and the Parties would expect to build on this to agree a methodology with the appointed third party to create a formal reporting standard. The price investment would be measured across Asda and Sainsbury's and the net amount reported. For the avoidance of doubt the Parties would not reduce the price commitment as a result of store divestments, if they are at the level set out in the Parties' response to the Notice of Possible Remedies.

The reporting would be for a minimum of 3 years (consistent with the time period envisaged for investor returns) and the combined group would publish a report annually and announce it at its Preliminary results announcement. The price investment commitment will be recorded as a public statement of intent in the shareholder circular that is required to be sent to Sainsbury's PLC shareholders to approve the transaction. Such statements must be verified to a very high standard by the PLC Board and UBS in its capacity as Financial Sponsor. A failure by any consumer facing brand to not live up to its public commitments to customers would be highly damaging to the trust and reputation that Sainsbury's and Asda have built up over many years.

(28) For example, in response to the WPs, the Parties highlighted that the CMA's analysis, particularly of the constraint from the discounters, relied extensively on submissions by competitors that were, on their face, contrary to objective fact, and/or to their previous public statements and submissions to the CMA. Such statements included, for example, the statement by Tesco that "*Aldi and Lidl are a constraint but they are not yet a full substitute, so, at best, it is a very limited constraint*" – in direct contrast to its submission in the *Tesco/Booker* investigation that "*It is irrefutable that the discounters are close competitors to Tesco (and the other multiples)*". The Parties pointed out to the CMA it was incorrect to put such weight on competitor submissions of this type, particularly as they had clearly not been tested rigorously before the CMA relied on them. Whilst the PFs acknowledge the inconsistency in Tesco's statements (and those of other competitors) when describing the competitor statements initially, the CMA's competitive assessment fails to do so, and simply notes without qualification that third parties have indicated that the discounter constraint was limited. There is also no evidence that these statements have been tested against competitors' internal documents. This is plainly insufficient and does not address the substantive robustness concern identified by the Parties.

(29) Similarly, the Parties have highlighted throughout the process that the CMA's survey methodologies contain fundamental flaws. For example, the Parties repeatedly informed the CMA that its online survey is not representative of the Parties' overall base of orders and is biased towards orders from heavy users of online deliveries, who by their nature are less likely than the average or the marginal online customer to switch to in-store groceries. The Parties have also repeatedly highlighted the framing bias that results from carrying out a survey of online shopping behaviour via an online survey. The CMA has failed to address these (and other) significant flaws in the survey. As a result, the CMA's online survey has been found by Professor P. Sturgis (Professor of Research Methodology at the University of Southampton and Specialist Advisor to the House of Lords Select Committee on polling issues), an expert in survey design, to be "*likely to contain a range of random and systematic errors as a result of risk factors arising from the way the survey was designed, implemented, and analysed*", with the result that "*there is a high risk that key estimates from the CMA online survey cannot be taken as an accurate guide to customer behaviour in the event of a merger between the Parties*".

(30) Additionally, in response to the fuel WP, the Parties highlighted an error in the code used by the CMA to predict fuel price changes. This error had resulted in price increases of over 1ppl being predicted <u>around 10 times as often</u> as is the case when the error is corrected – meaning that the number of areas where Pricing Indicator (as it is now termed) predictions exceeded 1ppl were greatly overstated. The PFs do not refer to the CMA's earlier analysis or to the Parties' submission, but they do rectify the error in the code. At the same time, however, the CMA has shifted its focus to local areas where the Pricing Indicator suggests only a 0.75ppl or greater increase. Had the CMA remained consistent, and raised concerns about sites with Pricing Indicator predictions above 1ppl (as was done in the WPs), only 4 Asda and 22 Sainsbury's fuel sites would have been caught. Instead, the lower 0.75ppl threshold for concern catches 15 Asda and 41 Sainsbury's fuel sites. The PFs do not offer any explanation for this shift in the CMA's thinking, and it is impossible to reconcile with the low degree of accuracy afforded by the Pricing Indicator measure, which predicts the actual outcomes of the Parties' pricing policies to within 0.75ppl <u>less than 50% of the time</u>.

VI. The defects in the CMA's approach lead to fundamentally incoherent and illogical results

(31) The above defects (which are discussed in detail in the chapters below) have led the CMA to reach provisional conclusions that are fundamentally incoherent and at odds with any real-world sense checks.

(32) In relation to in-store grocery, the CMA has posited a Phase II test that is stricter, and identifies almost 200 more SLCs when the discounters are included in the market, than the Phase 1 test in this case, which excluded the discounters from the analysis. The CMA's GUPPI threshold implies a critical diversion threshold over four times more invasive than the standard threshold used to screen out areas at Phase

1, meaning that it would condemn as automatic SLCs horizontal overlap areas in *Tesco/Booker* that were considered unproblematic at Phase I, and not even considered at Phase II. This is fundamentally incoherent.

(33) Comparing the results of the CMA's GUPPI threshold for local in-store and online groceries to standard diversion and market share tests, the CMA's threshold (absent efficiencies), creates a presumption of an SLC in a market with 15 identical competitors going to 14 competitors or two firms with a market share of 6.7% each combining to create a single firm with just over 13% market share.

(34) Not only that, but the CMA's GUPPI threshold results in a competition test that essentially ignores or is essentially independent from the level of competition. For in-store groceries, the CMA's threshold of 1.5% (before credit for efficiencies) means that, even taking account of brand weights, an SLC will arise if the Parties have a Large Store within 7 minutes of each other, even if there are six equally-strong competitor stores within 7.5 minutes. Similarly, for online groceries at the local level, the threshold has been set so low that nearly all Asda "Supply Points" are considered problematic, regardless of the number of online providers in the area. Finally, the CMA's national GUPPI assessment for online groceries threshold proceeds on the principle that, absent efficiencies, any result above a GUPPI threshold of 0% is sufficient upward price pressure to provide evidence of a problem, a threshold which would be met if a single person in the entire UK switched from Asda to Sainsbury's or vice versa.

(35) Finally, in relation to online specifically, the CMA's approach to assessing diversion is so flawed that it generally predicts greater switching between the Parties in areas with greater numbers of online competitors. When the CMA builds on this to take account of the expansion plans of third parties, this results in the plainly illogical outcome that diversions between the Parties increase, thus suggesting that entry by new players reduces competition in a market.

VII. Conclusion

(36) It is clear, therefore, that the CMA's assessment in the PFs is wholly undermined by: (i) inadequacies and errors in the CMA's analysis; (ii) unjustified dismissal of relevant evidence; (iii) insufficiently robust investigation of third-party evidence; and (iv) a failure to remedy previously identified defects. The result of these defects is that the CMA has created and relied on a series of competition tests so divorced from any sensible measure of competition that they make no sense.

(37) As a result of the provisional conclusions reached, the CMA's Notice of Possible Remedies ("**NPR**") proposes (as a potential alternative to prohibition) an incredibly wide-ranging and impractical divestiture remedy. This Response does not repeat the submissions of the Parties' in their response to the NPR. However, given the clear interrelation between the CMA's flawed PFs and its proposed remedies, the Parties consider it helpful to address what appears to be a fundamental misconception with respect to the remedies needed in this case.

(38) The CMA appears to be attempting to recreate or replicate the Parties' current businesses via the remedies. In particular, the CMA appears to be approaching remedies on a "top down" basis in order to create a new player of the same scale and with the same supply-side and multichannel characteristics of Asda or Sainsbury's. This is unnecessary even on the basis of the CMA's PFs, let alone on a corrected basis.

- First, there appears to be no dispute between the Parties and the CMA that competition in groceries is fundamentally local. Customers base their choice of store on the options available to them in their local area by reference to convenience, price, quality, range and service. Thus, how the Parties compete in each local area will determine, in the aggregate, how they compete at a national level.

- Second, whilst in some industries there may be national parameters of competition that are not determined by reference to the "aggregation of local competition," this is not the case here and the CMA has not found otherwise. As a result, the CMA's provisional SLC findings are predicated on the aggregate incentives to degrade the customer offering across the Parties' stores (the only exception to this is the very specific coordinated effects theory of harm in online which, for the reasons set out in this Response, is not supported by the evidence). The CMA's provisional SLC findings are therefore "bottom up".

(39) An effective remedy to the CMA's provisional SLC findings can therefore also be "bottom up". In other words, by divesting to a viable and effective competitor in each local area in which an SLC is found, the Parties' individual local incentives and thus their aggregate national incentives will remain unchanged. There will be no incentive to degrade the customer offer and thus no SLC.

(40) Further, if the CMA addresses the fundamental flaws in the PFs, the number of local SLCs will fall significantly and the resulting divestiture package needed to remedy them (as set out in the Parties' response to the NPR) will be feasible. Such a divestiture package provides an opportunity to strengthen the market by allowing multiple buyers to benefit from these potential divestments and thus strengthen competition across all local areas in which a store is sold. Further, by enabling the Proposed Merger to proceed, this would allow the £1.6 billion of synergies to be achieved and thus allow the Parties to invest in lower prices across all of their stores (as the synergies would create a downward pressure on pricing in all areas).

(41) The Parties reiterate their commitment to the Proposed Merger, as well as to constructive engagement with the CMA to address the PFs and find an effective and comprehensive remedy to whatever reasonable SLCs remain in the CMA's final report.

VIII. Overview of the chapters in the Response

(42) This Response is divided into the chapters outlined on the following pages.

Summary of the Parties' response

Chapter 1: GUPPI

- The CMA's unilateral effects assessment in the grocery sector is centred on the GUPPI. The GUPPI thresholds chosen by the CMA are unprecedentedly low, do not fit the facts and evidence in the case (which the CMA has not attempted to check) and result in a competition "test" which is essentially independent of competition. This has led the CMA to reach provisional conclusions that are fundamentally incoherent and at odds with any real-world sense checks.

In particular,

- The CMA's assessment is unable to support an automatic SLC decision rule, given its GUPPI estimates are not only systematically biased upwards, but also fail to meet basic standards of statistical significance governing the reliability of economic evidence.
- The CMA's chosen GUPPI thresholds are radically out of line with all norms and are incoherent, in particular when set against recent closely-analogous CMA inquiries, *Tesco/Booker* and *Ladbrokes/Coral*.
- The legal consequence of the above flawed approach is that the CMA has misapplied the "expectation of SLC" test under s.36(1)(b) of the Enterprise Act 2002. The CMA's GUPPI thresholds cannot support an "expectation" of adverse effects underpinning the CMA's SLC findings.

Chapter 2: Efficiencies

- The rejection of the Parties' quantified synergy case, which is the product of a detailed empirical assessment by two independent experts, is an unreasonable interpretation of the evidence.
- The CMA does not explain why it is better placed than Sainsbury's, Asda and two highly experienced retail industry specialists to ascertain the level of synergies to be expected in a significant deal of this kind.
- The CMA's use of comparators to calculate an efficiencies credit of £400 million is vague, opaque, and far less robust than the Parties' detailed empirical assessment.
- Management confidence in the Parties' synergies case is demonstrated by the public commitment to reduce prices to customers by £1 billion annually (by year 3), which will be subject to independent review and the Parties are prepared to work with the CMA to find a means of providing assurance these savings will be delivered to customers.
- When errors of interpretation are corrected for, the comparators used by the CMA corroborate the existence of significant synergies, both consistent with the Parties' empirical analysis and considerably higher than the current CMA estimate.
- There is no evidence for doubting the principles of price harmonisation. The fact that harmonisation is an enduring benefit reflects the judgement of two retail industry specialists, established practice in analysing retail mergers, and the combined expertise of the Sainsbury's and Asda businesses.
- While the Parties are confident of realising the £1.6 billion of synergies quantified by [a consultant], the CMA should at a minimum allow for an efficiencies credit of £1 billion. This total reflects the Parties' public and has been substantiated by [a third party's] sensitised analysis on a highly conservative basis.

Chapter 3: In-store groceries: local assessment

- The CMA's estimates of Asda and Sainsbury's store diversions is significantly biased upwards for over 75% of the SLCs that the CMA finds. Correcting for this systematic bias would substantially reduce the number of SLCs.
- The CMA relies almost exclusively on its survey, which suffers from significant flaws, highlighted by the Parties and which have been repeatedly ignored by the CMA.

- The adjustments made by the CMA to reflect the CMA's entry/exit analysis have been made in an ad-hoc and unwarranted fashion both in terms of the brands selected and the magnitude of the adjustments made.
- The CMA has rejected key local evidence which would have made its local analysis more robust, including additional local survey work, impacts data and the Parties' gravity models. The failure to engage with the Parties' gravity models is particularly egregious, as they are more accurate versions of the CMA's WSS used in the ordinary course of both Parties' businesses and access to these has been repeatedly offered to the CMA (and declined).
- Finally, there are a number of other issues within the CMA's local analysis that have the result of significantly overstating the number of SLCs. These include incorrectly omitting own-brand diversions and incorrectly estimating the halo effect attributable to driving GM sales.

Chapter 4: Grocery: national assessment

- The PFs do not identify a distinct "national" parameter of competition that is independent from local competition. The national SLC identified in the PFs reflects the aggregation of local concerns.
- The CMA's assessment of evidence on the closeness of competition between the Parties is flawed:
    - The national average weighted GUPPIs for each of Sainsbury's and Asda (2.5% and 3.3% respectively) are too low to give rise to "substantial" upward pressure on centrally-set prices. Given the centrality of the GUPPI to the CMA's local analysis, it is inconsistent to position it as merely confirmatory for the national analysis.
    - The Parties' combined shares of supply are too low for unilateral concerns to arise and other quantitative evidence shows the Parties are not closer competitors than their shares suggest.
    - Qualitative evidence does not show the Parties to be particularly close competitors. Despite reviewing over 138,000 internal documents, the PFs do not cite a single internal document to show that the Parties are close constraints on each other's strategic decision making.
    - The CMA's focus on shorthand labels of the "Big 4" (versus "discounters") ignores both the dynamic nature of the grocery market and the varying competitive constraints of retailers. It significantly overstates the closeness of competition between the Parties and understates the extent of the constraint from others.
- Although the available evidence does not show the Parties to be particularly close competitors, local divestments in local areas based on a credible, evidenced based GUPPI threshold, will remedy any national problem based on the aggregation of local competition.

Chapter 5: Convenience

- The SLCs in relation to convenience stores at the national and local level identified in the PFs fail basic evidentiary standards.
- The CMA's national SLC finding is based solely on its equivalent findings for supermarkets. As explained above, the Proposed Merger does not give rise to a national SLC for supermarkets.
- The CMA's local findings have been made in the absence of any proper engagement with the Parties in relation to their convenience estates and appropriate investigatory steps to properly examine the facts of this case.
- The CMA relies entirely on the findings made in *Tesco/Booker* without giving any consideration to the relevant differences with the convenience offerings at issue in that case. Conversely, the CMA departs from the GUPPI threshold used in *Tesco/Booker* which has direct and immediate read across to this case without justification.
- The finding of 65 local convenience SLCs results from duplicating Asda's stores from two different datasets. The CMA has also incorrectly counted Asda Living stores as convenience stores. Correcting for these mistakes, reduces the local SLCs reduces by more than half (to 32) even before addressing the problems noted above.

Chapter 6: Online

- The CMA's provisional concerns regarding online grocery retailing are wholly unsupported by the evidence. When reporting on the recently announced tie-up between Ocado and M&S, Bernstein Research noted the UK is "the most competitive grocery ecommerce market in the world". Any reasonable analysis of the dynamics of online grocery retailing shows the Proposed Merger will not give rise to an SLC on any basis.
- The CMA has failed to recognise that online and in-store groceries compete in a single overall market for groceries, thus significantly underestimating the constraint from in-store groceries in its analysis.
- The CMA relies on its own inherently flawed online survey to the exclusion of other relevant evidence. This survey is described in an independent survey expert's report as "*likely to contain a range of random and systematic errors as a result of risk factors arising from the way the survey was designed, implemented, and analysed*", with the result that "*there is a high risk that key estimates from the CMA online survey cannot be taken as an accurate guide to customer behaviour in the event of a merger between the Parties*".
- The CMA's position fails entirely to address the likelihood and significance of entry and expansion in online grocery retailing, and therefore completely understates the dynamic and increasing competitive constraints on the Parties. In particular, the CMA fails to identify the upcoming entry by M&S through its tie-up with Ocado, and gives insufficient weight to the expansion plans of other rivals.
- The CMA's predictor for SLCs suggests that areas with more competitors have greater number of SLCs than areas with fewer competitors, and in many cases adding a competitor predicts that the area become less competitive. A consequence of this is that the CMA's modelling of competitor entry and expansion actually predicts areas becoming less competitive and actually increases the number of SLCs relative to no entry.
- Provisional concerns regarding the scope for the Proposed Merger to give rise to coordination with Tesco are also at odds with the weight of evidence as well as economic and legal principles. In particular, the CMA has significantly overstated the level of transparency and understated the degree of complexity around online delivery pricing which make it impossible for parties to align on and monitor coordination or to punish deviation. The CMA has also significantly underestimated the external constraints on online coordination (including from in-store groceries and competitor expansion) and has failed to provide any credible evidence that there would be an incentive to coordinated in the manner suggested.

Chapter 7: Fuel

- The CMA departs from the standard approach to reviewing fuel retailing mergers on the basis that there are too many local areas to review. However, the CMA's analysis contains a basic coding error that more than *doubles* the number of areas caught by standard filters. Had the CMA not made this basic error, the number of local areas remaining for review would be 43. This is considerably fewer than the 84 areas that were caught by similar filters and investigated using the standard approach in the recent MRH/MFG case – which was dealt with under the significantly shorter Phase I statutory timeframe of 40 working days.
- Instead, the CMA applies a rigid "decision rule" which automatically generates an SLC finding in every local area where either the GUPPI or the "Pricing Indicator" measures are above the respective thresholds set by the CMA. This "either/or" approach is patently unreasonable because it means the CMA is not placing any weight on the evidence from these measures where they do not support an SLC finding.
- In fact, neither of the two measures used in the CMA's "decision rule" achieve a standard of accuracy and reliability that should be considered reasonable to determine an SLC finding – particularly when applied with the extremely low thresholds set by the CMA.
- The most robust approach would be to follow established Phase I decisional practice, and engage in the application of initial filters followed by closer scrutiny of evidence concerning local areas flagged by those filters.

CHAPTER 1 - GUPPI

I. Introduction and Summary

A. Summary of the CMA's approach

(1) The CMA's unilateral effects assessment in the grocery sector is centred on the Gross Upward Price Pressure Index (**GUPPI**). As this Chapter shows, the GUPPI thresholds chosen by the CMA are fundamentally problematic and result in SLC findings that are wholly unsupported by the evidence.

1. Local analysis

(2) For both in-store and online, the CMA uses an overall GUPPI threshold of **2.5%** as a "decision rule" such that any local area exceeding that threshold qualifies as an automatic SLC area. The 2.5% total is based on a 1.5% GUPPI threshold at which there is a presumption of an SLC (absent efficiencies), but also includes an exceptional 1% efficiency credit, to take the figure to 2.5%.

(3) The CMA allows a 1.5% GUPPI measure for issues of "substantiality" and "uncertainty" referring to this as "*sufficient margin above the lower bound of 1% … for efficiencies*".[4] This "sufficient margin" of 1.5% upward price pressure allows the CMA *"to be satisfied, on the balance of probabilities, that in each area failing the decision rule, the Merger gives rise to an SLC*".[5]

(4) The CMA also considers that there is an exceptional "efficiency credit" in this case (not normally accounted for in the standard GUPPI model, or in decisional practice on GUPPI thresholds). The CMA notes that the Parties' proven efficiencies "*translate into a downward pressure of around 1%*" such that "*a GUPPI of around 1% or below would [not] be supportive of an SLC finding"*.[6] In other words, absent efficiencies, it follows that the GUPPI threshold would remain at 1.5% at this point.

(5) On the basis of the above, the CMA finds local SLCs in 984 instances across the Parties' estates.[7]

2. National analysis

(6) For its national in-store analysis, the CMA does not replicate a GUPPI threshold decision rule approach, but says that its calculations of the Parties' national aggregate (average weighted) GUPPI scores are "*one indicator*" in its SLC analysis "*in the round*".[8] On the CMA's calculations, the Parties' national GUPPI scores are 2.5%, and below 3.5%, respectively. The CMA provisionally finds that "*our national weighted GUPPI calculations, which at 2.5% and [below 3.5]% indicate a level of upward price pressure that we consider would be substantial, having taken into account the [1% credit for] efficiencies … As a result we [find] on the balance of probabilities … an incentive to degrade PQRS across the Parties' national supermarket estates resulting in an SLC in each local area where one or more of the Parties' supermarkets is present.*"[9] Thus, the CMA's conclusions on a 2.5% GUPPI are, in substance, no different than formally applying a national SLC "threshold" of 1.5% – and then providing a credit of 1% for efficiencies. The finding that this 2.5% GUPPI (including efficiencies) result/threshold is consistent with a

4 PFs, paragraph 8.249.

5 *Ibid*.

6 *Ibid*, paragraph 8.236.

7 This total breaks down as follows: supermarkets: 629; online: 290; convenience: 65. The number of convenience SLCs is 32 after fixing the CMA's coding error.

8 PFs, paragraph 8.69; cf. "*in combination with [a] range of qualitative and quantitative evidence*".

9 PFs, paragraphs 8.78-79.

national SLC coincides, to the decimal point, with the lower of the Parties' respective national GUPPIs for in-store groceries.[10]

(7) For its national <u>online</u> analysis, the CMA aggregates the local GUPPI findings to identify a national incentive to degrade PQRS across Supply Points and proceeds on the principle that, absent efficiencies, any result above a national GUPPI threshold of 0% is sufficient upward price pressure to indicate an SLC problem.[11] The national GUPPI scores of the Parties, deducting 1% efficiencies, are <u>below 1</u>% for Sainsbury's and below <u>2.5</u>% for Asda, and the CMA provisionally finds that "*the national GUPPI … shows that there would be material upwards pricing pressure post-Merger, particularly for Asda customers*."[12] The CMA therefore finds that less than 1% upward price pressure absent efficiencies is "*material*" for SLC purposes, and that this is "*particularly*" true at a result below 2.5%.

B. Critique of the CMA's approach

(8) The CMA's approach to GUPPI is fundamentally flawed as set out below. First, the CMA's thresholds simply do not fit the facts and evidence – something the PFs do not even attempt to check. Second, the CMA's assessment is unable to support an automatic SLC decision rule insofar as it fails to meet basic standards of statistical significance governing the reliability of economic evidence. Third, the CMA's chosen GUPPI thresholds are both radically out of line with all norms (whether based on GUPPI, or cross-checked against concentration thresholds) in general, and incoherent in particular when set against closely-analogous CMA inquiries, *Tesco/Booker* and *Ladbrokes/Coral*.

(9) The legal consequence of the above flawed approach is that the CMA has misapplied the "*expectation of SLC*" test under s.36(1)(b) of the Enterprise Act 2002 (the "**Act"**). The CMA's GUPPI thresholds cannot support an "*expectation"* of adverse effects underpinning the CMA's SLC findings. The issue of market size or '*importance*" does not and cannot change this: Parliament did not give licence under the SLC test for lower standards of proof, or laxer evidentiary standards where the market is large or important.

1. The GUPPI thresholds do not fit the facts and evidence in this case

(10) At paragraph 8.231 of the PFs, the CMA acknowledges that the GUPPI calculates only <u>expected pricing pressure</u> and not the price rise or other non-price deterioration in quality, range or service that may be expected to result. It also accepts[13] that: (i) it must be satisfied, on the balance of probabilities, that in each local area captured by the GUPPI decision rule, the Proposed Merger would result in an SLC; and (ii) this is to be achieved by calculating the GUPPI "*using robust evidence*". As a result, it is incumbent on the CMA to test its proposed GUPPI thresholds properly by reference to the available evidence of how the Parties are likely to react to pricing pressure. However, this has not been done.

(11) The Parties have submitted evidence showing how they react in practice to competitor entry/exit, which is directly relevant to how they, in fact, react to real or perceived inflections in competitive pressure. Unlike previous cases, such as *Ladbrokes/Coral*, where the CMA used this type of evidence to check whether its GUPPI/WSS thresholds were appropriate, the CMA has ignored the real-world evidence in this case. This is clearly inappropriate.

(12) The CMA's threshold presumes that tiny changes in competitive pressure are material at far lower levels than that recognised by the Parties in reality. The CMA's GUPPI threshold at 1.5% (absent efficiencies)

[10] Had the national GUPPI threshold chosen been even a tenth of a percentage point higher (i.e. a threshold of 2.6%), the lower of the two national GUPPIs results could not meet the threshold. Had the threshold been one percentage point higher (3.5%), neither Party would have met this threshold.

[11] For the online national GUPPI threshold, the CMA <u>does not apply a</u> 1.5% margin for uncertainty because it considers that the national diversion for online is (allegedly) "*robustly estimated*" – relative to the in-store diversion inputs (see PFs, paragraphs 11.49-50)

[12] PFs, para 11.56; PFs Executive Summary, para 63.

[13] PFs, paragraph 8.230.

presumes that virtually 100% of areas in which the Parties overlap within seven minutes would see an increase in price or deterioration in QRS.

(13) This does not correspond with the way that the Parties take account of competitive entry in their day-to-day business. The Parties only adjust store budgets for a relatively small proportion of competitive entry events within [✂] minutes. Even when there are Large Store impacts within one to three minutes, the Parties' behaviour shows a clear pattern: the proportion of significant impacts declines by reference to (i) how far away the new entrant store is and (ii) the increasing total number of competitors in the catchment. This real-world pattern is consistent with common sense intuition but is not reflected in the CMA's approach (in which the existence of problematic areas is essentially independent of the level of competition up to seven minutes away).

2. The CMA's assessment fails basic standards of reliability of economic evidence

(14) A key part of the CMA's rationale for using very low GUPPI thresholds is that its GUPPI estimates are both unbiased and robust. This is not correct. As shown below in section III, the GUPPI estimates, based on its WSS diversions estimates, are not only significantly upwardly biased for stores with a diversion of less than 25%, but also exhibit considerable imprecision.

(a) The GUPPI estimates are systematically biased upwards

(15) The evidence shows the CMA's estimated WSS diversions for the Parties' overlapping stores not only *systematically over-estimate the actual diversion* at an individual store level below 15%, but also systematically over-estimate the aggregate survey diversions below 25%. As the vast majority of the CMA's SLCs (75%) have an aggregate diversion of less than 25%, this implies that the vast majority of the CMA's SLCs are affected by this upward bias in the CMA's estimated WSS diversion. Indeed, looking only at the surveyed stores, the WSS aggregate diversion is greater than the aggregate survey diversion for <u>29 of 30</u> (97%) Sainsbury's centroids and <u>32 of 37</u> (86%) Asda centroids.

(16) This systematic bias is compounded by the CMA's very low GUPPI threshold. The extent of the resulting bias can be demonstrated by a comparison of how many of the Parties' 93 surveyed stores fail the GUPPI threshold depending on the measure of the survey diversion used to estimate the GUPPI. For example, using the CMA's estimated WSS diversions, rather than actual survey diversions, the number of Sainsbury's SLCs at a 2.5% GUPPI threshold increases from 25 out of 45 (56%) to 40 out of 45 (89%).

(17) Since the CMA uses estimated WSS diversions for non-surveyed stores, which account for the vast majority of stores, the above bias significantly increases the number of SLCs identified, particularly given the CMA's very low GUPPI threshold. Correcting this bias by using the proportion of SLCs using actual survey diversions would reduce the number of SLCs from <u>**395 Asda SLC stores to 296**</u> and <u>**428 Sainsbury's stores to 267**</u>, even using the CMA's 2.5% GUPPI threshold.

(18) The upward bias is even clearer in relation to online grocery at national level. The CMA effectively uses a 0% net threshold for the online national GUPPI as it argues that their national diversions are robust and do not set out the 1.5% allowance for uncertainty found in the Local chapter.[14] However, as diversions cannot be negative, then (by definition) the errors cannot be symmetrical around a zero threshold. Therefore, a GUPPI threshold higher than 0% absent efficiencies is necessary for the CMA to reasonably decide that an SLC is more likely than not.

(b) The GUPPI estimates are too uncertain to be reliable

(19) The CMA implies that, regardless of the robustness of its estimates, it can rely on them provided that the errors in the estimate are symmetric and argues (contrary to the evidence) that their estimates are unbiased, and are the best available evidence in this case. Regardless of whether that is correct, simply

[14] See also Para 11.98 which uses a 1% GUPPI including efficiencies, and therefore 0% absent efficiencies.

ignoring the extent of uncertainty around their diversion and GUPPI estimates ignores standard methods to consider statistical significance. Further, whilst symmetry is necessary, it is not, by itself sufficient for the CMA's statutory obligations. For example, although flipping a coin to determine whether an SLC exists would create symmetric errors, such a test would be plainly incompatible with the CMA's statutory obligations. The CMA goes on to acknowledges that there is uncertainty, and states that it is appropriate to account of this in the GUPPI threshold. However, in setting out the 1.5% GUPPI threshold the CMA provides no evidence on: (i) the amount of uncertainty in its estimates; (ii) the basis the 1.5% was determined; (iii) the proportion of the 1.5% accounted for by uncertainty versus the other biases; and (iv) whether it is sufficient to account for the levels of uncertainty in this case.

(20) As we show, the diversion estimates used by the CMA, particularly at low levels of GUPPI, have so much uncertainty around them that it is not possible to say that they are any different from zero. In fact, most of the CMA's estimated WSS results lie significantly outside the actual measure of the diversions generated by the CMA's own survey. For example, 73% of the surveyed Asda stores diversions and 77% of the surveyed Sainsbury's stores diversions have actual survey diversions that are statistically different from the CMA's predicted WSS diversions. This reflects the substantial amount of variation associated with the CMA's estimated WSS diversions. Applying standard 90% confidence intervals[15] to the estimated Sainsbury's to Asda WSS diversions, the average confidence interval (as measured by the median) spans 18.3%. This is over 2.5 times as large as the WSS threshold that the CMA is using to determine an SLC (on average, 7% at a 1.5% net GUPPI).

(21) With respect to online grocery, there are even greater levels of uncertainty in the relevant CMA estimates. The CMA relies exclusively on its survey evidence to derive diversion ratios for the GUPPIs. However, given the low number of Supply Points for which the sample size is over 100 respondents, the CMA has to create a proxy diversion rate for the overwhelming majority of Supply Points (488 of the 530). As there is almost no relationship between the survey diversion and the estimated proxy diversion rate for the same areas, the CMA's estimated WSS diversion is extremely poor predictor of the actual diversion ratio.

(22) As a result of the above biases and uncertainties, the CMA cannot meet its legal obligation of forming an expectation of an SLC on the balance of probabilities.

(c) The CMA's approach ignores the dynamism of the market

(23) The CMA's approach to the GUPPI threshold is static and ignores the real world dynamic nature of the market. By focusing disproportionately on shorthand "Big 4" labels, the CMA appears to assume that any "Big 4" transaction is presumptively bad, no matter the facts and evidence or the dynamic responses from competitors. The CMA may formally take account of planned new local stores in its model but by assuming that pricing pressure, no matter how tiny, will always translate into an actual price increase, it effectively ignores competitors' repositioning (by improving and upgrading the offer in existing stores) and the ability to open new stores. Equally, it effectively ignores dynamism in online, of all sectors, such as the expansion of rivals' online offer into new areas (such as M&S/Ocado) and innovations and repositioning that improve it. It also ignores dynamic customer behaviour. Using this static model, as a decisive decision rule, abstracts from the reality of the UK grocery sector in 2019.

(24) Further, the CMA is misplaced in its assessment of other factors that would counteract the passing-on of small amounts of upward price pressure into adverse effects for customers.

[15] See paragraph 17 of the *Suggested Best Practice for Submissions of Technical Economic Analysis from Parties to the Competition Commission*; see also the CMA's decision in *Reckitt Benckiser / K-Y brand merger inquiry*, decision of 12 August 2015 ("***Reckitt/Benckiser***"), which used a range of diversion ratios from survey evidence and variable margin estimates based on the parties' data to compute Illustrative Price Rises ("**IPR**"), and used 95% confidence intervals in the estimate of the diversions.

3. The very low GUPPI thresholds are radically out of line with all norms and incoherent when set against Tesco/Booker and Ladbrokes/Coral

(25) The CMA's approach to GUPPI thresholds in this case is unprecedented.

(26) It results in a Phase II test, purportedly on the balance of probabilities, that is more invasive than the Phase I "*may be the case*" standard. Further, despite the fact that the Phase II assessment recognises that Aldi and Lidl are a competitive constraint, it nonetheless generates 35% more SLC areas than the Phase I assessment which excluded Aldi and Lidl. There is no precedent in the UK for a Phase II case generating more SLC findings on "*more likely than not*" than was found on a "*may be the case*" standard.

(27) Neither the CMA, its predecessors, the US antitrust agencies or the European Commission has ever found a problem based on GUPPI as a threshold (or simply an input) anywhere near as low as those chosen by the CMA.[16] The CMA's *Tesco/Booker* horizontal and vertical safe harbours presumed no problem below a 5% GUPPI;[17] in *Ladbrokes/Coral*, the problem SLC threshold was equivalent to a GUPPI of over 10%.[18]

(28) Contrary to the CMA's assertions, limited weight can be given to older non-GUPPI examples (and the handful of Phase I cases cited by the CMA). The old *Somerfield/Morrisons* case (2005), if deserving of any weight, points to higher thresholds than the CMA has used. Outside the UK, the CMA refers to the US *Dollar Tree* matter: in that case the US Federal Trade Commission said it was "*inappropriate*", at this stage of economic learning, to use GUPPI as a presumption of competitive harm (see Schedule 1.1). That matter therefore contradicts, rather than, supports the CMA's decision rule approach.

(29) The fact that the GUPPI thresholds have been set at unreasonably low levels is clear from "real world" sense checks and set against normal concentration thresholds of concern.

(30) At its most basic, the CMA has set the GUPPI thresholds so low that it has created an SLC test that is essentially independent of the level of competition:

- For in-store groceries, the CMA's threshold of 1.5% (absent efficiencies) means that, even taking account of brand weights, if the Parties have a Large Store within 7 minutes of each other, there will be an SLC, to all extents entirely independent of the number of competitor stores within 7.5 minutes.
- Similarly, for online groceries at local level, the threshold has been set so low that nearly all Asda Supply Points are considered problematic, regardless of the number of online providers in the area.
- For online groceries at national level, the implication is from the CMA's greater than 0.0% threshold is so low that, if a single person in the entire UK switched from Asda to Sainsbury's, then (absent efficiencies) the threshold would be exceeded.

(31) A comparison of the results via diversion ratios into concentration measures based on the number of competing firms (fascia counts) and market shares further illustrates the extent to which the CMA's approach produces radically unexpected results.

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16 To the best knowledge of the Parties' advisers, based on published decisional practice.

17 CMA decision, *Anticipated acquisition by Tesco PLC of Booker Group plc*, decision of 20 December 2017, paragraph 9.50 – 9.53 and 11.7 ("*Tesco/Booker*", attached as **Annex_005_002**).

18 The decision rule in that case was formally expressed in different terms but the CMA used a 10% GUPPI as a lower-bound in formulating its decision rule, setting itself a ballpark guide of [10-20]% GUPPI to set the range of its "WSS" intervention threshold, where WSS is an "*expected diversion ratio*" (CMA, *Ladbrokes/Coral merger inquiry*, decision of 26 July 2016, paragraph 7.127 – 7.129, "**Ladbrokes/Coral**", attached as **Annex_005_007**).

(32) A GUPPI threshold of 1.5% (absent efficiencies), using the Parties' margins, translates into a critical diversion threshold of just over 7% (7.1%) across the two Parties, and as low as [✂]. This is the same expected diversion ratio that one would expect to find in a market with approximately 15 symmetric firms, each with approximately 6.7% market share. Thus, absent efficiencies, the CMA's threshold creates a presumption of an SLC in a market with 15 equally-strong rivals going to 14, or two firms combining to create a single firm with just over 13% market share. This creates a presumption of an SLC that in other cases would not even be considered a potential problem let alone a likely one.

(33) In consequence, the CMA's current 1.5% GUPPI test would condemn as automatic SLCs horizontal overlap areas in *Tesco/Booker* that never even made it to Phase II. This is fundamentally incoherent.

4. The CMA consequently misapplies the 'expectation of SLC' test

(34) The legal consequence of the above flawed approach is that the CMA has misapplied the "*expectation of SLC*" test. For the reasons outlined above and discussed in detail below, the CMA's GUPPI thresholds cannot be justified on the quality of the CMA's estimates and analysis: quite the contrary.

(35) Nor is this flawed application of the test saved by the unusually large size or "household importance" of the grocery sector.[19] The CMA's reference to the scale of harm of a 1% national grocery price rise appears to suggest that it can adopt a standard of risk that is more cautious due to market size. This would be wrong: the test the CMA must apply is not "*plausible risk*" but "*more likely than not*".

(36) Finally, even if market importance were relevant to the question of what amounts to "*substantial*", i.e. the "S" in SLC (which is not supported by the Act, the CMA's guidance, any UK grocery merger case, or even the 2008 *Groceries* inquiry), this would in any event not change the fact that the CMA's GUPPI analysis in this case does not allow any confidence in predicting the risk of adverse effects.

(37) Regardless of market size, therefore, an uncertain or low risk remains an uncertain or low risk, and something that does not fit the facts cannot be held to be more likely than not.

C. Conclusion

(38) The centrepiece of the CMA's analysis is the GUPPI threshold, a simple and static model that, as the CMA acknowledges, does not predict actual price rises. The CMA cannot rely on such a model in this way without properly assessing the extent to which it accords with the available evidence, verifying the robustness of the assumptions and methodology, and cross-checking the output of the model to real world conditions of competition. As the above shows, the CMA has failed to carry out these necessary steps. This is borne out by the fact that the very low level of GUPPI chosen as a threshold would imply that, in the groceries market, tiny changes in competitive pressure would translate into price increases, which is not the case. Further, the uncertainties and biases present in the CMA's model render the results unsafe, as they fail to meet standard robustness requirements.

(39) As a result, and because of the very low threshold level chosen, rather than predicting to any real degree the likely competitive impact of the Proposed Merger, the CMA's GUPPI model essentially identifies SLCs regardless of the extent of competitive constraint present. This leads to perverse results.

(40) Given that the CMA's GUPPI thresholds fail to accord with and explain what is currently observable reality, without the merger, they are unsafe as a prediction to the future world with the merger.

(41) The sections below address the CMA's GUPPI analysis as follows:

- **section II** focuses on the facts and evidence in this case. It shows why the CMA's GUPPI is contradicted by the evidence;

[19] PFs, paragraph 8.239 and note 153.

- **section III** shows that the CMA has conducted a flawed assessment tainted by bias and uncertainty as a matter of economic theory and practice;
- **section IV** shows that the CMA's GUPPI thresholds are radically out of line with all norms and incoherent when set against the CMA's closest analogous inquiries, *Tesco/Booker* and *Ladbrokes/Coral*;
- **section V** explains, in light of previous sections, that the CMA's assessment of uncertainty and substantiality misapplies the "expectation of SLC" test; and
- **section VI** concludes on the business and regime implications of taking such a radical approach to mergers in (large) retail sectors, or in grocery in particular.

II. The CMA's GUPPI thresholds do not fit the facts and evidence

A. Introduction

(42) The CMA accepts that its assessment contains biases (either upward or downward). However, having done so, it makes no attempt to quantify the relative importance of these biases, nor does it acknowledge the Parties' analysis of biases.

(43) Similarly, the CMA acknowledges the existence of uncertainty in some of its estimates, but makes no attempt to quantify this uncertainty or link it back to the threshold. The CMA simply asserts that its decision rule of 2.5% GUPPI, or 1.5% absent efficiencies, was calculated "[*t*]*aking the factors above in the round"*.[20] The PFs provide no explanation of how it took these factors in the round, or indeed which factors were important or not.

(44) Nor do the PFs provide any analysis to check whether a presumption of a substantial lessening of competition at a 1.5% GUPPI is appropriate in the current case. It simply asserts that it is: in lieu of any demonstrable stress-testing against evidence, the PFs substitute repeated (and unsubstantiated) exhortations that the work was "*careful*", "*robust*", and "*unbiased*".[21]

(45) This contrasts to the CMA's robust approach in the closest methodological (and only other decision rule) analogue, the *Ladbrokes/Coral* inquiry (Phase II, 2016). In that Report, the CMA first proposes a candidate diversion threshold of 15-20% including out of market (or 30-40% on the basis of the WSS "expected diversion ratio" absent the out of market) and then demonstrably checked that against the evidence it had on competitor presence, concessions, refurbishments and entry and exit in order to determine which of the different thresholds best fitted the evidence.[22]

(46) In particular, in *Ladbrokes/Coral*, testing a 30% WSS threshold, the CMA looked at the proportion of stores being predicted as problematic at different groupings of distance, and then looked at how well this corresponded to Ladbrokes' and Coral's impacts. If the WSS predicted a high proportion of problematic stores in a particular category, but in reality neither Ladbrokes nor Coral considered or reacted to impacts in the same category, this would imply that the WSS was too high. Only after comparing the predictions of SLC at different thresholds with the actual evidence did the CMA conclude that a WSS of 35% was appropriate (corresponding to a 10-15% GUPPI).

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20 PFs, paragraph 8.249.

21 See e.g. "*… a significant amount of analysis … evidence we consider to be robust … subject of careful scrutiny … extensive CMA store exit survey (… the subject of careful planning, and high-quality fieldwork) … margin information .. carefully assessed … careful analysis .. in our judgement an unbiased estimate*" (PFs, paragraph 8.246).

22 *Ladbrokes/Coral*, paragraph 7.123 *et seq.* (attached as **Annex_005_007**).

(47) The PFs argue that *Ladbrokes/Coral* was different, and thus can be ignored, because of the different market context and the fact that it used a WSS threshold rather than a GUPPI threshold.[23] With respect to market context, as set out below, this does not remove the need to follow methodological good practice and confirm whether the model is a reasonable fit with actual commercial behaviour. The second argument, on the WSS threshold, is surprising for the CMA to make: as the CMA is aware, there is a direct relationship between the WSS and the GUPPI: the WSS is an estimate of diversion, and the GUPPI is a direct function of diversion. Further, the *Ladbrokes/Coral* Report explicitly makes the link, saying that a WSS candidate threshold of 30-40% translates to a GUPPI threshold of 10-15%.[24] As such, there is no basis to claim that there is a meaningful difference between the use of a WSS threshold and a GUPPI threshold, and thus to disregard what the CMA did in *Ladbrokes/Coral*.

(48) The CMA concludes that *Ladbrokes/Coral* demonstrates the importance of looking at "*each case on its facts*."[25] However, in the present case, the CMA has made no attempt to consider whether its presumption of harm at 1.5% absent efficiencies is correct and validated by the facts. This is wholly unsatisfactory given that the CMA could have performed precisely the tests that it did in *Ladbrokes/Coral*. Indeed, as this section shows, had the CMA done so, it would have found that its 1.5% GUPPI threshold on which there is a presumption of an SLC absent efficiencies does not fit the data.

B. The CMA's local GUPPI threshold for in-store groceries ignores the extent of competition

(49) In *Ladbrokes/Coral*, the CMA verified that its threshold was meaningful by first considering the implications for its threshold with respect to those markets it has identified as problematic and the number of fascia within them. If it identified large numbers of problematic stores even in areas where there were large numbers of competing (excluding the Parties) stores post-merger, this would suggest that the WSS threshold (and its corresponding GUPPI threshold) were set too low.

(50) The same analysis can be done with the 1.5% threshold used by the CMA in the present case. It is appropriate to use this threshold, as the CMA presumes an SLC for any area greater than 1.5% absent efficiencies. The table below replicates the analysis in Ladbrokes/Coral for Large Stores. It considers the number of competitors within half the full distance used for calculating the WSS, and the different distance bands. The same table for a 2.5% GUPPI is provided in Schedule 1.3.

(51) The table shows that, even though there may be up to 20 rival stores (Medium or Large) within 7.5 minutes, the CMA finds every area in which the Parties have a Large store within three to five minutes from each other to be problematic. Indeed, the CMA still finds virtually 100% of areas as problematic if the Parties have a Large store within seven minutes of each other, even if there are between 10-15 competing stores (excluding the Parties) within 7.5 minutes of the centroid.

Table 1 Proportion of Large Store SLCs on a 1.5% GUPPI by number of competing stores and Parties' overlap drive times

Number of competitors within 7.5 minutes	***Drive time band (minutes)***							
	0-1	**1-3**	**3-5**	**5-7**	**7-9**	**9-11**	**11-13**	**13-15**
0-5	100%	100%	100%	100%	100%	95%	67%	21%

23 PFs, paragraph 8.226.

24 As a sense check to understand just how different a position that the CMA has taken relative to the last time it used the WSS as a hard threshold, in the current case, even if one accepts the CMA's view of the Parties' margins, a 1.5% GUPPI would translate into a WSS of 7.5% on average across the Parties. This is substantially lower than the 15-20% threshold used in *Ladbrokes/Coral* (even though the Parties' margins here are significantly lower) and thus one would expect a WSS threshold in Sainsbury's/Asda to actually be *higher* than *Ladbrokes/Coral*.

25 PFs, paragraph 8.226.

Number of competitors within 7.5 minutes	Drive time band (minutes)							
	0-1	1-3	3-5	5-7	7-9	9-11	11-13	13-15
5-10	100%	100%	100%	99%	98%	79%	28%	0%
10-15		100%	100%	100%	79%	62%	0%	0%
15-20		100%	100%	78%	80%	33%		
20-25				100%				

Source: CRA analysis.

Note: Store count excludes the Parties. The drive time bands in the column heading are the drive times between the centroid and the closest Large store of the other Party.

(52) In contrast, the extract below shows the equivalent table for Ladbrokes/Coral at its WSS threshold of 35%[26]:

Table 15: Distribution of LBOs with a WSS higher than 35%

%

		Distance band							
		0-100m	*100-200m*	*200-300m*	*300-400m*	*400-500m*	*500-600m*	*600-700m*	*700-800m*
Number of competitors within 400m	0	100	100	96	87	69	68	51	49
	1	98	85	60	22	4	0	0	0
	2	65	42	25	3	0	0	0	0
	3	38	17	9	0	0	0	0	0
	4	22	8	6	0	0	0	0	0
	5+	20	2	0	0	0	0	0	N/A

Source: CMA analysis.
Note: The distance bands in the column heading are the distances between the centroid LBO and the closest LBO of the other party (so if the other party has more than one LBO, only the closest affects the characterisation of the area).

(53) That table clearly shows a more sensible relationship between the WSS and the number of competitors – as the number of competitors increases, even when the Parties are at the closest distance to each other at 0-100m, the proportion of SLC areas found declines. This makes intuitive sense: the presence of greater competition means that there is less likely to be a problem.

(54) It should be noted that, unlike in Ladbrokes/Coral, in the present case, the CMA has found that different brands have different weights associated with them, and therefore one needs to correct for differences in brand weights. To do so, the table below uses the brand-size-distance weights for each brand. The weights are expressed relative to the CMA's estimated weight for a Large Tesco.[27]

Table 2 Proportion of Large SLCs on a 1.5% GUPPI by weighted number of competing stores and Parties' overlap drive times

Weighted number of competitors within 7.5 minutes	Drive time band (minutes)							
	0-1	1-3	3-5	5-7	7-9	9-11	11-13	13-15
0-1	100%	100%	100%	100%	100%	96%	72%	37%
1-2	100%	100%	100%	100%	100%	88%	43%	0%

26 *Ladbrokes/Coral*, paragraph 7.133 (attached as **Annex_005_007**).

27 The weights are calculated at each drive time minute in the WSS curve and then averaged overall all drive times to obtain a single brand weight for each party. For the Parties and Tesco, weights are calculated separately for Medium and Large stores.

Weighted number of competitors within 7.5 minutes	*Drive time band (minutes)*							
	0-1	**1-3**	**3-5**	**5-7**	**7-9**	**9-11**	**11-13**	**13-15**
2-3	100%	100%	100%	98%	96%	75%	13%	0%
3-4		100%	100%	100%	88%	67%	11%	0%
4-5		100%	100%	100%	77%	50%	33%	0%
5-6		100%	100%	100%	50%	0%		0%
6-7			100%	50%		100%		0%
7-8								
8-9				0%				

Source: CRA analysis.

Note: Weighted store count excludes the Parties. The drive time bands in the column heading are the drive times between the centroid and the closest Large store of the other Party.

(55) The table shows that factoring in brand weights does not change the outcome. Even though there may be the equivalent of up to six Large competitor stores within 7.5 minutes of an area (excluding the Parties), if there are any areas in which the parties have a store within seven minutes of each other, the CMA has set the threshold so low that they will all be presumed problematic. Indeed, the CMA finds that 99% of all areas within seven minutes, regardless of the number of rival competitors, are SLCs.

(56) Thus, the threshold has been set as such a low level that it essentially ignores the amount of competition for much of the Local area. As a result, the use of a 1.5% threshold has created a competition test that effectively reduces down to whether the firms overlap within 7 minutes.[28] An SLC threshold that is essentially independent of the level of competition for much of the catchment, such as this one, cannot be appropriate.

C. The CMA's threshold is inconsistent with the Parties' Impact Data

(57) The CMA has argued that its entry/exit analysis provides a more robust analysis than the Parties' own impact analysis which they perform in the course of business.[29] The Parties disagree, as discussed further in the Chapter 3 of this Response. However, regardless of whether that is the case, as in Ladbrokes/Coral, evidence of how the Parties react to competitive entry in reality offers a good sense check for the level of WSS/GUPPI threshold that would be appropriate.

1. Sainsbury's

(58) Sainsbury's principally estimates the impact from competitor entry/exit to determine whether the sales target or budget that a store receives during the financial year needs to be adjusted in response to local competitor activity.

(59) Each store has an annual budget which the store manager is targeted to meet. In the event of competitor activity in the area, the store's budget may be adjusted during the year to ensure that a store is not disadvantaged (for example by a competitor opening next door) or advantaged (for example by a competitor closing next door). The target budget of a Large or Medium store qualifies for an adjustment

28 There is only two cases of an overlap at 5-7 minutes with 6-7 competitors, and only one case at the same distance with 8-9 competitors.

29 PFs, paragraph 8.145 *et seq*.

if the measured impact is above [✂] for Sainsbury's supermarkets. Below this level, whilst the store may be impacted, it is not considered sufficient to require adjustment.[30]

(60) [✂]

2. Asda

(61) Asda measures competitor impacts principally to quantify the amount of reimbursement or 'overlay' to be provided to the impacted store if it has been affected by competitor activity.

(62) If the measured impact per week is [✂] than stores average weekly sales, an overlay is applied. Below this level, while a store may be impacted, it is not considered sufficient to require adjustments.[31]

3. Comparison to the GUPPI threshold

(63) The fact that both Asda and Sainsbury's (i) pre-select competitor impacts on the basis of those that they believe are most likely to have had an impact and (ii) disregard competitor impacts that they estimate to be too small to be meaningful or require funding, provides a clear benchmark of the same type used in Ladbrokes/Coral to consider whether the GUPPI/WSS threshold has been sensibly calibrated. If the GUPPI/WSS threshold is set too low, then it would identify overlapping stores as potentially problematic even though the stores with the same characteristics would not be considered as having an impact by the Parties.

(64) Tables 3 and 4 below provide the proportion of entry events that were estimated to have an impact greater than [✂]% (using Sainsbury's threshold regarding the minimum impact needed before it is reacted to). Schedule 1.3 provides the same tables using Asda's [✂]% threshold, which shows that the overall conclusion does not change. Table 3 provides the unweighted brand table – which is directly comparable to Table 1 above. Table 4 provides the weighted brand table, and is directly comparable to Table 2 above.

Table 3 Proportion of impacts from Large stores above [✂]% by number of competing stores and Parties' overlap drive times

Number of competitors within 7.5 minutes	***Drive time band (minutes)***							
	0-1	**1-3**	**3-5**	**5-7**	**7-9**	**9-11**	**11-13**	**13-15**
0-5	100%	33%	100%	29%	27%	33%	0%	0%
5-10	50%	71%	74%	43%	25%	20%	7%	0%
10-15	100%	83%	50%	23%	0%	7%	0%	0%
15-20			0%	17%	0%	0%	0%	0%
20-25				0%		0%	0%	0%

Source: CRA analysis of the Parties' impacts analysis.

Note: Store count excludes the Parties and is calculated on the date of the impact. The drive time bands in the column heading are the drive times between the centroid and impacting Large store. The measured impact prior to rounding is used for Sainsbury's impacts and any negative impact is assumed to be zero. Entries not monitored by the Parties are added as zero impacts.

[30] [✂]

[31] [✂]

Table 4 Proportion of impacts from Large stores above [✂]% by weighted number of competing stores and Parties' overlap drive times

Weighted number of competitors within 7.5 minutes	*Drive time band (minutes)*							
	0-1	1-3	3-5	5-7	7-9	9-11	11-13	13-15
0-1	100%	100%		33%	31%	64%	0%	0%
1-2		43%	100%	43%	18%	13%	0%	0%
2-3	100%	100%	100%	50%	25%	22%	12%	0%
3-4	100%	60%	44%	0%	0%	10%	0%	0%
4-5	0%	75%	0%	20%	0%	0%	0%	0%
5-6			0%	50%	0%	0%	0%	0%
6-7				0%	0%	0%	0%	0%
7-8				0%		0%	0%	
8-9				0%			0%	0%

Source: CRA analysis of the Parties' impacts analysis.

Note: Weighted store count excludes the Parties and is calculated on the date of the impact. The drive time bands in the column heading are the drive times between the centroid and impacting Large store. The measured impact prior to rounding is used for Sainsbury's impacts and any negative impact is assumed to be zero. Entries not monitored by the Parties are added as zero impacts.

(65) Comparing Tables 3 and 4 with Tables 1 and 2, it is clear that the level at which the CMA presumes there is competitive harm to store revenues is far lower than the level which the Parties consider to be impactful. For example, as previously discussed, the CMA's threshold at 1.5% presumes that virtually 100% of areas in which the Parties overlap within seven minutes are problematic. However, the Parties only consider a relatively small proportion of the impacts within five to seven minutes in their data. Even when there are Large Store impacts within one to three minutes, the Parties only respond to some and the response rate declines as the number of competitors increases. This pattern – that the proportion of significant impacts declines both with (i) the distance of the entry stores and (ii) the total number of competitors in the catchment – is not reflected in the CMA's approach (in which the existence of problematic areas is essentially independent of the level of competition up to seven minutes away).

(66) Importantly, the Parties' impacts data provides a very conservative measure of the extent of competitive reactions, as the data concerns budgetary allowances for small spend overlay rather than significant competitive investment.

D. The CMA's local GUPPI threshold for online groceries ignores the extent of competition

(67) The CMA uses a 1.5% GUPPI as a presumption of an SLC (absent efficiencies) in its online local analysis. The same flaws set out above also apply to the CMA's online analysis. By setting the GUPPI threshold this low, the CMA's competition analysis effectively reduces down to the question of whether the Parties' Supply Points overlap, rather than considering whether there is effective competition in the area such that the merger is unlikely to give rise to a substantial lessening of competition.

(68) The table below provides the proportion of Asda and Sainsbury's SLC Supply Points that are presumed to be SLCs, expressed as a function of the number of competitors. Because the CMA's estimate of margins (which is one of the determinants of GUPPI) is based on a simple extrapolation of in-store allocations and substantially overestimates the Parties' real online margins, the table also provides the same results using Parties' estimates of their online variable margins.

Table 5 Proportion of SLC Supply Points by number of rivals within each supply point

	CMA Margin Estimates		Corrected Margin Estimates	
	SLC Proportion of Asda's Areas	SLC Proportion of Sainsbury's Areas	SLC Proportion of Asda's Areas	SLC Proportion of Sainsbury's Areas
3 online providers	100%	29%	0%	0%
4 online providers	90%	15%	30%	0%
5 online providers	97%	8%	3%	0%
6 online providers	96%	18%	30%	0%
7 online providers	100%	2%	23%	1%
8 online providers	100%	3%	100%	0%

(*) Each Supply Point is allocated to a type of area (e.g. "3 online providers" area, "4 online providers" area etc.) based on the largest proportion of its revenue it derives from that area.

(69) As can be seen above, based on the CMA's initial estimates of local online margins, the GUPPI threshold has again been set so low that nearly all Asda Supply Points are considered problematic, regardless of the level of competition. Even when there are eight online providers, the CMA finds that all Asda areas are problematic.

(70) Using the corrected online margins for the Parties does change the results but not in an intuitive fashion. The proportion of areas identified as being SLCs for Asda is largely independent of the degree of competition and is actually highest in the case where there are 8 online operators – with all 17 supply points in this band found as SLCs. This shows that especially with the CMA's view of the Parties' online margins, at the level of GUPPI threshold set by the CMA, the extent of competition plays no real part in the determination of whether a supply point is problematic or not.

III. The CMA's assessment of the bias and uncertainty of its GUPPI estimates is flawed as a matter of economic theory and practice

(71) The CMA's GUPPI estimates are based on an economic model and data that rely on a number of assumptions, derivations and extrapolations. In order for the resulting estimates of the GUPPI to be considered robust, standard economic practice would require that the CMA test its estimates of the GUPPI along with the key inputs such as WSS for bias and uncertainty. As will be seen from the assessment below, the CMA's local analysis is neither unbiased nor sufficiently robust to support the uniquely low GUPPI threshold proposed. Not only are the CMA's GUPPI estimates, based on its estimated WSS diversions upwardly biased for the Parties' stores with a diversion less than 25%, but there is considerable uncertainty associated with the estimated WSS diversions used to estimate the GUPPIs and hence with the estimated GUPPIs as well.

A. The evidence does not support the CMA's argument that there is "symmetry of error"

(72) The PFs state that "*there will inevitably be some uncertainty around elements of our evidence but … we have no reason to consider that this would bias the analysis in any particular direction*."[32] Thus, the PFs argue that any errors in identifying false positives or false negatives are equally like to occur and, in aggregate will be symmetric and cancel each other out. The PFs also state that the CMA's evidence e.g. the CMA's survey and its ad-hoc/erroneous inclusion of six-point estimates from the entry/exit data) is

[32] PFs, paragraph 8.244.

robust and the subject of careful scrutiny, concluding that it is the best "unbiased estimate of the relevant variables".[33]

(73) However, nowhere in the PFs does the CMA actually seek to examine or test whether its estimated GUPPIs are unbiased and not subject to large measurement error. As shown below, in actuality there is significant evidence from the CMA's own survey that suggests not only are the PFs analysis biased and therefore cannot be treated as a best estimate, but the estimates are subject to material measurement error.

1. The CMA's local WSS diversions are biased upwards, overstating diversions between the Parties

(74) The CMA's GUPPI estimate relies on the CMA's diversion estimates. The CMA uses WSS estimates (which are based on using the survey store diversions to forecast the WSS diversion for non-surveyed stores) for the vast majority of the stores (955 out of 995, or 96%). Given that the CMA views the direct survey estimates of the diversion as robust and unbiased, we have compared the survey diversions with the CMA's estimated WSS diversions to determine the extent to which the WSS estimates provide an unbiased and reliable estimator of actual survey diversions. The CMA did an equivalent analysis in the Local WPs to support its position that its previous WSS estimates were reliable and robust, but have not replicated this in the PFs.

(75) Schedule 1.2 contains a comparison of the WSS diversions and the actual survey diversions between the Parties' overlapping stores (i.e. the diversion from Sainsbury's to Asda and from Asda to Sainsbury's) at each of the 93 surveyed stores where the Parties overlapped with each other.[34] This shows that, for Sainsbury's, the WSS diversion is greater than the actual survey diversion for <u>80 of the 96</u> stores with a diversion of less than 15%. Similarly, for Asda, the WSS store diversions are greater than the survey store diversions for 91 of the 101 online observations with survey store diversions less than 15%. Thus, at an individual store level, the WSS diversions are biased upwards.

(76) This bias in WSS diversions at individual store level carried through (and enhanced) when WSS diversions are aggregated within a local area to show the total diversion to all the stores of the other Party. The data shows that there is a systematic and material upward bias in the WSS *aggregate* diversions (i.e. the aggregate diversion to all the stores of the other Party) that occurs when the aggregate survey diversion is less than 25%.

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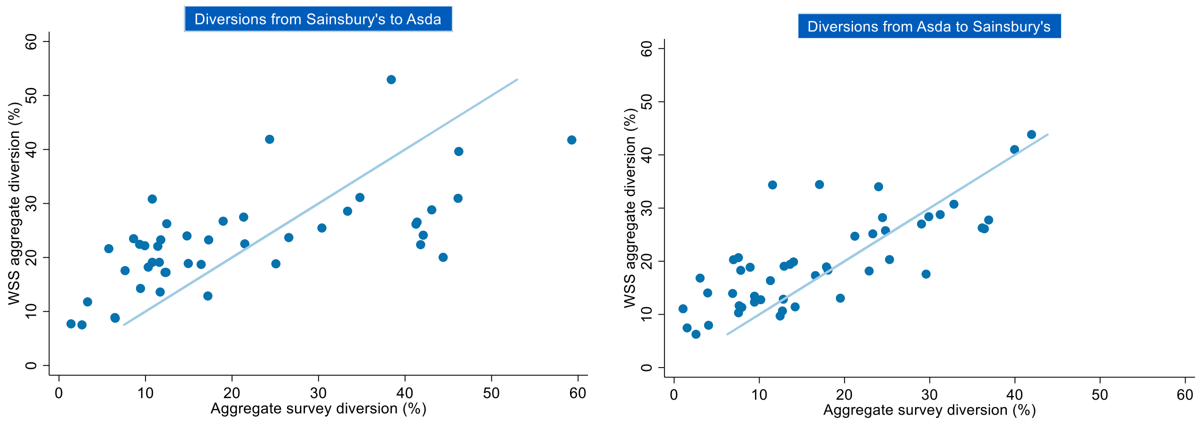
[33] PFs, paragraph 8.246.

[34] As the CMA included pipeline stores when they calculated the WSS, we have re-calculated the WSS for those surveyed stores that are affected by pipelines to ensure that the estimated WSS diversion reflects the set of rivals present at the time of the survey and hence ensure the estimated WSS diversion is comparable to the survey diversion ratios.

Figure 1 Survey Aggregate diversions versus WSS Aggregate diversions (%)



Source: CRA analysis

(77) The above figures show that, when the aggregate survey diversion is less than 25%, the WSS aggregate diversion is greater than the aggregate survey diversion for 29 of 30 (97%) Sainsbury's centroids and 32 of 37 Asda (86%) centroids. Moreover, the upward bias in the estimated WSS is substantial, as the aggregate WSS diversion is at least 5% higher than the aggregate survey diversion for 19 Sainsbury's centroids and 16 Asda centroids, and at least 10% higher for nine Sainsbury's centroids and nine Asda centroids.[35]

(78) In summary, the evidence shows that contrary to the rationale the CMA provides for the usage of a very low GUPPI threshold, the CMA's estimated WSS diversions are not an unbiased estimate of the actual diversions between Sainsbury's and Asda.

2. Systematic bias in the WSS aggregate diversion causes a material over-statement of potential SLCs, particularly given the low GUPPI threshold

(79) At the very low GUPPI threshold that the CMA uses to identify potential SLCs, the bias is significantly more important because, the lower the threshold, the greater the impact of the bias. Thus, the combination of the bias and the very low GUPPI threshold means that the CMA incorrectly identifies a very large number of stores as being potential SLCs.[36]

(80) To demonstrate the extent of this problem, the GUPPI is calculated under both the aggregate actual survey diversions and the aggregate estimated WSS diversions for each of the Parties' 93 surveyed stores. These are then examined to compare which of the 93 stores are identified as potential SLCs under the CMA's 1.5% threshold and the 2.5% threshold (which includes efficiencies) using the different diversion measures.[37] This is shown below.

[35] There is also some evidence that for stores with an aggregate survey diversion of more than 25%, the WSS systematically under-estimates the actual aggregate survey diversion. However, this problem affects a smaller number of the surveyed stores. For example, among the 88 observations for which Sainsbury's has an aggregate diversion greater than 25%, the survey diversion is greater than the aggregate WSS diversion only 14 times.

[36] Furthermore, the fact that there is a bias means there is a much greater number of false positives in the CMA's list of potential SLCs than false negatives.

[37] Note that pipeline stores are excluded.

Table 6 Potential SLCs identified using the survey and WSS aggregate diversions

	No. of surveyed stores	No. of SLCs identified using survey diversions	No. of identified SLCs using WSS diversions	No. of SLCs identified using survey diversions	No. of identified SLCs using WSS diversions
		1.5% threshold		2.5% threshold	
Asda	48	41	47	30	40
Sainsbury's	45	39	43	25	40
Total	**93**	**80**	**90**	**55**	**80**

Source: CRA analysis

(81) As Table 6 shows, the upward bias translates into a material number of overlap stores being incorrectly identified as potential SLCs at either threshold. For example, with a 2.5% GUPPI threshold, the number of Asda SLCs increases from 30 out of 48 (63%) using survey diversions to 40 out of 48 (83%) using WSS diversions. Thus, using the estimated WSS to calculate the GUPPI results in 10 (21%) additional stores being incorrectly identified as being potential SLCs.[38]

(82) The effect of the upward bias is even greater for Sainsbury's. With a 2.5% GUPPI threshold, the number of Sainsbury's SLCs increases from 25 out of 45 (56%) using survey diversions to 40 out of 45 (89%) using WSS diversions. The use of the estimated WSS to calculate the GUPPI results in an additional 15 (33% more) stores being incorrectly identified as potential SLCs.

(83) Thus, for both Asda and Sainsbury's, using the WSS to calculate the GUPPI leads to a substantial over-estimation of the number of possible SLCs.

(84) The impact of the upward bias in the WSS diversion would be much less pronounced if a GUPPI threshold of, for example, 5% is used. With a 5% threshold, 16 of the 48 surveyed Asda stores (33%) are identified as potential SLCs using both the survey diversions and the estimated WSS diversions.[39] For Sainsbury's, 15 of the 45 surveyed stores (33%) are identified as potential SLCs using the survey diversions to calculate the GUPPI, compared with 12 (27%) if the estimated WSS is used.[40]

(85) Since the WSS is being used to estimate GUPPI for the vast majority of the Parties' overlap stores – 955 of the 995 overlap stores (96%) – the upward bias in the WSS diversion for stores with survey diversions less than 25% combined with a very low GUPPI threshold means that the CMA has identified far too many overlap stores as being possible SLCs. Extrapolating the figures in the above table to all of the stores where the CMA is using the estimated WSS to calculate the GUPPI, suggests that (ignoring pipeline stores and even applying a 2.5% threshold):

- the correct number of Asda SLC stores is 296, rather than 395. The use of the WSS diversion increases the number of SLCs by 33%; and

38 The equivalent figures using a 1.5% threshold are 41 and 47, a 13% increase in the number of SLCs. Note that the proportion of stores being incorrectly identified as potential SLCs is smaller for the 1.5% threshold not because the bias is less, but because nearly all stores are identified as SLCs at 1.5% using both the survey and the estimated diversion. At a 0% threshold there would be no difference between which stores are identified as SLCs in the survey and the WSS estimate because all stores would be considered SLCs in both estimates (regardless of the bias).

39 Of which 13 of the 16 are common to both the direct diversion estimate and the WSS diversion estimate.

40 Among the 12 stores identified as potential SLCs using the estimated WSS diversions, nine are also identified as SLCs using the survey diversions.

- the correct number of Sainsbury's SLC stores is 267, rather than 428. The use of the estimated WSS results in a massive 60% increase in the number of potential SLCs.

B. Even if the CMA's estimated GUPPIs were unbiased, the extent of uncertainty around the estimates is too high to support the CMA's approach

(86) The CMA implies that, regardless of the robustness of its estimates, it can rely on them provided that the errors in the estimate are symmetric and argues (contrary to the evidence) that their estimates are unbiased, and are the best available evidence in this case. Regardless of whether that is correct, simply ignoring the extent of uncertainty around their diversion and GUPPI estimates ignores standard methods to consider statistical significance. Further, whilst symmetry is necessary, it is not, by itself sufficient for the CMA's statutory obligations. For example, although flipping a coin to determine whether an SLC exists would create symmetric errors, such a test would be plainly incompatible with the CMA's statutory obligations. The CMA goes on to acknowledges that there is uncertainty, and states that it is appropriate to account of this in the GUPPI threshold. However, in setting out the 1.5% GUPPI threshold the CMA provides no evidence on (i) the amount of uncertainty in its estimates, (ii) the basis the 1.5% was determined, (iii) the proportion of the 1.5% accounted for by uncertainty versus the other biases, (iv) and whether it is sufficient to account for the levels of uncertainty in this case.

(87) As shown in this section, in actuality the level of uncertainty around the CMA's GUPPI estimates is particularly high in this case. The reason for the high level of uncertainty is because the GUPPI is the product of the surveyed diversion ratio and the estimated WSS diversion ratio, both of which have significant uncertainty (or variance) associated with them. The CMA has provided no evidence that its 1.5% threshold is sufficient to take account of the actual uncertainty associated with its GUPPI estimates. This section provides a lower bound estimate of the degree of uncertainty around the CMA's GUPPI estimates by looking at variance around the CMA's WSS estimates and the implications of this for the resulting estimates of the GUPPI.[41] It shows that in many cases, it is not possible to say whether the CMA's estimate of GUPPI is statistically significantly different from 0, or indeed significantly above the 1.5% threshold that the CMA considers excluding efficiency.

1. Most of the CMA's estimated WSS diversions lie outside the actual measure of survey diversion

(88) To examine the level of uncertainty of the estimated WSS diversions, we extend the above comparison of them with the actual survey diversions by taking account of the uncertainty associated with the WSS diversion estimate. If, as the CMA claims, its estimated WSS diversion ratio is an accurate and reliable estimate of the actual diversion ratios between the Parties, then we would expect to find that the estimated WSS diversion lies within a reasonable confidence interval of the corresponding survey diversion. However, as shown below, this is not the case.

(89) Using the methodology set out in the CMA's Survey Guidelines, we calculate the "Wald" confidence intervals for each survey store diversion between the Parties' stores in the surveyed areas.[42] As also noted in the CMA Survey Guidelines[43], if the diversion ratio is small (or the number of respondents in the survey is less than 30), then a different technique, "the Wilson interval", should be used. Therefore, we use this Wilson interval rather than the Wald approximation for survey diversions of less than 10%.[44]

[41] The uncertainty is a lower bound because there is also variation with respect to margins and relative price ratios.

[42] The CMA's survey guidelines give the standard error of a survey diversion by assuming the survey diversion ratio is the result of a binary response to a store diversion question (i.e. the consumers have been asked whether they would divert to the particular rival store), and use the standard approximation for the error term of a proportion (see #4:30-4:32). We adopt this approach and use the Wald approximation.

[43] CMA Survey Guidelines, footnote 40.

[44] In each of the surveyed areas the survey sample is greater than 30.

(90) Table 7 below shows the number of overlapping stores that have an estimated WSS diversion that lies outside the confidence interval of the corresponding survey store diversion ratio. For these stores it is not possible at any reasonable level of statistical confidence to say that the estimated WSS is a good proxy of the actual store diversion in the survey.

Table 7 Number of surveyed stores where the estimated WSS diversion outside the 90% confidence interval of the corresponding survey store ratio

	Nos of overlapping stores	90% CI	80% CI	60% CI	50% CI
Asda	122	73% (89)	78% (95)	89% (109)	92% (112)
Sainsbury's	118	77% (91)	82% (97)	88% (104)	90% (106)
Using the Wilson interval for stores with diversions less than 10%					
Asda	122	59% (72)	73% (89)	87% (106)	92% (112)
Sainsbury's	118	62% (73)	69% (82)	86% (101)	89% (105)

Source: CRA Analysis

(91) The above table shows the estimated WSS diversion is a very poor predictor of the actual survey diversion. For example, 73% of the surveyed Asda stores' diversions had WSS predictions that lay outside of the 90% confidence interval for the survey estimate. That is, the vast majority of the actual diversions from the survey are statistically significantly different from the estimated WSS diversions. This shows that in the vast majority of cases the estimated WSS is not an accurate point estimate of the corresponding survey store diversion.

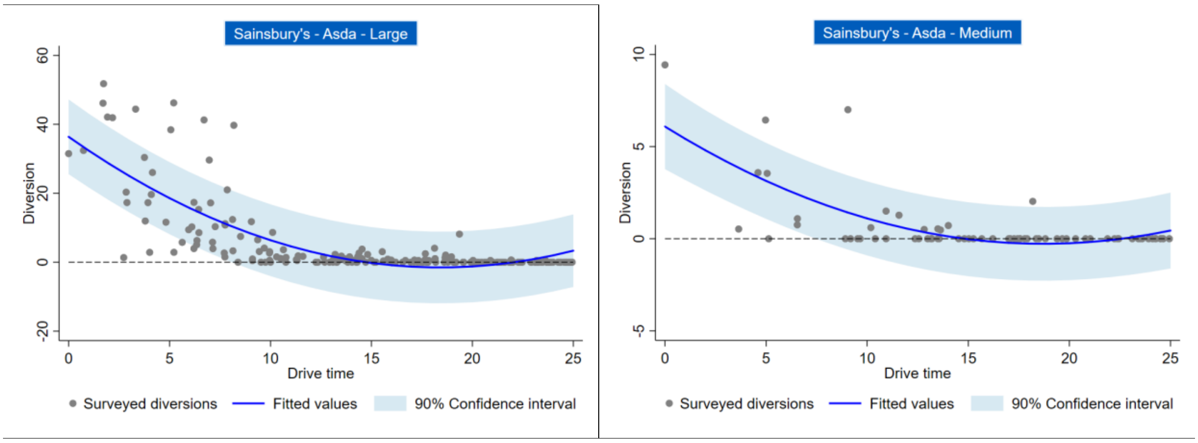
2. There is significant uncertainty around the resulting diversions

(92) In light of the significant number of WSS diversion estimates that lie outside the 90% confidence interval for surveyed stores and the fact that the CMA relies on WSS diversion estimates for its assessment of 96% of stores, the extent of uncertainty around the estimated WSS and hence GUPPI of stores that have not been surveyed, is highly relevant. The section below provides an assessment of the level of uncertainty for these stores. The full methodology for calculating the extent of uncertainty around the WSS predictions is in Schedule 1.2; in sum, it derives from the uncertainty arising from the regressions the CMA uses to estimate the relationship between the survey diversions and drive-times that are then used to forecast the weights used in the WSS.

(93) The graphs below provide the 90% confidence interval around the forecasted store weights for Sainsbury's to Asda for Large and Medium stores: i.e. the forecast weights based on the estimated regressions of the survey diversions on the drive-time between the stores.[45] As can be seen, there is substantial uncertainty in the CMA's forecasts of the store weights, especially for Large stores, such that it is not possible to say with any significant level of statistical certainty that the forecast store weight is different than 0.

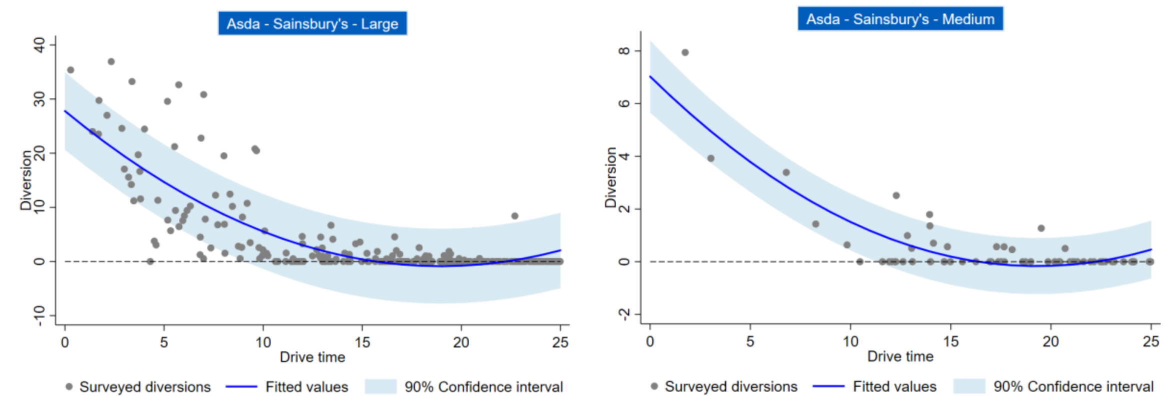
[45] Note: Estimated separately, rather than pooled data.

Figure 2 90% Forecast confidence intervals for diversion weights for Sainsbury's-Asda large and medium stores



Source: CRA analysis

Figure 3 90% Forecast confidence intervals for diversion weights for Asda-Sainsbury's large and medium stores



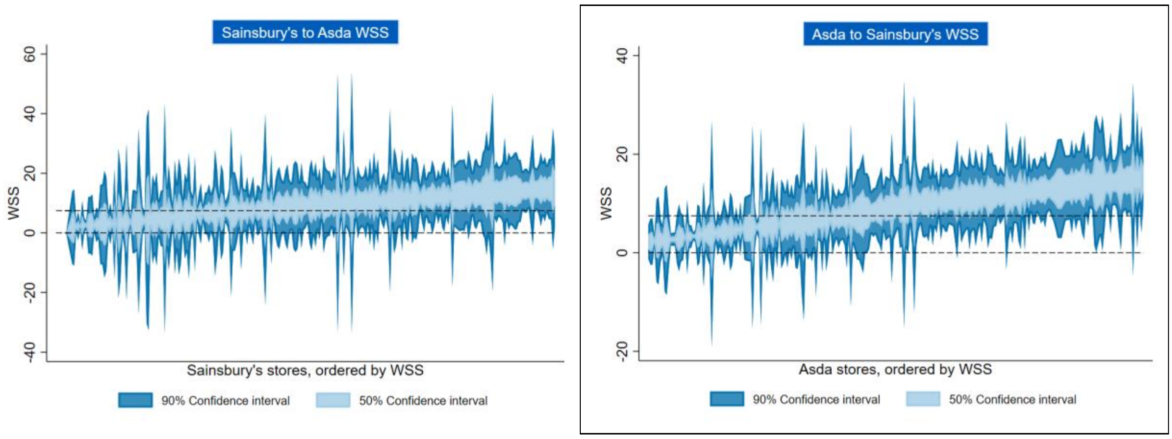
Source: CRA analysis

(94) Much of the uncertainty associated with these forecasts weights arises from the variation in the survey store diversion that is not being captured by the CMA's regression, and only a small amount is due to the uncertainty regarding the estimated coefficients in the CMA's model.[46]

(95) The errors associated with the forecast diversion weights translate into significant errors for the estimated WSS diversion. These are shown below for all Asda and Sainsbury's stores with estimated diversions lower than 15% – i.e. those that are particularly pertinent for a 1.5% and 2.5% GUPPI threshold.

[46] Moreover, since the CMA's regressions suffer from heteroscedasticity as the errors appear to decline with drive-time, if this heteroscedasticity was taken account of in the regression analysis then it is likely that the forecast error would be larger at closer drive-times and then decline as the drive-time increases. Therefore, the confidence intervals in the above figures are likely to under-estimate the actual forecast error for drive times less than 10 minutes and over-estimate them for drive times greater than 10 minutes. Unfortunately, due to time constraints in response to the PFs the Parties have not been able to adjust the CMA's regressions to allow for heteroscedasticity.

Figure 4 **90% and 50% confidence intervals for the CMA's estimated WSS diversions (all Sainsbury's and Asda stores with an estimated WSS diversion less than 15%)**



Source: CRA analysis

(96) Both charts show there is a substantial amount of variation associated with the CMA's estimated WSS diversions. For the 90% confidence intervals associated with the estimated WSS diversions for Sainsbury's to Asda, the average confidence interval (as measured by the median) spans 18.3 percentage points. This means that one can only say with statistical confidence that the true estimate lies in an 18 percentage point range. This is over 2.5 times as large as the WSS threshold that the CMA is using to determine an SLC (on average, 7% at a 1.5% net GUPPI).

(97) Indeed, for a substantial number of stores the confidence intervals for the estimated WSS diversion are so large that they include zero diversion. This occurs because although the diversion ratio is bounded by zero and one, the CMA did not account for this when it estimated the relationship between the survey diversions and the drive-time. Of the 474 Asda stores for which an estimated WSS diversion ratio to Sainsbury's is used to estimate the GUPPI, 86 have a 90% confidence interval that includes zero and almost all of these stores (75) have an estimated WSS diversion less than 15%.[47] Of the 243 Asda stores with an estimated WSS diversion less than 15%, in 30% of cases the estimated WSS is not statistically significant from zero.[48]

3. The uncertainty around the estimated WSS diversion leads to significant uncertainty with respect to GUPPI estimates

(98) Finally, as the estimated WSS diversions are used to estimate the GUPPIs, the uncertainty in the WSS estimates translates into material uncertainty for the estimated GUPPIs. The following two figures show the estimated confidence intervals for Sainsbury's and Asda stores with estimated GUPPIs less than 5% and greater than 5%, along with the CMA's 1.5% threshold for uncertainty and 2.5% threshold for uncertainty and efficiencies.[49]

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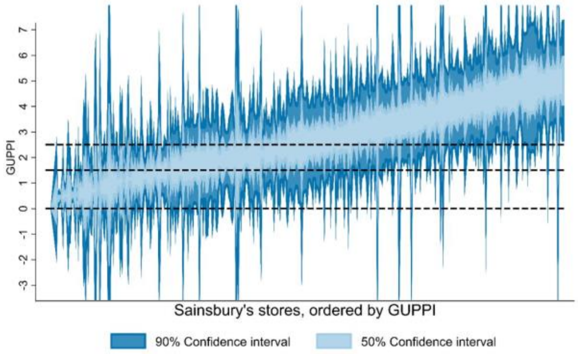
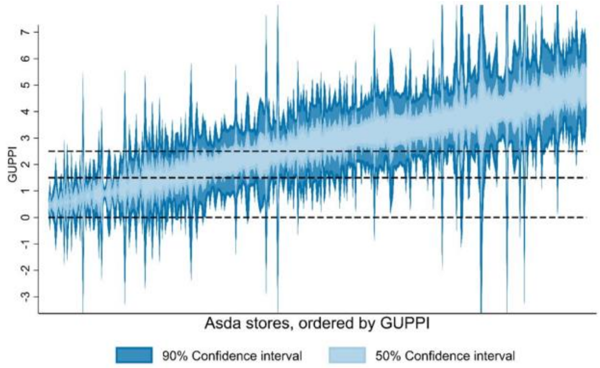
[47] The equivalent figures for Sainsbury's are that 160 stores of the 481 stores where the estimated WSS diversion to Asda is used to calculate the GUPPI have a 90% confidence interval that includes zero, and again the vast majority of these stores have diversion ratios less than 15%.

[48] Of the 249 Sainsbury's stores that have an estimated WSS diversion less than 15%, in 55.8% of cases the estimated WSS is not statistically different from zero at the 5% level.

[49] There is additional measurement error around the variable margin and price ratio. For the purposes of this paper, we have simply assumed that this error is 0. This assumption means that the GUPPI error examined in this section is an under-estimate of the actual error associated with the GUPPI.

Figure 5 **90% and 50% confidence intervals for the CMA's GUPPIs (all Sainsbury's and Asda stores with an estimated GUPPI less than 5%)**





Source: CRA analysis

(99) Both charts show there is a substantial amount of variation associated with the CMA's estimated GUPPIs. The 90% confidence interval for Sainsbury's stores with an estimated GUPPI of less than 5% has a median range of 4 percentage points for Sainsbury's and 3 percentage points for Asda.[50] To put the size of the intervals in perspective, the confidence interval is larger than 2.5 percentage points for 429 out of the 481 Sainsbury's stores in the analysis. This means it is larger than the actual GUPPI threshold set by the CMA for 89% of Sainsbury's stores. For Asda, 364 out of the 474 stores have a 90% interval larger than 2.5%.

(100) As with the diversions, for a substantial number of stores, the 90% confidence interval for the estimated GUPPIs is so large that it includes zero, including a number of stores where the estimated GUPPI is greater than 2.5%. Moreover, there are 48 Asda and 71 Sainsbury's stores where the estimated GUPPI is greater than 2.5%, but the 90% confidence interval includes 1%, meaning that it is possible that the actual GUPPI is less than the CMA's 1% threshold given for efficiencies. Finally, 172 Asda stores and 187 Sainsbury's stores that the CMA identifies as SLCs (i.e. above 2.5%) have confidence intervals that include 2.5%, and so at standard levels of statistical testing it cannot be ruled out that these stores actually have a GUPPI that is less than 2.5% (and therefore are not SLCs).[51]

C. Use of an extremely low GUPPI thresholds in online is even more problematic given the even greater levels of uncertainty in the relevant CMA estimates

1. A national online GUPPI threshold of >0.0% makes no economic sense

(101) As discussed above, the PFs argue that zero allowance for uncertainty regarding the estimate of national online GUPPIs is needed because the "*national diversion for online delivered groceries is robustly estimated (given the scale and representativeness of our survey) and whilst certain factors may lead us to consider that the online margins are over-estimated, the figures used may not take into account the wider economic benefit of providing an online delivered groceries delivery service*".[52] On this basis, the PFs use a >0% GUPPI threshold and, absent efficiencies, any diversion between the Parties, no matter how small, would exceed the threshold.

50 The median 90% confidence interval associated with the estimated GUPPIs for Sainsbury's stores spans 4.1 percentage points, and for Asda 3.4 percentage points. This shows that there is a large amount of uncertainty associated with the estimated GUPPI that are less than 5%, which are the stores that are more likely to be identified as being potential SLCs if a very low GUPPI threshold is used.

51 Even if the 50% confidence interval is used instead, then there are 67 Asda stores where the estimated GUPPI is greater than 2.5%, but the 50% confidence interval includes 2.5%, and 81 Sainsbury's stores.

52 PFs, paragraph 11.50.

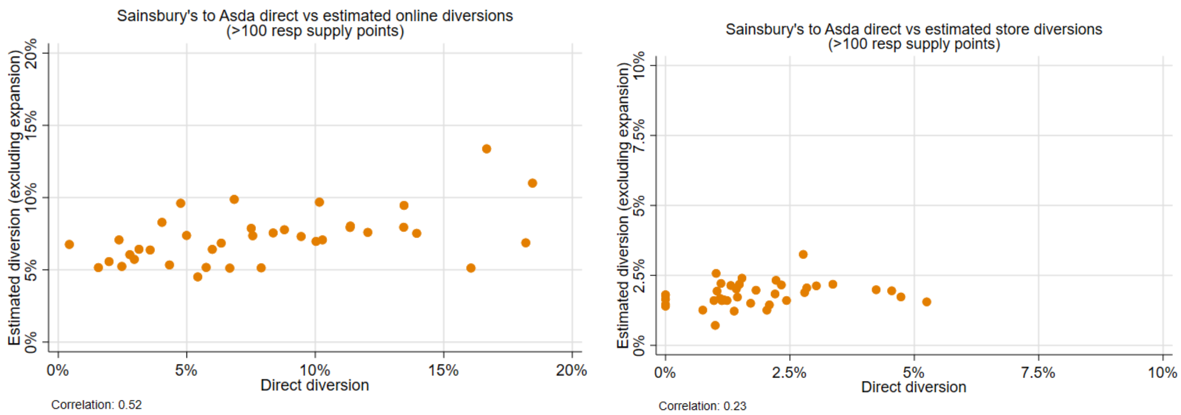
(102) This cannot be correct. The Parties have already explained to the CMA that, as diversions are bounded by 0, it is not possible for diversions to a store to be less than 0. Whilst the CMA acknowledges the Parties' submission in this respect, it has not addressed it. If there is a >0% threshold for diversions, and diversions cannot be negative, then by definition any errors around a true estimate of 0 have to be positive and biased upwards. This means there is no ability for the CMA to say, on the balance of probabilities, that there will be an SLC absent efficiencies for any diversion above 0%.

2. Local online GUPPI threshold is extrapolated from survey diversions and has no explanatory power

(103) For its analysis of the Parties' local Supply Points, the CMA relies exclusively on the survey evidence to derive diversion ratios for the GUPPIs. Whilst the CMA uses actual survey diversions for the small number of Supply Points where the sample size is over 100, for the overwhelming majority of the Supply Points (488 of the 530), the CMA does not have a sufficiently large sample to calculate a diversion from the survey. Therefore, the CMA relies heavily on creating a proxy for diversion ratio for these Supply Points.[53]

(104) In creating this proxy, not only is there very limited variation around the survey diversion ratios (because there are only 42 areas out of the 530 surveyed), there are also significant differences between the characteristics of individual areas. As part of the robustness checks for the estimated diversion ratios, the CMA compares the estimated diversion ratios with the direct survey diversion ratios.[54] The CMA claims that it has confidence in its estimates.[55] However, this confidence is not well founded. The figures below plot this correlation between the online and in-store diversions for the Sainsbury's 38 Supply Points where the sample size is above 100 (and hence the direct diversions are assumed to be informative and robust).

Figure 6 **<u>Sainsbury's diversions to Asda for supply points with over 100 respondents</u>**



(105) As seen above, the CMA's online estimated diversions between Sainsbury's to Asda online are essentially all the same – between 5-10%, independent of whether the survey diversion was close to 0% or above 15%. Similarly, when estimating Sainsbury's online to Asda in-store diversions, there is almost no relationship between the survey diversion and the estimated diversion.

(106) For Asda, there were only 3 Supply Points where the sample size was above 100. As such for diversions from Asda the CMA is relying entirely on the band analysis for all 285 Supply Points without being able to check the validity of this.

[53] See the Parties' response to Chapters 9 to 12 of PFs (online) for further details of the CMA's extrapolation methodology and the problems with it.

[54] PFs, Appendix I, paragraph 42 to 47.

[55] PFs,Appendix I, paragraph 46.

(107) This shows that the CMA's predicted diversion measure provides no explanatory power. This is particularly problematic given that for low diversions, i.e. around a 1.5% threshold, the estimated diversions are generally higher than the survey diversions.

D. The CMA is wrong to claim that biases go both ways but cannot be quantified

(108) In a number of places, the CMA makes broad statements that the GUPPI may be biased downwards on the basis of so called 'second order' or 'feedback effects'.[56] The PFs state that the CMA has taken account of these issues when setting any threshold of concern, which presumably led to a significant reduction in the otherwise applicable threshold, given how low the GUPPI threshold was ultimately set.

(109) However, the PFs completely ignore the Parties' submission that these second order effects are called "second order" precisely because they can only apply after the first order effects, and only as a proportion of the first order effect.[57] The PFs appear to imply that these second order effects can be substantial. Indeed, the PFs state that "*if it were shown that these effects were unusually limited in a particular case (for any given first-order price increase) this would also reduce the likelihood that a relatively low GUPPI would translate into a price increase consistent with an SLC.*"[58]

(110) This seems to have entirely ignored the Parties' submission which demonstrated that, given relevant factors for this case, these second order effects are only substantial when first order effects are large.[59] In such an instance, then there is already a concern that would be picked up under a sensible GUPPI screen. As a result, the additional effect from the feedback effects makes almost negligible difference as to whether a given GUPPI threshold would catch them or not.

E. The CMA fails to account properly for countervailing factors

1. Fundamental failure to account for dynamism and rivals' responses

(111) The CMA's approach to the GUPPI threshold is fundamentally static and ignores the dynamic nature of the market.

(112) In terms of supply-side dynamism, the CMA may formally take account of known planned new local stores in its model but by assuming that pricing pressure, no matter how tiny, will <u>always</u> translate into an actual price increase, it effectively ignores competitors' repositioning (by improving and upgrading the offer in existing stores) and future entry. This is particularly relevant in the current case with Aldi and Lidl, who have significantly repositioned their brands and offer closer to Sainsbury's and Asda (among others) in the recent period, entered with hundreds of stores in different areas, and made continual public statements about their ambition to continue to expand in new areas. Equally, the CMA effectively ignores dynamism in online, of all sectors, such as the expansion of rivals' online offer into new areas (such as M&S/Ocado) and innovations and repositioning that improve it.

(113) On the demand side, the CMA fails to account for the fact that its diversion ratio estimates do not factor in dynamism of customer preferences, instead assuming these are locked in at the ranked preferences given on the day of the survey. For customers whose first and second preferences were the two Parties, the survey estimates do not capture how close competitors third and fourth local preferences are, or what customers would do if, for example, Aldi and Lidl, opened or repositioned further.

(114) This model is static insofar as it uses snapshot diversion estimates based on customers' responses to hypothetical questions. Dynamic factors must be assessed and factored appropriately into the threshold.

[56] See for example PFs, paragraph 8.231 and paragraph 8.243.

[57] See Parties' response to GUPPI WP, Section VII.

[58] PFs, paragraph 8.243.

[59] See Parties' response to GUPPI WP, Section VII.

2. CMA's analysis of other countervailing factors is misplaced

(115) At paragraph 8.241, the PFs state that the CMA has considered what factors may lead to a provisional conclusion that small (but positive) levels of pricing pressure would not be likely to translate into price increases (or other deterioration in QRS) that would be consistent with an SLC. The CMA finds that "*in addition to the downward pressure exerted by efficiencies, this may arise where: there was expected to be little or no pass through to consumers; there would be a cost to the merged entity of implementing the price rise or QRS degradation (eg because of operational difficulty); and/or the size of the gain was somehow insufficient to motivate the merged entity to take action, even if potentially profitable*". However, the CMA states that none of these factors apply in the present case.

(116) As noted, the Parties disagree fundamentally with the starting premise that such modest quantum of upward price pressure would translate into an incentive to increase prices even regardless of the points made in E.1 above. In any event, the CMA's points in paragraphs 8.241-242 are not correct, as follows.

(117) First, the presumptively high-pass on rate – over 100% under the isoelastic demand premise -- is incorrect. It derives from the *Somerfield/Morrisons* Report which made clear that its assumption of isoelastic demand was just that – an assumption made in 2005, and even then not based on analysis of any evidence.[60] The CMA is wrong to assert that the later *Groceries* inquiry embraced an isoelastic demand assumption;[61] in fact, the CC in that inquiry used <u>linear</u> demand, and expressly <u>rejected</u> isoelastic demand.[62] As the CMA in this case has not attempted to show which demand form is most appropriate to UK groceries in 2019, it cannot presume the existence of a high industry pass-on rate of over 100%, let alone a firm-specific rate of over 100% (as suggested by an isoelastic demand).[63,]

(118) Second, as to the countervailing cost of implementing the upward price pressure into adverse effects, for the local analysis, the only significant aspect of competition which the CMA acknowledges is flexed is range. Contrary to the CMA's assertion, range cannot be easily flexed with changes in competition because there are costs to significantly changing the range. Further, range is predominantly determined on the basis of local tastes rather than the extent of competition. As such, there is a cost to significantly changing range in a local store that would unlikely be surmounted given the low level of pricing pressure found by the CMA.

(119) The same is true of service, as the majority of service standards are set nationally, including availability, and cleanliness standards. Further, reducing service levels has a cost to the Parties due to the significant reputational implications given the need for consistency across the brand that go beyond just the store in question.

(120) Finally, the CMA significantly overstates the Parties' ability to translate very small changes in aggregate upward pricing pressure across all the local areas into actual national prices. First, the CMA has not factored in the extent of local divestments at a reasonable GUPPI. Given that these divestments will be

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60 CC, *Report on the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, decision of 2 September 2005, paragraph 7.19 (e), ("**Somerfield/Morrison**", attached as **Annex_005_009**): "*There was no reason for our having adopted an isoelastic rather than linear demand in estimating the scope for price increases; and the formula we adopted consequently predicted price increases, of over 1,000 per cent in the case of the Johnstone store, that could not possibly be sustained*."

61 PFs, para. 8.225(b).

62 Footnote 3 in CC, *Groceries Inquiry Report* (Appendix B) rejects the use of isoelastic demand, and favours linear demand, as follows: "*One retailer criticized **our use of a linear demand** and suggested we use an isoelastic demand function instead. It also pointed to analysis the CC did during the Somerfield/Morrisons case where the CC did not think it was appropriate to use a linear demand function. We note that the type of analysis conducted in this case is of a different nature to the one conducted in Somerfield/Morrisons. One feature that makes **isoelastic demand unsuitable in this context is that it is not well equipped to examine the effect of large changes in quantity such as the ones examined in our analysis"*** (emphasis added).

63 Industry wide cost increases are more likely to be passed on than firm-specific cost increases (as this would disadvantage the firm relative to competitors); the Parties note that Mastercard also failed to prove pass-on of interchange fee costs by Sainsbury's in the interchange fee litigation (*Sainsbury's Supermarkets Ltd v Mastercard Inc*, [2018] EWCA Civ 1536, para 485).

those local areas with the highest GUPPI, the national GUPPI estimates post-divestments will be significantly lower than the 2.5% and 3.3% National GUPPI found by the CMA. Such low level GUPPIs cannot be assumed to translate into actual price increases, especially given that the GUPPI does not include many important dynamics including brand repositioning, entry and expansion.

IV. The very low GUPPI thresholds are radically out of line with all norms and incoherent when set against Tesco/Booker and Ladbrokes/Coral

(121) The CMA's GUPPI thresholds result in a Phase II test, purportedly on the balance of probabilities, that is more invasive than the Phase I "*may be the case*" standard – which as a matter of law is supposed to be more cautious, and flag more possible issues, than ultimately would qualify as "*more likely than not*" (Phase II calibre) issues.[64] This is true here even though the CMA itself cautioned that the Phase I test was not fit for a contemporary Phase II, noting: "*the approach adopted in this Phase 1 decision is … not intended to act as the starting point from which the Phase 2 analysis will develop*".[65] Further, despite the fact that the Phase II assessment recognises that Aldi and Lidl are a competitive constraint, it nonetheless generates 35% more SLC areas than the Phase I assessment which excluded Aldi and Lidl.

(122) The Parties' advisers have been unable to find any precedent in the UK for a Phase II local overlap case generating more SLC findings, on a "*more likely than not*" standard than was found on a "*may be the case*" standard. The unreasonableness of this outcome is reinforced by comparisons of decisional practice and outcomes.

A. The GUPPI threshold is set at an unprecedentedly low level, particularly as it is used as an automatic-SLC generator

(123) Across every UK, US and EU case the Parties can identify, there is no precedent for a GUPPI threshold as low as 2.5%, let alone 1.5% (or indeed 0%, for national online), in a **Phase II** case or case with a balance of probabilities i.e. more-likely-than-not standard.

(124) Further, the Parties' advisers have been unable to locate a UK, US or EU **Phase I** case (where the legal standard is more conservative) with GUPPIs this low as the basis for a screen or filter, let alone as an automatic SLC (i.e. Phase I decision rule); in any case, none emerge from the Phase I cases cited by the CMA in the PFs.[66]

(125) Finally, the Parties' advisers are unaware of any decisional rule approach in any jurisdiction, based on a GUPPI threshold, other than this case and *Ladbrokes/Coral*. In the US, a decision rule approach was categorically rejected by the US FTC as being too blunt and unsafe an approach at this stage of economic learning: see *Dollar Tree.*[67] In any event, it is surely uncontroversial that using a decision rule calls for a more judicious approach to the threshold, and greater confidence in "more likely than not" determinations, than using GUPPI as one of a number of inputs, or as first screen.[68]

[64] See *OFT v IBA Health Ltd [2004] EWCA Civ 142*.

[65] CMA Phase I decision, paragraph 43.

[66] PFs, footnotes 138-150, paragraphs 8.225(b) and (c).

[67] The rejection of the "presumption of harm" approach based on GUPPI in *Dollar Tree* is discussed further at Schedule 1.1.

[68] This is apparent not just from the FTC's views but as a proposition of English law. In *Hornal v Neuberger Products Ltd* [1957] 1 QB 247, [1956] 3 All ER 970, Lord Justice Morris said that "*the very elements of gravity*" were part of the range of considerations to be considered in deciding an issue on the balance of probabilities. See also, Response to GUPPI WP of 21 December paragraphs 103ff.

B. The approach on presumption of likely SLC is incoherent when read against the two closest analogy inquiries – Tesco/Booker and Ladbrokes/Coral

(126) The radical departure of the CMA on GUPPI is further reinforced by closer inspection of the closest analogies to the present case, *Tesco/Booker and Ladbrokes/Coral*. These are the closest analogies and starting points for the present case because:

- **Tesco/Booker** – applies the Phase II legal test, expressly uses GUPPI thresholds for calibrating SLC risk in the retail grocery sector, and is recent (2017); and
- **Ladbrokes/Coral** is the only other SLC decision rule case, it applies the Phase II legal test, expressly uses GUPPI to set the parameters of its decision rule (albeit ultimately framed as an "expected diversion ratio" or WSS threshold[69]), is also in a UK retail sector, and is also recent (2016).

1. Incoherence when set against Tesco/Booker

(127) The CMA's attempt to paint the *Tesco/Booker* decision as of limited or no relevance – as a vertical case – is plainly wrong for the following reasons.

(128) First, there were horizontal retail grocery overlaps in the *Tesco* case. Under the heading "Horizontal Effects" the CMA said:

> *We have built on the CMA's phase 1 decision … We have applied a GUPPI framework in our assessment and used a 5% GUPPI as the benchmark for identifying stores which may give rise to potential concerns.*[70]

(129) This was cross-referred to past practice which the CMA had summarised as:

> *In the past, for some (but not all) horizontal mergers, the CMA has taken the approach that a GUPPI of less than 5% indicates that concerns could be ruled out. Typically, this has been followed by closer examination of markets where the GUPPI was 5% or higher. In other cases, the CMA has signalled that a higher threshold may be appropriate*.[71]

(130) There can be no doubt that the CMA expressly turned its mind to, and developed, a 5% GUPPI safe harbour for horizontal overlaps. There is therefore no legitimate distinction between the two cases in principle.

(131) It is also not determinative that there were "*only 2*" horizontal overlaps at Phase II, such that the issue was "*very minor".*[72]. The PFs gloss over the fact that Phase II "*built on*" Phase I, which had screened out areas with less than 33% critical diversion ratio (and "5 to 4" or more).[73] This standard at which the CMA screened out horizontal overlaps at Phase I in *Tesco* (<33%) is over 4 times higher than the [>7.1]% critical diversion standard at which overlaps are automatically condemned as SLCs in this case on a Phase II standard.

(132) In other words, the CMA's current 1.5% GUPPI test would condemn as automatic SLCs horizontal overlap areas in *Tesco/Booker* that never even made it to Phase II. This is fundamentally incoherent.

(133) Further, as a matter of principle and legal duty, it cannot be argued that the CMA can misapply the SLC test at Phase II or be cavalier with risk of harm to customers, on issues that are not large-scale in absolute

69 The CMA explains in that Report that "*the WSS can be interpreted as a proxy for the expected diversion ratio*" (7.76).

70 *Tesco/Booker*, paragraphs 11.6-11.7. Emphasis added.

71 *Ibid.,* paragraph 9.46. Emphasis added.

72 PFs, para 8.225(b).

73 See also, *Tesco/Booker,* Phase I decision of 21 July 2017, paragraph 99(b).

terms or do not dominate a case relative to other issues in that case.[74] As to scale, the aggregate sum of the horizontal overlap markets at issue in *Tesco* is likely to be larger than the markets at issue referred in numerous CMA Phase II inquiries (e.g. £5-10m in the current *Tobii/Smartbox* inquiry, and £15-20m in the recent *Vanilla/Washstation* prohibition).[75]

(134) Second, as to the point that *Tesco/Booker* was primarily vertical[76] that is common ground, as is the corresponding fact that a vGUPPI is a vertical measure.

(135) In this respect, the PFs fails to engage with an important point already made in the Parties' response to the GUPPI Working Paper (dated 21 December 2018),[77] namely that the large-scale "retail to wholesale" vertical theory the CMA considered in *Tesco/Booker* looked at upward pressure to worsen the offer at Tesco-owned retail stores to drive customers to Booker-supplied stores. The CMA could not have put it more clearly: "*Tesco controls its own stores. Any deterioration will therefore be passed through, fully, to shoppers*."[78]

(136) In terms of proximity to end-consumers, the CMA has not explained how this is any different to a horizontal retail overlap. What is more, the CMA applied this theory to 2,300 Tesco-owned stores, so the "error cost" of an unduly lenient standard applied in *Tesco/Booker* (the 5% vGUPPI) would be huge.

(137) The second reason the CMA gives for downplaying the analogy from *Tesco/Booker* is that vertical mergers are "*inherently more efficiency-driving than horizontal mergers*".[79] This is accepted as a generic statement, all else equal. However, generic statements cannot override the facts present in this case. The variable cost savings actually evidenced and actually given quantified credit by the CMA in this case are, in line with economic textbooks and CMA Guidelines no less "inherently efficiency-enhancing" than a vertical efficiency. [80] The CMA cannot therefore ignore the relevance of the fact that in *Tesco/Booker* vertical efficiencies were assumed (even though not proven); whereas in this case they have actually been proven and accepted as likely in fact. As a result, the "efficiency-driving" nature of *Tesco/Booker* by virtue of it being a vertical case does not serve to distinguish it from the present case.

(138) In the absence of any valid reason to distinguish the *Tesco/Booker* decision, the CMA has no basis for ignoring the Parties' submissions that the 5% GUPPI safe harbour in that case should apply equally in the present case.

2. Incoherence when set against Ladbrokes/Coral

[74] In terms of significance beyond the immediate case, it is also relevant that Phase II cases act in practice as precedent for both business and Phase I decision-making, most notably in the grocery sector. For example, the CMA Phase I decision in *the anticipated acquisition by Co-operative Group Ltd of Nisa Retail Ltd* , ME/6716-17, 23 April 2018 ("***Nisa/Co-op***") would have been planned by those parties using *Tesco/Booker*, which approach the CMA followed closely. As the CMA notes, the CC *Report on the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, decision of 2 September 2005 ("**Somerfield/Morrison**", attached as **Annex_005_009**), was "*subsequently adopted*" in various Phase I cases from 2006-2014, prior to *Tesco/Booker* (2017); see paragraph 8.225(b) and cases cited at PFs, footnotes 139-144.

[75] The CMA refers to "*close to £15m*" in the Phase I decision in the *Completed acquisition by JLA New Equityco Limited through its subsidiary Vanilla Group Limited of Washstation Limited*, decision of 16 April 2018, paragraph 147; revised to *"£15-20m*" net revenue in the Phase II Final Report, decision of 11 October 2018, paragraph 3.2; see also the Phase I decision in the *Completed acquisition by Tobii AB of Smartbox Assistive Technology Limited and Sensory Software International Limited*, ME/6780/18, decision of 25 January 2019, paragraph 234.

[76] PFs, para 8.225(a).

[77] Parties' response to the GUPPI Working Paper (dated 21 December 2018), paragraph 54.

[78] *Tesco/Booker*, paragraph 10.15.

[79] PFs, para 8.225(a).

[80] CMA, Merger Assessment Guidelines, paragraph 5.7.9 (attached as **Annex_005_010**), reflecting standard textbook economics that any firm (even a monopolist, let alone a merged firm with a 29% market share) has a profit-maximising incentive to lower prices when its variable costs decrease.

(139) *Ladbrokes/Coral* is a direct comparator to the present case in terms of the methodology used to assess the risk of probable harm for SLC test purposes.[81]

(140) As set out above, *Ladbrokes/Coral* used a sense-check review of GUPPI decisional practice to arrive at a GUPPI threshold range no lower than 10% (i.e. 10-20%) as the range within which its decisive intervention threshold (decision rule) should fall. The lower bound of 10% GUPPI compares directly to the 1.5% GUPPI, absent efficiencies, used in the PFs – the standard here is over 7x lower than the lower bound in *Ladbrokes/Coral*. As far as critical diversions are concerned, as a comparator, grocery industry margins are a fraction of gambling industry margins (e.g. half the size). It follows that the critical diversion should be proportionately *higher* here, given that grocery margins are so much lower, reflecting higher consumer demand elasticity as a result of strong industry competition.[82]

(141) It is wrong for the PFs to claim that "*there was no discussion in the decision as to the threshold at which a GUPPI would or would not support the finding of SLC"* (i.e., the WSS intervention threshold) as it was referred to in *Ladbrokes/Coral.*[83] The CMA said:

> *The **GUPPI** … combines the estimates of diversion ratios with an estimate of variable margins to produce a **metric that assists with the interpretation of diversion ratios**. …*
>
> ***On that basis, we considered that a plausible intervention threshold** should capture LBOs with diversion to the other merging party of between 15% and 20% (**corresponding to a GUPPI between [10–20]% and [10–20]%). The corresponding WSS [range is 30% to 40%, which we then focused on** with a view to determining a candidate WSS intervention threshold.*[84]

(142) Contrary to the positioning in the PFs, it is clear that the CMA in *Ladbrokes* used GUPPI thresholds (including the 10% lower bound) to set the "ballpark" range of possible thresholds for intervention using a critical expected diversion ratio (WSS) threshold.

3. The comparison shows the serious flaws in the CMA's approach

(143) Reading these two closely analogous precedents together, it is clear that the CMA's approach is flawed in failing to grapple with the incoherence between these decided cases, and the proposed approach in the PFs.

(144) While it is not suggested these cases are binding, they strongly imply a starting point, if not in the 10%+ GUPPI range, then a range closer to 10% than the presumptive no SLC safe harbour of 5% GUPPI. Instead, the CMA has started from zero and worked its way up -and only to a modest degree, ultimately settling on an automatic SLC deep within the *Tesco* safe harbour range.

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81 The GUPPI model is neutral as to industry and the products bought by customers, and captures differences in the intensity of industry competition via the level of margins.

82 The higher the margin, the lower the critical diversion ratio is for the same GUPPI result (as GUPPI = diversion x margin). In policy terms, this matches the CMA/predecessor general inferences that higher margins signal weaker industry competition (lower customer elasticity); conversely, lower margins imply stronger industry competition. The UK authorities derive these inferences form the Lerner Condition which holds that variable margins are the inverse of demand elasticity: lower margins signal higher customer elasticity; higher margins signal lower elasticity. These inferences are particularly relevant here given that food and non-food grocery shopping is non-discretionary; in other words, high elasticity does not reflect that people will eat much less food if the prices go up; rather, this high elasticity signals that they have many grocery alternatives choices about where to buy food. In other words, the reason for the Parties' low variable margins is that grocery competition is very strong. Given the modest diversions on average nationally, this strong competition remains post-merger (aided by divestments in the subset of local areas where local diversions are high).

83 PFs, paragraph 8.226.

84 *Ladbrokes/Coral* , paragraphs 7.128-129, footnote 118. Emphasis added.

(145) The CMA's position is also at odds with GUPPI practice in the EU (to which the CMA had regard in *Ladbrokes/Coral*)[85] and with the FTC's position in the United States.[86]

C. Other older, non-GUPPI and/or Phase I cases do not assist the CMA

(146) In the years since GUPPI was introduced (late 2009) and applied in the UK (2010), there is no support in any UK Phase II decisional practice, applying the relevant SLC standard, for a GUPPI threshold of below 5%, let alone the fractional levels of the PFs.

(147) As far as Phase I GUPPI cases go, the CMA notes that in two sectors the CMA/OFT used thresholds above 5% (bowling, cinemas) and in two sectors (petrol, building supplies) an SLC was found that corresponded to a GUPPI of below 5%.[87] As a starting point, these cases are of very limited comparative value.[88] Significantly: (i) these are Phase I cases applying a different legal standard; (ii) in none was a GUPPI as low as 2.5% or 1.5% or less used, (iii) none were decision rule cases, even on a Phase I standard; and (iv) the cases are all older, and outside the grocery sector.

(148) Finally, in "*taking a broader view*" of prior cases in the grocery sector, the CMA relies heavily on the 2005 Phase II case of *Somerfield/Morrisons,* which was followed in a number of grocery store Phase I cases predating *Tesco/Booker*.[89] The PFs are wrong to place weight on *Somerfield* (2005) to distract from the clear implications of *Tesco/Booker* (2017). Unlike the test used in *Tesco/Booker*, the *Somerfield* test is not a GUPPI test, and has two limbs, as follows.[90]

(149) One limb of the *Somerfield* test is a critical diversion ratio of one-seventh i.e. 14.3%. An area needed to fail <u>both</u> limbs to be a likely SLC in that case: if the diversion ratio was 14.2%, the result was no SLC.

(150) The other limb of the test is a "5% IPR" threshold test, IPR being an older price pressure test than GUPPI that has never again been employed at Phase II in the same way as *Somerfield*. This is in large part because IPRs are hugely sensitive to demand curve assumptions, a disadvantage that the GUPPI quite deliberately avoids.[91] The PFs state that a 5% isoelastic IPR equates (on the Parties' margins) to a GUPPI below 5% (3.2%).

(151) A careful application of the *Somerfield* test does not support the CMA's 1.5% net GUPPI in this case for the following reasons.

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85 *Ladbrokes/Coral*, para. 7.129, footnote 118. The European Commission has not, when it has used GUPPI, found concerns or used thresholds with a GUPPI below 10%. In the recent European Commission decision in T-Mobile NL/Tele2NL, M.8792, 27 November 2018 (decision not yet published), GUPPIs of under 10% were considered not to present a competition concern.

86 See Schedule 1.1 on the FTC's *Dollar Tree* decision.

87 PFs, paragraph 8.225(c), footnotes 149-150.

88 *Coral/Ladbrokes*, footnote 118.

89 PFs, paragraph 8.225(b).

90 The logic of *Somerfield/Morrisons* (attached as **Annex_005_009**) is summarised in paragraph 7.12: "*In … an undifferentiated market, two firms each, for example, with 12.5 per cent (i.e. one-eighth) of the total market would have diversion ratios to one another of 14.3 per cent (ie, one-seventh). Since the merger of two such firms would result in a market share of 25 per cent, and since our Merger Guidelines suggest that mergers which result in a market share of below 25 per cent are less likely to raise competition concerns, a diversion ratio of 14.3 per cent seemed a reasonable level at which to consider diversion ratios that would give rise to competition concerns. We therefore examined whether those stores identified as giving rise to an SLC on the basis of a 5 per cent 'illustrative price rise' … [and] had revenue diversion ratios in excess of 14.3 per cent*."

91 For example, comparing to GUPPI, a 5% IPR with a <u>linear</u> demand assumption translates to a GUPPI <u>above</u> 5%; with a constant-elasticity (<u>isoelastic</u>) demand assumption the 5% IPR translates to a GUPPI <u>below</u> 5%. The CMA's Retail Merger Commentary (attached as **Annex_005_006**) notes that "*GUPPI is the most commonly used measure*" and a "*disadvantage of the IPR approach is that its results are sensitive to assumptions about the way demand changes with price*" (paragraph 5.14). IPR was developed by Shapiro in a 1996 journal article. He subsequently introduced GUPPI (and not IPRs) in the US. In the UK, while Phase I cases applied *Somerfield/Morrisons* (attached as **Annex_005_009**), at Phase II, IPRs have not been used in a decisive fashion in the manner of *Somerfield/Morrisons* at Phase II in the UK. As such, the *Somerfield/Morrisons* test is a one-off that subsequent CC and CMA inquiries have chosen not to adopt – and the CMA has not employed IPR in *Ladbrokes/Coral, Tesco/Booker* or this case.

- First, applying *Somerfield* would result in no SLC finding with diversion below 14.3%, period, even if the IPR were above 5%. The CMA's 1.5% GUPPI converts to a 7.1% diversion. A 14-year old test that finds an SLC only where the diversion ratio is at or above 14.3% can provide no support for a test whose critical diversion is more than twice as low;
- Second, *Somerfield's* use of isoelastic demand was, and remains, an unproven assumption. The CMA is wrong to assert that the later *Groceries* inquiry embraced an isoelastic demand assumption;[92] in fact, the CC in that inquiry used linear demand, and expressly rejected isoelastic demand.[93] As noted, a 5% IPR with linear demand would support a GUPPI >5%; and
- Third, even excluding the fact that it is essentially reliant on an arbitrary demand assumption, on its face, the CMA's 5% IPR converts into a GUPPI of 3.2% - over 2x as high as the CMA's proposed 1.5% GUPPI absent efficiencies. Moreover, flaws in the original *Somerfield* analysis have never been interrogated and corrected (its successors were all Phase I cases). For example, the iso-elastic IPR cited by the CMA not only assumes a pass through of 100% for which no empirical evidence has been provided, but it is also based on a demand function which assumes that in equilibrium, neither Parties will react to a change in each other's prices. A demand system which implies no competitive interaction between two parties makes limited sense to use in a merger model.[94]

(152) Accordingly, if the *Somerfield/Morrisons* decision has any relevance to this case, it is that it shows that the critical diversion in this case, and corresponding GUPPI threshold, is far too low.

D. The GUPPI thresholds are inconsistent with CMA and predecessor guidance

(153) The CMA's critical diversions also convert into market share and fascia reduction tests at levels fundamentally at odds with current CMA guidance. CMA guidance notes that

> *In relation to the number of firms, previous OFT decisions in mergers involving retailers suggest that the OFT has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above*).[95]

(154) This restates the old "4 to 3" (or fewer) intervention threshold in grocery and other retail sectors. As set out above, a GUPPI threshold of 1.5% (absent efficiencies), using the Parties' margins, translates into a critical diversion threshold of just over 7%, equating to a fascia reduction of 15 to 14 -- not 4 to 3 applicable to unilateral effects in differentiated markets.[96]

(155) Looked at in terms of market shares, this 15 to 14 threshold would be the same applied to a market with approximately 15 equal-strength (symmetric) competitors, each with approximately 6.7% market share. Thus, the 15 to 14 threshold equates in market share terms to an automatic SLC when two such firms combine to create a single firm with just over 13% market share. This creates a presumption of an SLC that in other cases would not even be considered a potential problem. The original CC merger guidelines

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92 PFs, para 8.225(b).

93 Footnote 3 in Appendix B of the Groceries Inquiry Report rejects the use of isoelastic demand, and favours linear demand, as follows: "*One retailer criticized **our use of a linear demand** and suggested we use an isoelastic demand function instead. It also pointed to analysis the CC did during the Somerfield/Morrisons case where the CC did not think it was appropriate to use a linear demand function. We note that the type of analysis conducted in this case is of a different nature to the one conducted in Somerfield/Morrisons. One feature that makes **isoelastic demand unsuitable in this context is that it is not well equipped to examine the effect of large changes in quantity such as the ones examined in our analysis"*** (emphasis added).

94 Concerns with the use of iso-elastic demand function were acknowledged by Shapiro: "Certainly, *it is desirable to find support for the constant-elasticity assumption in documents, in the testimony of industry participants, or in the data before using this formula or variants on it*." (page 26-27 emphasis added). Shapiro, C., 1996, "Mergers with Differentiated Products", *Antitrust*, Spring 1996.

95 CMA, Merger Assessment Guidelines, paragraph 5.3.5 (attached as **Annex_005_010**).

96 If out-of-market diversion were 25%, it would translate to an 11 to 10 merger threshold, so the point is of equal force regardless of reasonable estimates of out-of-market diversion.

articulated the presumption, also found in EU merger control, that a merger would be unproblematic with a market share below 25% (as cited in *Somerfield/Morrisons*).[97]

(156) However, in this case, the CMA has created a presumption of harm at a combined market share of <u>below half</u> this level.

(157) In consequence, the CMA's current 1.5% GUPPI test would condemn as automatic SLCs horizontal overlap areas in *Tesco/Booker* that were considered unproblematic at Phase I and not even considered at Phase II. This is fundamentally incoherent.

V. The CMA's assessment of uncertainty and substantiality misapplies the expectation of the SLC test

(158) Under s.36(1)(b) of the Act the CMA must decide whether a merger ". The CMA's Guidelines explain that the expectation of a likely *adverse effect on customers* is what makes a lessening of competition "substantial"[98] – or turns an LC into an SLC.

(159) In terms of the materiality of adverse effects such as price rises in this case, the Parties' case has never been that the CMA or customers should accept a small level of price increase as immaterial for SLC purposes; the Parties' case has always been the prices *will go down* with the Proposed Merger. It was therefore the Parties who proactively argued that there are no "tolerable" levels of price increase or other consumer harm that the CMA, or consumers, should simply have to accept in this case.[99] The CMA embraced this point in the PFs.[100] The disagreement between the Parties and the CMA is therefore not about what, precisely, qualifies as a "material" price rise or whether it should be tolerated.

(160) Rather, the key legal issue in dispute is whether tiny changes in competitive pressure (of 7.1%, when measured in terms of diversion) can provide a safe foundation for a conclusion that *any* material price effects are *likely* on the balance of probabilities under s.36(1)(b) of the Act. For the reasons set out below, this cannot be the case.

A. It is normal to use 5% for materiality purposes in merger control, including for purpose of GUPPI thresholds

(161) The CMA in the present case is not using a full-blown merger simulation model to predict price rises. Such models require critical inputs such as the correct demand form (pass-on rates) and are highly complex. Instead, the CMA has used the much simpler model of GUPPI, as a "*measure of pricing pressure; not price increases*".[101]

(162) Like the "*normal*" use of 5% for the SSNIP test that underpins quantified market definition,[102] a 5% materiality threshold is normally applied in contexts such as upward price pressure because it is a

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97 *Somerfield/Morrisons*, paragraph 7.12. The CC built its 14.3% diversion ratio analogy in that case with an undifferentiated market, despite groceries being differentiated. In fact, the later CMA Guidelines update this to note that "*previous OFT decisions in markets where products are undifferentiated suggest that combined market shares of <u>less than 40%</u> will not often give the OFT cause for concern over unilateral effects*" (at 5.3.5).

98 The CMA Merger Assessment Guidelines (attached as **Annex_005_010**) say: "*A merger gives rise to an SLC when it has a significant effect on rivalry over time, and therefore on the competitive pressure on firms to improve their offer to customers or become more efficient or innovative. A merger that gives rise to an SLC will be* ***expected to lead to an adverse effect for customers. Evidence on likely adverse effects will therefore play a key role*** *in assessing mergers"* (paragraphs 4.1.1 to 4.1.3). Emphasis added.

99 See Response to GUPPI WP, paragraph 40 and 55.

100 PFs, paragraph 8.240.

101 PFs. paragraph 8.240.

102 The CMA Merger Assessment Guidelines (attached as **Annex_005_010**), paragraph 5.2.12: "*the Authorities normally use a SSNIP of 5 per cent*".

sensible approach when taking models or thought experiments, and drawing critical conclusions from them, justified on the balance of probabilities.

(163) Long before the 5% threshold of *Tesco/Booker* (see above), the CC put it best when it said in *Somerfield*:

> *We note that the analytical process described above will* ***always produce a positive predicted price rise****, for any merger in which the diversion ratio exceeds zero and firms are making positive margins.* ***In practice, some mergers clearly do not result in an SLC****. It seems to us likely that, in this inquiry,* ***where the diversion ratio is low*** [in that case, below 14.3%] *and the illustrative price increase is low (because margins are low), t****here is no SLC: that any lessening of competition is non-existent or insubstantial. We would expect no (or at least no substantial) price rises or reductions in PQRS where this is so****. It should not be assumed that the 'predicted price rises',* ***below 5 per cent****, in these cases represent real price rises that are in some way 'acceptable' to the CC.*[103]

(164) Indeed, contrary to the suggestion in the PFs, the UK authorities have consistently used the "*normal*" 5% SSNIP across all Phase II grocery merger cases: in *Safeway*,[104] in *Tesco/Booker* and this case: for example, in both its online and grocery store surveys, it asked customers what they would do if prices went up by 5%.[105] More importantly, when the issue was not the conceptual issue of market definition but an actual safe harbour/intervention threshold, the UK authorities I Phase II merger grocery cases have used <5% (IPR in *Somerfield*; see above) and <5% GUPPI (*Tesco/Booker*).

B. The present case does not justify a very low threshold in support of an expectation of SLC

(165) The PFs imply that there are two exceptional dimensions to this inquiry that justify a lower GUPPI threshold.

(166) First, they imply that the issue of **uncertainty** is unusually modest in this case because of the exceptional quality of the CMA's own (very large) investigation. [106] In short, the CMA's premise is that it has both (i) collected abnormally high quality inputs (unusually certain margin estimates and consumer survey estimates); and (ii) handled these inputs in an unusually error-free and unbiased way, such that the CMA is able to estimate GUPPIs with exceptional accuracy. This is plainly wrong. For all the reasons set out above, the CMA has no basis for its confidence in the robustness of its GUPPI inputs and thresholds.

(167) Second, they state that in the approach to **substantiality** (the "S" in SLC), it is permissible to take account of the exceptionally large size and "importance" to households of the UK grocery market.[107] The clear implication is that the CMA considers it appropriate to take a different approach to SLC when the underlying market is very large and/or "important".

(168) There is no doubt that a small percentage increase in price in UK groceries nationally would, for the sake of argument, result in significant consumer detriment. However, on the facts and evidence, the above sections show that there is no plausible risk, let alone an expectation, of prices increases at the CMA's chosen GUPPI levels.

[103] Somerfield/Morrison's, paragraph 7.12, footnote 1, (attached as **Annex_005_009**). Emphasis added, and cited with approval in a leading article by Professor Carl Shapiro, the then-head of the DOJ Economics Division responsible for introducing GUPPI it the revised US merger guidelines in 2010. See Carl Shapiro, The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years, 77 Antitrust LJ 701 (2010) at 733.

[104] OFT, *Asda Stores Ltd / Safeway / Wm Morrison Supermarkets plc*, ME/1769/05, paragraph 5.3.

[105] Tesco/Booker, footnote 82 (attached as **Annex_005_002**).

[106] PFs, paragraph 8.246.

[107] PFs, paragraph 8.239.

1. Market importance and standard of belief

(169) Although not formally couched as such, to the extent that the CMAs reference to the scale of harm of a 1% national grocery price rise contemplates the *de facto* use of standard of risk that is more cautious due to market size, this would be wrong: the test the CMA must apply is not e.g. "*plausible risk*" but "*more likely than not*". Market size cannot be relevant to the question of forming an expectation of an SLC.

(170) Parliament did not incorporate a "precautionary principle" (which protects the public from plausible risks, even if they are not likely to eventuate) into Phase II. Nor did it introduce a variable standard of belief, such that a lower standard was appropriate when the market is large and a higher standard where it is small.[108]

(171) Rather, it adopted a balanced approach that protects the interests of customers in being protected from likely harm but recognises that: (i) freedom of contract and private property should be overridden only with suitable precautions; and (ii) M&A enables business to contribute to UK productivity (GDP) and innovation, and HMRC tax revenue, which benefits all UK citizens, including "low income households"[109] as consumers, as employees, and as taxpayers and recipients of public spending. Ultimately, over-enforcement by applying precautionary principle standards that prohibits or chills M&A activity would therefore harm the UK economy, including consumers.

2. Market importance and the 'substantiality' of the loss of rivalry

(172) Moreover, the CMA's erroneous application of the SLC test is not cured even if market importance were relevant to the "*substantial*" (S) in SLC. First, this reading is not supported by the Act, the CMA's guidance, or any UK grocery merger case (or even the 2008 *Groceries* inquiry):

(a) SLC test construction and practice

(173) The SLC test asks: what difference will the merger make?[110] This is a function of: (i) how competitive the market is; (ii) how much of that competition the two merging parties represent; and (iii) remaining competition -- how rivals and customers would dynamically respond to a strategy of making customers worse off. For none of these is it relevant whether the (grocery) market is large or important.

(174) Parliament did not specify a different test, or a different variation of the SLC test, when the market is **large** (i.e. where important means market size). This makes sense because it is undeniable that the corollary of taking a stricter approach to a large market is taking a more lenient approach to a smaller market.[111] The cost to customers would be the same if a lenient standard were applied 100 times across cases where, each time, the market was worth 1% the size of a market that is 100 times the size of the average CMA case. Essentially these points were made in the Hansard debates concerning the SLC test in the

[108] *OFT v IBA Health* [2004] EWCA, paragraph 48. Compare the span of belief at Phase I which ranges from the "*more than fanciful*" at the lower extreme through to less-likely-than-not for the "*may be the case*" standard.

[109] Cf. para 8.239.

[110] See the CMA Merger Assessment Guidelines, sections 4.1 and 4.3 (attached as **Annex_005_010**) and *Celesio AG v OFT*, paragraph 174 – in which the CAT observed that *"[w]e agree that the SLC test requires the OFT to consider what competition may be lost as a result of the proposed merger".*

[111] This is reflected in CMA decisional practice. The CMA and its predecessors under the Act from 2003-19 have considered SLC questions across many hundreds of merger cases affecting small, medium and reasonably large-sized markets, and including in retail, compared to a handful of cases affecting very large sectors.

Enterprise Bill.[112] Further, by definition, all Phase II merger inquiries are deemed by the CMA to relate to markets of sufficient importance.[113]

(175) Equally, Parliament did not specify a different test for **retail** markets than for markets where customers are SMEs/larger businesses as opposed to consumer households; s.30 of the Act does not discriminate between customers at any level of the market.[114] This makes sense also from a consumer welfare perspective, because the best way to protect consumers from the creation of market power via mergers is to prevent mergers creating market power at <u>any</u> level of the supply chain, <u>not</u> just the retail level.

(176) Consistent with the Act, the CMA Guidelines refer only in relevant part to customers and do not single out retail markets or consumer markets for differentiated treatment for SLC or theories of harm purposes. There is no basis for singling out grocery retail mergers as distinct from other retail markets and as requiring stricter intervention standards. The use of 5% materiality in all Phase II grocery merger cases (see para. 212 above) reinforces the normality of approach, as does the CMA's Retail Mergers Commentary (revised in 2017).[115]

(b) AEC test construction and practice

(177) In favour of market importance of groceries pointing to differential treatment, the CMA cites only one case: the Groceries market inquiry of 2008.[116] However, market importance is no doubt relevant to market investigations under the "<u>AEC</u>" test, as common sense and the very nature of this tool would imply.

- From a <u>statutory</u> construction standpoint, the AEC test, which has no "substantial" concept in the legislative test, and has no direct read-across to the proposition that, under the S in the SLC test, market importance allows a differentiated approach to whether a loss of competition is "substantial".
- From the point of view of UK interpretative <u>practice</u>, this one AEC test example should be set against long-standing <u>SLC</u> test practice: the *Tesco/Booker* 5% horizontal GUPPI and 5% vGUPPI safe harbour, the other merger cases using 5% materiality thresholds-- including the in-store and

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112 Lord Sainsbury, speaking on behalf of the Government, said: '*A merger that results in a [SLC] will have a serious impact on consumers <u>and other businesses</u> flowing from the fact that the merged business is now in a position to exercise market power. It <u>does not matter whether the market is small or large –- the impact on the consumers affected will be the same</u>.*' (emphasis added) (*Hansard* HL Deb. vol 639, column 799, 15 October 2002).

113 This is because there is a Phase I discretion not to refer a merger for Phase II inquiry if the markets are of "insufficient importance": see s.33(2)(a) of the Act.

114 The CMA's citation of s.25(3) ERRA on the general mission statement of the CMA does not mean the actual customer benefits provision in the Part III merger control provisions of the Act can be disregarded, which clearly underline that the welfare of all customers is important.

115 See CMA revised Retail Mergers Commentary, April 2017, paragraph 3.35: "*The CMA has used a 'four to three' fascia count threshold in mergers in the grocery sector. That is, the CMA has identified overlaps as potentially problematic where the merger reduces the number of fascia in the market from four to three. In other sectors, the CMA has often used a 'five to four' fascia count threshold.*"

116 PFs, footnote 153 [use this one example (and uncited UK merger cases) to support the claim that the grocery sector could be subject to differential treatment because of its importance: "*For example, in considering what constituted a 'small but significant' price increase for the purposes of establishing market definition (the SSNIP test), the CC in the Groceries Market Investigation explicitly acknowledged that the importance of groceries expenditure in the household budget may justify using a figure lower than 5%, referring to a US precedent where a 1% price increase was instead used: CC Groceries Market Investigation , paragraph 4.11 and footnote 1 on page 49*"]. In this case the CMA has no evidence to show or measure what customers would do in response to a hypothetical 1% price increase. The CMA probably did not do this because it considered 1% price increases tolerable: see *Somerfield/Morrisons*, discussed above and the PFs' commentary on market importance. The better view is that it did this because it is a normal way of tackling materiality for predictive purposes of merger control.

online surveys used to derive diversion and GUPPI results in this very case. The CMA has no data on a 1% SSNIP in this case.[117]

- Finally, it is also relevant how that 1% SSNIP test was used in that one AEC test example, and the gravity of its consequences. It was not used (as in *Tesco/Booker* and other cases) to set a safe harbour or an intervention threshold: it was used in part to refute Tesco's argument of a national geographic market (in which it used a 5% SSNIP model)" by means of a 1% SSNIP analysis. The upshot of this was that the CC reached the (obvious) conclusion that UK grocery markets are local in dimension.

3. Conclusion

(178) Taking the above factors together do not validate the CMA's argument that it is legitimate to use a 1.5% GUPPI threshold to establish a more-likely-than-not SLC.

(179) First, set against the above, the CMA has asserted, not demonstrated, that "market importance" is relevant to the S in SLC, a test which focuses on loss of rivalry.

(180) Second, even if "market importance" were relevant to the S in SLC, it does not follow that market importance can in this case justify an upward price pressure "buffer" for uncertainty and substantiality as low as 1.5% (and by this logic, could be higher if the market were "less" important).

(181) This is because market size or importance does not change the conclusion that the CMA has erred in its application of the "*expectation"* part of the *"expectation of SLC*" test. Regardless of market size, an uncertain or low risk is an uncertain or low risk, and something that does not fit the facts cannot be held to be more likely than not.

VI. The CMA's approach raises business uncertainty and regime implications beyond this case

(182) Business confidence in the predictability of regulations and norms in practice, beyond simply the legislative framework, is critical to their investment decisions within and into the UK, of which M&A is an important part.

(183) As discussed in detail above, the CMA in this case ignores the standards it applied to the large retail grocery acquisition by the Parties' closest competitor, Tesco, in 2017. In that report, the CMA's GUPPI and SLC approach was coherent with prior practice (unlike in the present case). A wholesale departure from established and core principles of assessment, as has happened in this case, creates unpredictability and uncertainty that can only harm investment incentives to the detriment of consumers.

(184) More generally, all or nearly all horizontal mergers would fail the CMA's GUPPI threshold in this case. To the extent that the CMA could attempt to limit the impact of its decision in this case by positioning it as "not a precedent" and "restricted to its facts" or only to "mergers between the Big 4", the Parties submit that this would be insufficient. If the CMA adopts *ad hoc* methodologies for assessment in specific cases (in particular in a case as large and high-profile as this one), it erodes confidence in the UK merger regime.

(185) Equally, if the CMA's position were that (large) retail mergers, and/or (large) grocery mergers in particular, should be subject to fundamentally different rules than other sectors, because of their "proximity" to consumers, it is of course entitled to hold that policy view. This would have implications for many other

[117] The CMA probably did not do this because it considered 1% price increases tolerable: see *Somerfield*, discussed above and the PFs' commentary on market importance. The CMA will know why it used 5% but the Parties suspect the CMA did so for the perfectly reasonable grounds that this is a normal way of tackling materiality for predictive purposes of merger control (in contrast to its ultimate GUPPI threshold).

markets that account for a significant percentage of household spending, such as telecoms, utilities, and mortgages, among others.

(186) However, Parliament has not given general blessing to the idea that retail markets, or grocery markets, should be subject to a different merger test or regime: the SLC test regime applies to protect all customers equally, including larger businesses, SMEs of all sizes, and consumers. That is also the soundest way to maximise overall consumer welfare. By keeping markets competitive at every level of the supply chain, the UK’s productivity and innovation is enhanced, and consumers, along with all customers in the supply chain, are better off.

(187) Should the CMA nonetheless now hold a contrary view, it should then petition Government to change the Enterprise Act to enshrine this view in law and should update the CMA’s merger guidance required under s106 of the Act.

CHAPTER 2 - EFFICIENCIES

I. Introduction and Summary

(188) This Chapter sets out the Parties' response to Chapter 16 of the PFs relating to the Parties' submissions on efficiencies.[118] This Chapter will explain that the rejection of the Parties' quantified synergies case, which is the product of a detailed empirical assessment by two retail industry specialists, is fundamentally flawed and relies on an unreasonable interpretation of the evidence.

(189) As set out in the Parties' response to the NPR, the realisation of these benefits for customers will be underwritten by the Parties' clear public commitment to £1 billion of price investment post-Transaction, which will be subject to independent review. While the Parties are confident of realising the £1.6 billion of synergies quantified by [a consultant] at a minimum, the CMA should give the Parties efficiencies credit for £1 billion, which has been substantiated by [a third party's] sensitised analysis on a highly conservative basis.

(190) The Parties do not restate all the arguments made in the Parties' prior submissions to the CMA but focus this response on the key areas where the CMA's analysis is either factually incorrect, misrepresentative of the evidence, unsubstantiated, or has ignored the Parties' previous submissions without providing adequate reasoning. The Parties also provide additional evidence to give the CMA additional comfort on the likelihood and sufficiency of efficiency gains arising from the Proposed Merger. The key arguments discussed in this Chapter are set out briefly below.

A. Management confidence in the synergies estimate is reflected in their commitment to significant price investment post-Transaction.

(191) As the CMA will have seen in its review of the Parties' internal documents, the Parties' senior management relied upon the quantified synergies analysis in approving the deal. In doubting the principles of harmonisation, the CMA questions the judgement of two retail industry specialists, well-established practice in analysing retail mergers, well-informed shareholders, and the combined expertise in supplier negotiations of the Sainsbury's and Asda businesses.

(192) Such is the confidence of the Parties' senior management in the quantified synergies case and the centrality of price investment to the transaction rationale, that they are committing to lowering prices by £1 billion annually by the end of the third year, starting with a first year investment of £300 million. This commitment will be subject to independent review and will be made public by the Combined Entity. Given that the Parties will definitively underwrite the delivery of synergy benefits for customers, the CMA can have absolute confidence that £1 billion of customer benefits will be delivered.

B. The CMA's dismissal of the Parties' quantified synergies case for groceries is unreasonable and inconsistent with the burden of proof

(193) The PFs reject the Parties' quantified synergy case, which reflects: (i) an extensive empirical exercise compiled by a retail industry specialist ([a consultant]); and (ii) a sensitised estimate by [a third party] to provide a highly conservative view on the synergies (using the methodologies and standards which would apply if the announcement of synergies was covered by Rule 28 of the Takeover Code).

(194) [A third party's] initial sensitised view reflected an early stage analysis, suitable for its limited initial remit of confirming that £500 million synergies could be announced to shareholders. This Chapter set out new evidence that [a third party] has updated its "sensitised" synergies estimate (detailed in **Annex_001V.2_001**). [A third party] has, on the basis of more granular data and refined methodology, calculated total merger synergies of over £[✂].

[118] The CMA's analysis with respect to the fuel synergies is addressed in the Chapter on Fuel.

(195) It would be highly unreasonable to disregard this synergies assesment, not least as [a third party] has quantified this amount as "*'suitable for public disclosure by the client without risk adjustment and reporting by us without qualification'*", pursuant to the rigorous standards of conservatism under Rule 28 of the Takeover Code (subject to the significant scepticism from shareholders and investors that are very familiar with synergy planning and delivery). [A third party's] analysis accounts for methodological and data assumptions made by [a consultant]. and discounts the synergies total as a result. It represents a highly conservative baseline for the synergies realisable (and that investors can rely upon).

(196) [A third party] has considerable experience in undertaking reviews of synergy estimates arising from M&A and grocery retail transactions in particular, including *Tesco/Booker* and *Coop/Nisa*. Importantly, [a third party] has had access to detailed information in assessing synergies in both the *Tesco/Booker* case and this case. While Tesco's submissions to the CMA may claim that the synergies arising from this Proposed Merger are likely to be lower than in their acquisition of Booker, this is an uninformed and conflicted view that should be given no weight. In contrast, [a third party's] assessment for both transactions has been informed by detailed evidence available in both cases.

C. Other sources of evidence strongly support the existence of significant synergies

(197) The PFs concede that other evidence in the case supports the existence of purchasing synergies. However, the Parties have significant concerns regarding the CMA's interpretation of this evidence and fundamentally disagree with the CMA using the comparators cited in paragraph 16.129 to quantify the efficiencies credit, rather than the Parties' quantified synergies case. When these errors of interpretation are corrected for, these comparators firmly corroborate the existence of significant synergies, both consistent with the Parties' empirical analysis and considerably higher than the current CMA estimate.

The CMA's own analysis shows far greater efficiency benefits than the CMA has granted.

(198) The CMA estimates scale benefits from the merger of £[✂] million, significantly higher than the £400 million of efficiencies it provisionally applies in the case.[119] No quantified reason has been provided to underweight this analysis. [✂].

Supplier feedback shows a clear expectation of significant purchasing synergies

(199) Despite repeated requests, the CMA has disclosed disappointingly little information relating to supplier and competitor submissions into the confidentiality ring. This information would have been highly probative for the Parties' case and the failure to disclose it undermines the Parties' rights of defence. From the limited information disclosed, however, there is no evidence that [a consultant] has over-estimated the scope for harmonisation benefits. The CMA acknowledges that "*suppliers consistently expected to have to reduce their prices to the Parties post-Merger*".[120]

(200) [✂] of the five large branded suppliers that provided detail of potential scope for purchasing synergies, believed that the scope for purchasing synergies was equal to or *significantly larger* than the Parties' estimates (up to 5 times that of the Parties). Similarly, over 80% of smaller suppliers that provided evidence to the CMA expected to receive lower prices, with the average potential harmonisation benefit calculated by these suppliers [✂] [a consultant's] quantitative analysis.

Representation of historical transactions that the CMA relies on is misleading and flawed

(201) The CMA continues to compare the Parties' quantified efficiencies case with historical cases in a manner that is not like-for-like comparable and is prejudicial.

(202) Comparing the Parties' gross (and confidential) synergy estimates with the publicly announced synergy values from previous transactions is not a like-for-like comparison and therefore inherently flawed. The

[119] PFs, paragraph 16.129.

[120] PFs, paragraph 16.101

CMA completely misconstrues [a third party's] analysis of comparable transactions. Submissions (both from [a third party] and the Parties) on this issue have been ignored. When this error of interpretation is corrected for, the Parties' quantified efficiencies case is not inconsistent with the comparators cited.

(203) Moreover, the CMA fails to acknowledge that there are compelling reasons why the scope for purchasing synergies in the present case is higher than for comparable transactions, given:

- Buying synergies account for a larger component of overall synergies in this deal than others.
- The change in size of the firms in this transaction is significantly greater than some of the comparators (e.g. Sainsbury's/Argos).
- Compared to other comparators (e.g. Tesco/Booker and Ahold/Delhaize), there will be much greater SKU overlap.
- Some of the comparators involve significant operational split between Europe and the US (e.g. Ahold/Delhaize).

D. Dismissal of the benefits of harmonisation is based on no evidence

(204) The CMA draws a false distinction between harmonisation on the one hand and (pro-competitive) buyer power[121] on the other as if the two are entirely independent of each other. Harmonisation and enhanced buyer power cannot be considered separately.

(205) Harmonisation is facilitated by information transfer but is underpinned and sustained by the Parties' negotiation tactics and increased buyer power (e.g. suppliers have one less significant outside option) and this buyer power persists over time preventing suppliers from clawing back the benefits of harmonisation, leading to the estimated benefits recurring on a sustained basis.

(206) The CMA provides no evidence from third party suppliers, competitors or from previous retail mergers to support a conclusion that harmonisation benefits represent a one-off benefit. Moreover, the PFs disregard clear evidence of durable harmonisation benefits from previous cases (including the Parties' demonstrable track record). Recurring and sustainable buying synergies as a result of harmonisation have ocurred in virtually every recent large scale retail merger. Instead, the CMA appears to distinguish the Proposed Merger from every other recent grocery retail case where harmonisation benefits have been successfully realised, including *Ahold/Delhaize*, *Tesco/Booker, Coop/Nisa* and *Asda/Netto*.

E. The 'back of the envelope' basis for the CMA's calculation of efficiencies credit is opaque and far less robust than [a consultant's] analysis and [a third party's] sensitised figures

(207) The CMA cites "*specific circumstances*" to downweight the efficiencies credit calculated by the CMA to the lower of the ranges indicated by the comparators.[122] No attempt is made to quantify the impact of any of these factors. On closer scrutiny, these factors are either not-specific to the Proposed Merger or based on speculative and unsubstantiated offsetting factors:

- The CMA believes plans to maintain separate brands may result in lower efficiencies, yet it is commonplace for mergers to achieve buying synergies whilst maintaining separate retail brands such as in *Ahold/Delhaize* (one of the CMA's primary comparators),*Tesco/Booker*, *Coop/Nisa, M&S/Ocado, Sainsbury's/Home Retail Group* and *Dixons/Carphone Warehouse.*
- Dis-synergies are based on unsubstantiated media speculation (e.g. alignment of staff contractual terms) or are irrelevant to the assessment (e.g. IT costs are fixed so would have no impact on short-term price setting).

[121] The Parties' buyer power will not be increased to such a level that would create anti-competitive buyer power that would harm consumers. The Parties note the CMA's conclusion at paragraph 15.42 that "*the overall net effect on UK consumers is unlikely to be negative*."

[122] PFs, paragraph 16.130.

II. The CMA's dismissal of the Parties' quantified synergies case is unreasonable and inconsistent with the burden of proof

(208) The PFs disregard the detailed evidence provided by two retail industry specialists. [A consultant] has undertaken an extensive empirical exercise that aggregates granular SKU and supplier-level data under "clean team" conditions. Secondly, the [consultant] analysis has been independently reviewed by [a third party], in accordance with the stringent methodologies and standards which they would apply if the proposed announcement of synergies was covered by Rule 28 of the Takeover Code.

(209) For the reasons consistently explained in the Parties' prior submissions, the Parties strongly believe that the synergies total calculated by [a consultant] is robust and indeed conservative. However, athough the Parties firmly believe that the ultimate value of the synergies total will reflect the [consultant's] number (and are planning on this basis), they consider that [a third party's] assessment is relevant to the CMA's assessment (given the inherent conservatism embedded in its approach). Dismissal of the Parties' entire quantified case (including [a third party's] de-risked analysis) is an unreasonable assessment of the evidence and is inconsistent with the CMA's standard of proof.

(210) In light of [a third party's] updated QFBS review, the Parties have a sufficiently high degree of comfort that these synergies will be delivered that they will publicly commit (subject to independent review) to underwrite the delivery of £1 billion of annual price investment to customers (by year 3). As a minimum, the CMA should therefore provide an efficiencies credit of £1 billion.

A. [A third party] has increased its sensitised view of synergies

(211) [A third party's] review of the Parties' synergies case in July 2018 was focused on confirming that that there was £500m available for investors.

(212) As foreshadowed in Sainsbury's oral hearing, [a third party] has now undertaken additional work (in conjunction with [a consultant]) to produce an updated report. This report shows that [a third party's] sensitised view of the total merger synergies has increased from £[✂] to £[✂]. The entirety of this increase derives from increased purchasing synergies. [A third party's] updated analysis reflects the provision of additional and more granular data by the Parties to [a consultant]. The Parties have annexed [a third party's] report at **Annex_001V.2_001**. The input provided by [a consultant] to [a third party] for the purposes of this analysis (together with the underlying model) is provided at **Annex_001V.2_003** and **Annex_001V.2_004**.

B. [A third party's] analysis is a highly conservative sensitised view and cannot be ignored

(213) The CMA does not explain why [a third party's] sensitised total is dismissed. The PFs note [a third party's] submission that: "*our sensitised view identified during our review is unlikely to be a reasonable guide to the ultimate financial impact of Sainsbury's and Asda implementing the Synergy Plan*." [123] This submission reflects the fact that [a third party's] assessment represented a conservative view at a particular period of time (with the synergies ultimately realised likely to exceed [a third party's] estimate).

(214) The Parties argued that the WP misinterpreted [a third party's] methodology and remit (and thereby failed to account for the conservatism inherent in [a third party's] sensitised total). [124] [A third party's] review had a very specific purpose – to assess whether there was at least £500m net synergies available for shareholders, to support a statement to shareholders about the anticipated synergies. Similarly, as [a third party] explained to the CMA: "*A potential initiative graded 'D', 'C' or 'B' is not necessarily 'worse' than one graded 'A'; it is simply, in our opinion, at an earlier stage of development reflecting the limited access*

[123] PFs, paragraph 16.29.

[124] The Parties' response to the Efficiencies WP, paragraphs 106 – 113.

to data and personnel and are based on less verifiable evidence at this point in time".[125] As such, [a third party's] initial assessment presented a view at a particular period of time. As further data is made available, [a third party] would typically expect that initiatives would improve in terms of their illustrative gradings (and the sensitised total would increase). This has now occurred, as explained above.

(215) These two factors imply that [a third party's] sensitised view represents a highly conservative view of [a consultant's] synergies case (and de-risks [a consultant's] analysis to reflect the uncertainties considered by the CMA). It does not follow that [a third party's] analysis is irrelevant for the CMA's assessment, rather it should be highly informative for the CMA's review as the lowest plausible bound for the appropriate synergies credit.

C. The CMA's dismissal of the Parties' quantified synergies case is inconsistent with the standard of proof

(216) The [consultant]-calculated efficiencies total meets any reasonable application of the Phase II standard of proof. Given the additional conservatism embedded in [a third party's] synergies total, the CMA's dismissal of [a third party's] assessment represents an unreasonable assessment of the evidence (particularly given that the CMA does not have significant expertise in the quantitative evaluation of synergies).

(217) The OFT has noted that the standard of proof for efficiencies: "*is based on probabilities, not certainties*."[126] In *Asda/Netto*, the OFT explained its reasons for accepting the Parties efficiences claim was as follows: "*The key to this reasoning is that the OFT considers that the underlying rationale for the buying synergies…is compelling and that the evidence submitted in internal documents is of a high standard. Indeed, these expected benefits were key in approving the transaction*".[127] In the present case (based on the Phase II test rather than Phase I), buying synergies are just as "compelling" to the transaction rationale and the evidence produced by [a consultant] and [a third party] is of a high standard.

(218) In rejecting the Parties' quantified efficiencies claim, the CMA is applying a standard of proof higher than is required to safeguard shareholders under the Takeover Code. No pre-merger assessment of efficiencies can ever be free of uncertainty; however, [a third party's] report was prepared in accordance with the methodologies and standards which would apply if the proposed announcement of synergies was covered by Rule 28 of the Takeover Code, a very high standard of conservatism, designed to provide shareholders with as much certainty as possible that the promised benefits will materialise.

(219) [A third party] has found approx. £[✂] of synergies to be "'*suitable for public disclosure by the client without risk adjustment and reporting by us without qualification*". To completely disregard the independent assessment of [a third party] (with extensive experience in this area), is an unreasonable assessment of the evidence on any analysis and is inconsistent with burden of proof in assessing efficiencies claims in Phase II mergers.

III. Other sources of evidence strongly support the existence of significant synergies and have been misconstrued by the CMA

(220) The PFs concede that other evidence in the case supports the existence of purchasing synergies[128]. As a preliminary point, the Parties agree that that the other evidence in the case firmly corroborates the existence of significant purchasing synergies. However, the Parties consider that it is unreasonable (and

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125 [A third party] Report, as explained in paragraph 109 of the Parties' Response to the Efficiencies WP.

126 OFT, *The completed acquisition by Global Radio UK Limited of GCap Media plc*, ME/3638/08, decision of 8 August 2008, paragraph 148.

127 OFT, *Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited,* ME/4551/10, decision of 20 October 2010, paragraph B.25 ("**Asda/Netto**", attached as **Annex_005_003**)

128 Paragraph 16.101 of the PFs states "*we consider there is other evidence available which supports an expectation that some degree of procurement savings would be available*."

inconsistent with the burden of proof) for the CMA to substitute its own judgement for the fact-specific empirical analysis of two retail industry specialists. Moreover, the CMA's use of the comparators cited at paragraph 16.129 is fundamentally flawed (and systematically biases down the CMA's assessment of efficiency credit for the Proposed Merger).

A. The CMA's estimate of the benefit from increased scale supports the Parties' submission but is downweighted inappropriately by the CMA

(221) The CMA has undertaken a detailed analysis of the likely benefits that would arise from the Proposed Merger from increasing volumes. The PFs note that this analysis applied to the Proposed Merger shows a reduction in COGs of roughly 2%, equivalent to (variable cost) efficiency gains of £[✂] million.[129] These would result from a mix of increased buyer power and economics of scale. This corroborates estimates from similar analysis undertaken by the Competition Commission (CC) in 2008, which, when applied to this case, the CMA indicates would be equivalent to variable cost reductions of £[✂] million.[130]

(222) The CMA has used this as one of the four key pieces of evidence used to inform its provisional efficiency conclusion of £400 million, which is significantly below the results of its own analysis. For the reasons set out below there is no good reason for the CMA to downgrade the estimate of the efficiency gains arising from the Proposed Merger of at least £[✂] million based on its own analysis. [✂].

(223) The response provided here is necessarily limited to the partial information the CMA has provided into the confidentiality ring and from the more detailed summary of the CC analysis[131] (the CMA states that their "*approach follows that used by the CC in 2008*"[132]).

1. The CMA's erroneous calculation understates the benefits

(224) It is unclear from where the CMA has obtained its £[✂] million estimate. Based on a procurement share change from 15% to 30%, the COGs saving is estimated to be 2.08%, which, when applied to COGs of £[✂] billion, gives a COGs saving of £[✂] million. The CMA has rounded down to 2% but, even on this basis the COGs saving is over £[✂] million, [✂] £[✂] million reported by the CMA.

2. The CMA's assumed 'upper bound' is contrary to the evidence available

(225) The CMA argues that the £[✂] million is best interpreted as an 'upper bound' of the strength of the relationship between volumes and costs leading them to downgrade the efficiency credit granted to only £400 million. The CMA argues the downgrade is justified because it is likely that factors affecting costs that are unobserved and not taken into account in their analysis (such as logistical arrangements and bargaining skills) are positively correlated with size. As a result, according to the PFs, the CMA's analysis may overstate the relationship between procurement volumes and costs.[133]

(226) The CMA provides no evidence to support its provisional conclusion that these unobserved factors are likely positively correlated with size. It is unclear why this would be the case and, without any evidence, is a tendentious conclusion for the CMA to draw:[134]

(a) **Bargaining and negotiating skills** should not vary by size.

(b) The **legacy of accounts** should not vary by size.

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[129] PFs, Paragraph 16.72

[130] Efficiencies WP, paragraph 64.

[131] CC, *Groceries Market Investigation*, 30 April 2008, Appendix 5.3.

[132] PFs, Appendix L, paragraph 6.

[133] See PFs, Appendix L, paragraph 4.

[134] Other reasons highlighted by Tesco to the CC were quick payment and efficient processes. Again, there is no *a priori* reason for these to vary systematically by size.

(c) While at first sight, **logistical and delivery arrangements** may have some scope to vary by size (e.g. more efficient use of fleet or better terms from a third party logistical provider), in practice these are just as likely to be driven by other reasons, for example, retailer coverage of rural areas, which are more costly to serve, or the geographical concentration of the store portfolio (the smaller the retailer, the more geographically concentrated they may likely be, which is confirmed by the greater geographic concentration of the smaller retailer in the CMA's sample).

(d) The **demand profile of customers** in a given retailer is also a possible unobserved factor noted by the CMA:[135] suppliers might grant lower prices to retailers whose demand for products is more price elastic (e.g. because the customers served by these retailers have different preferences or because these retailers have better own-brand products in the relevant categories). Evidence such as OC&C analysis of Customer Quality and Perception rankings (and third party feedback quoted in the PFs) confirms such differentiation in the CMA's sample. This suggests the CMA's analysis significantly underestimates the extent of the benefits as, contrary to the CMA's speculative assumption, this unobserved factor appears negatively correlated with size.

(227) The CMA has also ignored its own findings in its review of Asda's acquisition of Netto, which showed, [✂].[136]

(228) Following repeated requests, the CMA provided the data underlying its analysis into the confidentiality ring. While the Parties have had limited time to review this, two points stand out:

- [✂]
- [✂]

(229) In summary, the CMA's estimate when properly calculated should be £[✂] million. Further, it has provided no evidence to support the relationship between procurement volumes and costs being overstated. [✂].

3. The CMA's arbitrary procurement share assumption significantly underestimates the savings from its model

(230) The CMA's analysis uses branded SKU-level data across a range of grocery categories to estimate a relationship between procurement volume and cost. The CMA's analysis shows that this relationship is strong and that the relationship is stronger the lower the starting (or pre-Merger) share. The CMA applies the results of its analysis to an assumed uniform increase in procurement share across all product categories from 15% to 30% to obtain its results (a 2% reduction in COGs and efficiencies of £[✂] million).

(231) [✂]

(232) The Parties provided the CMA with detailed procurement share estimates[137]. These show the Parties have a combined share of [✂]% (Asda: [✂]%; Sainsbury's [✂]%). They also showed product category procurement shares, all of which are below the CMA's assumed starting share of 15% and many significantly so. These product category shares have been provided again below in Table 8.

(233) As the CMA has never challenged these procurement share estimates (which were the product of a detailed and robust methodology), the CMA cannot assume a procurement share change from 15% to 30% without any evidence provided to support this and without any challenge to the Parties' own

[135] See Efficiencies WP, paragraph 50(a).

[136] *Asda / Netto* at paragraph B.3 (attached as **Annex_005_003**).

[137] See Merger Notice, paragraph 598 and the Parties' Response to the Buyer Power WP, paragraph 60.

estimates.[138] This point was raised with the Panel Members in a discussion at the Sainsbury's Oral Hearing where the Panel Members acknowledged the variance in procurement shares.[139]

(234) Using the data released by the CMA into the Confidentiality Ring [✂].

(235) [✂]

(236) [✂]

(237) [✂]

Table 8 Market shares by product category, value-based 2017[140]

Product category	Sainsbury's	Asda	Combined	COGs saving implied by CMA analysis	Combined COGs (£m)	COGs saving (£m)
Bakery	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Meal Solutions	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Meat Fish & Poultry	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Produce	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Canned & Packaged	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Dairy	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Frozen	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Impulse Food	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Baby & Beauty	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Beers, Wines & Spirits	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Household & Pet-care	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Kiosk & Tobacco	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total / weighted average	-	-	-	[✂]	[✂]	[✂]

(238) Clearly, the slope of the regression line in the CMA's analysis may differ for Asda and Sainsbury's, the intercept for either or both Asda and Sainsbury's may not be the same as the sub-industry average (although given the CMA has only used six retailers these may not be significantly different), and the relationship within product categories will be different.

(239) Given the CMA's flawed assumptions regarding the Parties' procurement share noted above, the CMA's analysis significantly underestimate the benefits arising from the Proposed Merger. Using £[✂] million as

138 [✂]

139 Sainsbury's Oral Hearing transcript 19 December 2018, page 90.

140 These shares are those presented at Tables 16 and 17 of the Merger Notice. Combined shares do not add to the sum of those for Sainsbury's and Asda due to rounding.

an input to the CMA's provisional efficiency estimate will significantly understate the likely gains and indeed this updated analysis also confirms that the CMA's preliminary conclusion of £400 million in efficiencies is well below what would be expected to arise from the Proposed Merger.

B. CMA's analysis of historical transactions is flawed

(240) Comparators with historical transactions form the basis for three of the four comparators used by the CMA to calculate a synergies credit of £400m. Correcting for the CMA's errors of interpretation, these historical comparators (which demonstrate that harmonisation benefits have been consistently delivered) do not suggest that the scale of synergies for the Proposed Transaction are inconsistent with historical transactions. Moreover, there are compelling reasons why the purchasing synergies are expected to be higher in the present case.

1. The CMA repeatedly misrepresents evidence from [a third party]

(241) The CMA continues to incorrectly compare the Parties' gross (and confidential) unsensitised synergies with the *announced and sensitised* synergies from comparator transactions. This is flawed as it is not a like-for-like comparison: sensitised estimates should be compared with sensitised estimates.

(242) As a preliminary point, the CMA argues that, while Parties have provided examples where synergies have been over-delivered,[141] actual synergies can be either higher or lower than the original estimate and there is no "*evidence of systematic over-delivery*."[142] The CMA references a single McKinsey (US) article from dating from 2004 (based on a survey from 2002).[143] Leaving aside the fact that the evidence is 17 years old, it acknowledges that cost synergies are delivered in most cases, especially if they are calculated in a detailed 'bottom up' way as for the Proposed Merger. The PFs' unsubstantiated assertions and reliance on historic consultancy articles in this regard is not consistent with a robust assessment.

(243) The CMA also fails to recognise (as explicitly as it did in the WP) that publicly announced synergies are typically conservative, given statutory shareholder disclosure requirements and the reputational impact of under-delivery. In [a third party's] extensive experience, companies invariably announce synergies targets that are conservative compared to their gross estimates. For this reason, [a third party's] report also analysed the total announced synergies for the Proposed Merger against the *total announced synergies* in historical transactions. This is noted in the blue box at p.34 of [a third party's] report at: **Annex_001V.2_001**.

(244) To support its analysis of historical transactions, the CMA appears to place weight on the fact that a similar comparison of historical transactions was undertaken by [a third party].[144] However, [a third party's] analysis of the synergy plan was carried out considering the specific synergy savings calculated by [a consultant] and therefore did not consider these historical transactions directly as part of its sensitised assessment (given the inherent difficulties with this analysis noted above).

(245) The CMA also places weight on [a third party's] comparison of similar retail clean room analyses to show that the synergies' total estimated as arising from the Proposed Merger exceeds that in similar exercises: "*The Parties' estimations of savings on matched spend was [✂]% (even excluding Beyond Best Terms contribution), which was more than twice the average ([✂]%) and substantially higher than the maximum included in the comparator set ([✂]%).*"[145]

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141 Proving "systematic" over-delivery is impossible given that companies do not report on delivery against their gross synergies targets.

142 PFs, paragraph 16.61.

143 McKinsey "*Where mergers go wrong*", May 2004, available at: https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/where-mergers-go-wrong

144 PFs, paragraph 16.53.

145 PFs, paragraph 16.56(a).

(246) The CMA's assessment in this regard contains a serious misinterpretation of the relevant material provided by [a third party]. The comparator benchmarks cited by [a third party] are from other retail clean room exercises that include matched SKUs across <u>both own-label and branded SKUs</u>. In the Parties' synergy plan, matching was only undertaken for own-label SKUs. In general, as synergy savings (in percentage terms) on own-label products tend to be higher than those of branded products, it is entirely to be expected that the Parties' estimated savings on matched SKUs would be higher than in comparator transactions. This is explicitly noted in [a third party's] original report: "*matching was only carried out for own label SKUs, which typically achieve higher savings than their branded equivalents*." [146]

(247) Indeed, the blue-dotted boxes in the figure on page 28 of the [a third party] report focusing on comparators C and D (see below) highlight that the percentage savings on matched own-label SKUs for these two comparators were [✂]% and [✂]% respectively (i.e. stripping out the branded SKUs within comparators C and D). As per [a third party's] analysis, the most appropriate comparison is against these [✂]% and [✂]% values – i.e. the Parties' value ([✂]%) is within the range of these comparators[147].

(248) The erroneous nature of this analysis has been explained to the CMA on multiple occasions, specifically in the Parties' response to the WP (including the submissions by [a third party]) and was explicitly drawn to the CMA's attention in the Parties' response to the relevant put-back extract on 15 February 2019. The CMA has not explained why it continues to ignore the Parties' submissions on this point. As such the comparator used by the CMA at paragraph 16.129 based on a comparison of percentage saving on matched spend reflects a fundamentally flawed analysis.

Figure 7 Matched level SKU spend from [a third party] analysis[148]

[✂]

(249) Moreover, [a third party's] report also demonstrates that the savings assessed in its sensitised analysis as a proportion of baseline spend (at [✂]%) is within the range of comparators reviewed.

2. The CMA's comparison with historical transactions understates the potential gains from the Proposed Merger

(250) An estimate based to such a large extent on comparisons with other transactions will be subject to considerable limitations, particularly compared to the detailed estimates produced by [a consultant] and sensitised by [a third party]. The CMA notes that other analysts undertook similar comparisons, but at least one analyst (Jefferies) expressed similar misgivings regarding the probative weight that of such a comparison: "*there are very few scale deals in the food retail industry that can be used to put this target into better context"* and "*the context that can help arrive to a credible gross number is virtually non-existent (AD [Ahold Delhaize] being the only group that clarified a gross of €750m vs a net of €500m)*".[149]

(251) Nevertheless, taking this approach as given, the CMA misrepresents the evidence from comparator transactions, which significantly underestimate the potential gains from the Proposed Merger.

(252) First, the PFs consider *Ahold / Delhaize* to be a particularly instructive comparison given that it explicitly announced an expected value of <u>gross</u> synergies of €750m (as opposed to net synergies).[150] However, this does not account for the fact that the comparison that the CMA makes is against a <u>publicly-announced</u> gross figure of €750m, which is therefore still likely to be conservative. As outlined previously, publicly

146 [A third party] Report,13 July 2018, at slide 28 (attached as **Annex_001E_029**)

147 [✂]

148 See [a third party] Report, 13 July 2018, page 28.

149 Jefferies, "*J Sainsbury: WalXit or StuckMart?"* (11 May 2018) page 4, attached as **Annex_004B_071**.

150 PFs, paragraph 16.54.

announced synergies are typically conservative. In [a third party's] experience, companies invariably announce synergies targets that are conservative compared to their gross estimates.

(253) Second, the CMA notes that no two transactions are exactly alike, citing the fact that the Parties are planning to maintain separate brands (which may reduce the scale of synergies).[151] This is notwithstanding the fact that the merging parties also retained separate brands in *Ahold / Delhaize* (and indeed *Tesco/Booker* and *Coop/Nisa*).[152] Indeed, *Ahold / Delhaize* retained numerous separate brands within each territory in which it operated, including six brands in the U.S., three brands in Belgium, four brands in the Netherlands, and six brands in Central and South-eastern Europe.[153] If the CMA's logic is to be accepted, this should have curtailed the ability of the merging parties to realise purchasing synergies in *Ahold/Delhaize* to an even greater extent than for the Proposed Merger (where only two brands will be retained post-Transaction and in the same country).

(254) Third, the CMA entirely disregards the Parties' submissions setting out why the scope for purchasing savings is significantly higher than for *Ahold/Delhaize* due, first, to the significantly higher level of SKU and supplier overlap between Sainsbury's and Asda and, second, the much greater change in size of the firms in this transaction. To see this, note that *Ahold/Delhaize* was *<u>a cross-border merger involving operations in the Netherlands, Belgium, US and Central and Southern Europe</u>*.[154] Given the importance of national customer preferences and stocking influences (with recipes, packaging and standards varying from country to country) and consumer preferences in the grocery sector the *<u>level of overlapping SKUs and suppliers between Ahold and Delhaize would inevitably have been significantly less</u>*. The change in size where there are actual procurement overlaps was considerably less than the Proposed Merger. This also applies to the other comparator transactions where the change in scale and / or SKU overlap was significantly less, for example *Sainsbury's/Argos* and *Tesco/Booker*.

(255) Fourth, buying synergies account for a significantly larger component (c.[✂]%) of overall synergies in this deal than others (for example, Tesco/Booker's (only 48%), Morrisons/Safeway (only 33%)).

(256) For these reasons, the estimate for variable cost savings that the CMA cites based on *Ahold/Delhaize* at paragraph 16.129 is a significant underestimation of the savings for the Proposed Merger.

C. Third party supplier feedback supports the expectation of significant price reductions

(257) The Parties have serious concerns regarding the CMA's interpretation and representation of evidence received from third parties. As an initial point, the Parties have received limited visibility over the submissions by third parties (in particular large branded suppliers and the ex post analysis in Tesco/Booker). Given that this evidence forms part of the PFs conclusions on likelihood, this limits the Parties' ability to meaningfully respond and undermines their rights of defence.

(258) Concerns about the Proposed Merger from suppliers demonstrates that significant purchasing synergies are highly likely to occur and complaints from Tesco and Morrisons are indicative that these synergies will be rivalry-enhancing and pro-competitive, benefitting customers through price reductions.

(259) However, the third-party feedback summarised by the CMA clearly: (i) supports the existence of significant price differentials between Sainsbury's and Asda; (ii) shows an anticipation that harmonisation will occur (at least for small suppliers); and (iii) does not suggest that the potential for savings is systematically lower than the Parties' quantified synergies estimate may suggest (indeed, evidence from both small and large suppliers indicates that the opposite is true).

[151] PFs, paragraph 16.52(c).

[152] See the Parties' Response to the Efficiencies WP, paragraph 43.

[153] See the Parties' Response to the Efficiencies WP, paragraph 101.

[154] Around 32% of the stores and 61% of the revenue of the combined Ahold/Delhaize firm were in the US while 22% of the stores and 9% of the revenue was in Central and Eastern Europe, with the remainder in the Benelux.

(260) The CMA's assessment of supplier and competitor evidence misunderstands the relevant question. The Parties' quantified efficiencies case is not predicated on receiving the exact benefit from each supplier (as calculated by [a consultant]). Rather, the Parties believe that the [consultant] calculation is an accurate reflection of the benefits that will be achieved in aggregate across the supplier base. The CMA fails to adduce any quantitative evidence (either from suppliers or competitors) to suggest that the scope for purchasing synergies is systematically lower than the Parties' quantified synergies estimate suggests.

1. Smaller suppliers

(261) Feedback from smaller suppliers clearly shows a widespread expectation that the Parties will achieve lower prices and, significantly, that this will derive from the harmonisation of price terms.

(262) Of the 33 smaller suppliers that responded to the CMA questionnaire, 85% expected the Proposed Merger to have an impact on their supply terms, with over 80% expecting to receive lower prices for their products.[155] Moreover, the scope for harmonisation calculated by smaller suppliers is entirely consistent with the Parties' quantified synergies estimates. The weighted average of feedback from small suppliers indicates a reduction in prices of [0–5]%. [✄].

(263) Feedback from smaller suppliers also appears to contradict the CMA's position that there is limited scope for realising harmonisation benefits. Over [✄] of smaller suppliers anticipate that the Parties will receive not just some benefit from harmonisation, but the full value of the price differential.[156]

(264) The CMA attempts to downplay the evidence from smaller suppliers noting that these are generally "*indicative estimates of the expected outcome, rather than being supported by detailed analysis*" and that the evidence is based on a relatively small (and potentially unrepresentative sample).[157] The evidence from 5 large branded suppliers, however, is based on an even smaller and equally unrepresentative sample. These caveats are also not convincing given the extent to which smaller suppliers support the Parties' submissions. Given that smaller suppliers are likely to sell a smaller range of products, they may be able to give a more robust view of the potential scope for harmonisation.

2. Large branded suppliers

(265) Although the Parties have been given only very limited visibility over the submissions of large suppliers, it is clear that some of these suppliers believe that there is a significant scope for harmonisation.

(266) From the information made available, [✄] of the five large branded suppliers that provided detail of potential scope for purchasing synergies, believed that the scope for purchasing synergies [] than the Parties' estimates (up to 2.5-5 times that of the Parties in one case) [158]. This is not unexpected, given the deliberate conservatism applied in several aspects of [a consultant's] approach.

(267) The CMA states that its analysis suggests that there is significant variation in the calculations of third party suppliers compared to the Parties' estimates and that this undermines the validity of [a consultant's] assessment. Without details of the evidence and assumptions used by suppliers to estimate price reductions, the Parties remain unable to evaluate these claims. Although the CMA lists hypothetical reasons why supplier estimates may be robust,[159] it does not appear to have assessed whether in actual fact the methodologies underpinning the estimates it received were robust.

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155 PFs, paragraph 16.42.

156 PFs, paragraph 16.43.

157 PFs, paragraph 16.43.

158 PFs, paragraph 16.37.

159 PFs, paragraph 16.38(d)

(268) The Parties strongly dispute the CMA's contention that "*the Parties' public statements regarding their approach to harmonisation were clear and so should have an objective "correct" figure*"[160]. The Parties have not disclosed the methodology used by [a consultant] and it is clear from third party submissions cited in the PFs that suppliers have misunderstood the approach (i.e. they mistakenly believe that the Parties have not accounted for differences in promotional support).[161] The CMA further notes that "*these estimates were simply the direct comparison of the price differences*", which implies that suppliers may have employed a less robust methodology based on a simple SKU by SKU comparison, unlike the robust approach accounting for differing promotional structures employed by [a consultant].[162]

(269) Given that the CMA has consistently resisted the Parties' request for disclosure of the underlying evidence from large branded suppliers into the Confidentiality Ring, the Parties remain unable to meaningfully respond to the CMA's evidence.

3. Industry groups

(270) Feedback from industry groups suggests that the Combined Entity will be able to negotiate significantly reduced prices post-Transactions. For instance, the British Brands Group ("**BBG**") found that "*suppliers anticipate harmonisation of prices between the two businesses … The financial implications on suppliers are anticipated to be significant*", with trade differentials ranging from [✄]% at the upper end to [✄]% or no differences at the lower end.[163]

4. Issues raised by suppliers reflect a lack of insight into the Parties' methodology

(271) The PFs cite feedback from several suppliers regarding the Parties' ability to harmonise prices which clearly reflect a lack of understanding regarding the methodology employed by [a consultant].

(272) In relation to the comment that "*a number of these suppliers highlighted that differences in promotional approach could result in the Parties miscalculating these figures*"[164], the methodology used by [a consultant]. was precisely designed to fully account for differences in promotional funding (via the supplier methodology).

(273) Branded suppliers note that pure harmonisation of costs was unlikely without harmonisation of specifications. This will not reduce the scope for synergies for the following reasons:

- Firstly, [a consultant's] analysis is highly conservative with respect to aligning specifications (with only [✄] found to be matched).
- Secondly, many own-label products that are high-volume SKUs are very similar in specification (e.g. Granny Smith apples).
- Thirdly, own-label suppliers may obtain benefits without full alignment of specifications (i.e. product sources for common ingredients, production processes and logistics).
- Finally, there will be scope for harmonisation of specifications for certain own-label products across the Combined Entity post-Transaction.

5. Feedback from third party competitors is unsubstantiated and (at least for Tesco) is inconsistent with the evidence

(274) The CMA cites submissions from Tesco and Morrisons highlighting doubts over whether the synergies calculated by the Parties could be achieved. The Parties firmly believe that these submissions of competitors are best viewed as corroboration of the submission that harmonisation (and other) synergies

[160] PFs, paragraph 16.38(d).

[161] PFs, paragraph 16.34.

[162] PFs, paragraph 16.37.

[163] PFs, paragraph 16.45.

[164] PFs, paragraph 16.39.

are real, material, and recurring benefits which will lower the prices the Parties charge to customers, making the Combined Entity more competitive with these competitors – and it is this driving their tactical engagement with the CMA. The PFs acknowledge that the Parties' competitors may have specific incentives for engaging with the CMA.

(275) In this context, it is highly relevant that the submissions from Tesco and Morrisons that have been made available to the Parties are unsubstantiated by any empirical evidence. In particular, it is highly instructive that the CMA does not cite any quantitative evidence from Tesco/Booker implying that the harmonisation benefits obtained from suppliers were less than was estimated pre-merger. The Parties have repeatedly requested disclosure of a sufficient "gist" of the evidence submitted by Tesco into the confidentiality ring to test this point, however these requests have been consistently rejected.

(276) The only specific quantitative evidence disclosed in the PFs is that the synergies ultimately realised from each supplier in Tesco/Booker ranged from [✂]% of the pre-merger estimates. The CMA cites this as evidence that "*it was impossible to estimate with any accuracy the level of potential buying synergies at an individual supplier*" (including in its "conclusions" at para 16.93(b)). This evidence is meaningless absent any further context. For instance, based on the extract disclosed in the PFs, of 100 Tesco suppliers reviewed in this analysis 99 could have achieved estimates of [✂]% the initial estimate, with only 1 supplier achieving [✂]%.

(277) Significantly, this evidence provides no support for the proposition that it is impossible to estimate with any accuracy the <u>overall level</u> of potential buying synergies across the supplier base. Indeed, the fact that Tesco is successfully realising the expected harmonisation gains would appear to be supported by Tesco's public statements since the merger with Booker. For example, in its interim results in October 2018, Tesco announced that "*Booker delivering synergies; £16m in first half and on track to deliver at least £60m in full-year.*"[165]

(278) Tesco and Morrisons' qualitative criticisms of the Parties efficiencies are either unsubstantiated or are based on a misunderstanding of the Parties' quantified synergies case. Neither Tesco nor Morrisons are well-placed to comment on the feasibility of anticipated supplier synergies, as they have no visibility of the extensive evidence the Parties have put forward to support their claim. For instance, the Parties have explained to the CMA that although there ability to realise harmonisation benefits will be underpinned by enhanced buyer power, they will be able to offer a compelling growth story to suppliers.[166] These points were responded to at paragraph 87 of the Parties' response to the WP.

(279) It must also be recognised that while competitor submissions will clearly be self-serving, [✂].

D. The CMA disregards the Parties' proven track record in over delivering on synergies estimates

(280) The CMA disregards concrete evidence from relevant transactions demonstrating that the Parties have a proven track record in accurately forecasting and over-delivering on pre-transaction synergies estimates, notably for Asda's acquisition of Netto and Sainsbury's acquisition of HRG. This includes a demonstrable record in delivering harmonisation synergies from their own previous transactions.

(281) Sainsbury's purchase of Argos in 2016 demonstrates a proven track record in delivering synergies. Sainsbury's realised the publicly disclosed synergies estimate of £160m in FY18/19 [✂].[167]

165 Tesco Interim Results 2018/19, 3 October 2018, available at https://www.tescoplc.com/news/news-releases/2018/interim-results-201819/.

166 This was explained further in the Parties' Response to the Efficiencies WP.

167 The Parties' Response to the Efficiencies WP, paragraph 27.

(282) Similarly, the Asda/Netto transaction represents concrete evidence from a relatively recent supermarket merger involving one of the Parties and a meaningful test of the availability of variable cost purchasing synergies ([✂]) and the ability to deliver them. [✂].[168]

(283) The CMA appears to distinguish Asda/Netto (and indeed Tesco/Booker) on the basis that the harmonisation benefits will stem from bringing the bargaining power of a larger company (Asda) to bear on the supply terms for smaller company (Netto). The Parties fundamentally disagree that harmonisation benefits cannot be realised across two similarly sized companies. The Parties' quantitative assessment (corroborated by supplier estimates) demonstrates the existence of significant price differentials between the Parties. Post-merger, the Combined Entity will be twice the size and have significantly greater negotiating strength to leverage to ensure harmonisation of terms. This is consistent with the recent example of Ahold/Delhaize, where harmonisation benefits were realised (and indeed over-delivered) despite the fact that the merged parties were similarly sized.

IV. Benefits from harmonisation are misconstrued

(284) The CMA misrepresents the Parties submissions on purchasing efficiencies, drawing a false distinction between harmonisation on the one hand and buyer power on the other as if the two are independent.

(285) The CMA notes that: "*the Purchasing Synergies Analysis relies on a harmonisation approach to support the large majority of the £[✂] figure… it provides no indication of the post-Merger outcome of increased scale. The relatively small contribution from BBT… does not and is not designed to reflect the full extent of post-Merger changes in buyer power*." The CMA dismisses the long-run impact of buyer power by suggesting that the Purchasing Synergies Analysis rely instead on harmonisation alone and, as the information transfer associated with harmonisation is a one-off transfer, this benefit does not persist. The CMA argues that the benefits from the information transfer dissipate relatively fast.

(286) Harmonisation and buyer power cannot be considered separately. As outlined in the Response to the WP, while the efficiencies are initially facilitated by information transfer, the gains harmonisation is made possible through the increased scale of the Combined Entity and the loss of an outside bargaining option for suppliers in the negotiating process, giving the Combined Entity significantly greater negotiating leverage. The increased scale and greater negotiating strength will persist and will ensure the gains from harmonisation are sustained.[169]

(287) At the point of harmonisation, it should be uncontentious that a large, more significant customer (such as Tesco following its Booker acquisition) is better able to deliver harmonisation of terms (on equivalent products) compared to a smaller retailer (such as Co-op following its acquisition of Nisa).

(288) Following harmonisation, the recurring benefits inevitably depend on the Parties' negotiating strategy, including increased buyer power and scale. The CMA claims that the benefits from harmonisation disappear in the medium term as negotiations revert to prior to the Proposed Merger albeit with increased scale.[170] This misses the point. The negotiations never revert to 'prior to the Merger' exactly because of the buyer power and increased scale. For the CMA to state that "*there are no structural changes to allow this improved information to continue*" ignores the structural change represented by the Proposed Merger itself, involving a near doubling of procurement volumes. Harmonisation resets the "baseline" price for future negotiation. Suppliers may try to claw back lost margin over time but they will have lost a significant outside option and will be facing a buyer with enhanced purchasing scale. There would be significantly more risk in not reaching a successful negotiation as they now stand to lose double the volumes. The

[168] The Parties' Response to the Efficiencies WP, paragraph 28.

[169] The Parties' Response to the Efficiencies WP, paragraph 68.

[170] PFs, paragraph 16.45(b).

process through which harmonisation, and subsequent negotiation, occurs shows that the gains estimated through the Purchasing Synergies Analysis apply to estimating recurring benefits.

(289) This was taken into account in [a third party's] analysis of the long-run gains, based on previous experience. [A third party's] review was to a requisite standard for informing shareholders of the long-run gains resulting from the Proposed Merger (as noted on page 41 of [a third party's] updated report). The CMA's approach assumes [a third party's] analysis – and standard practice in analysis of harmonisation in other retail mergers, including *ex-post* analysis of the delivered benefits – is erroneous because it mistakenly extends harmonisation benefits that are one-off into multiple years.

A. Lack of evidence supporting the CMA's claims

(290) The Parties' senior management would not have approved the transaction if they did not consider that the quantified synergies to be annually recurring benefits, nor would they have publicly committed to £1 billion of annual price investment by year 3 (starting with an advance cheque prior to synergies realisation of £300 million in year 1). Sainsbury's and Asda have some of the most experienced negotiators in the UK grocery sector and firmly believe harmonisation benefits to be annually recurring. The CMA suggests its concerns are well founded but provides no evidence to support that harmonisation results in a one-off benefit:

- Aside from one statement from the FDF, no evidence is cited from suppliers (either large suppliers, smaller suppliers or branded suppliers) to suggest that harmonisation would be a one-off benefit. Conversely, [a consutlant's] interviews provided evidence that suppliers consider harmonisation to be an enduring benefit.
- The Parties' previous experience indicates that the gains from harmonisation are recurring and provide benefits over the long term. [✂].[171]
- No supportive evidence is cited from competitors. Tesco and Morrisons each flag a significant number of potential issues with the Parties' quantified efficiencies case, but neither of them suggests that harmonisation benefits would represent a one-off benefit.
- Harmonisation benefits are consistently identified as a synergy in the European retail context, with clear evidence of delivery. There is no evidence from these cases to suggest that harmonisation is a one-off benefit.
- The CMA is also taking an entirely inconsistent approach compared to previous cases where it has recognised and given credit for similar harmonisation benefits.

(291) The CMA suggests that these examples are not good precedents given that they involved a large company acquiring a substantially smaller company.[172] The Parties dispute that this is the case, noting that there is also a track record of harmonisation synergies being delivered between two similarly sized companies (e.g. *Ahold / Delhaize*, where estimates were exceeded).

B. CMA misunderstands the negotiating process

(292) The CMA dismisses circumstances in which the Parties could avoid renegotiation by transferring purchasing volumes to the more favourable contract terms, noting "*several potential challenges with this approach*."[173]

(293) Supplier E directly contradicts the CMA by explicitly supporting the Parties submission:

[171] The Parties' Response to the Efficiencies WP, paragraph 69.

[172] PFs, paragraph 16.103.

[173] PFs, paragraph 16.94

Supplier E stated that, in previous cases, the scenario was similar. Supplier E stated that they are concerned that this may happen with the merger between Sainsbury's and Asda, by which ***Sainsbury's may look to draw the stock in themselves and redistribute it to Asda, with Asda taking Sainsbury's cost price without having to negotiate***."[174]

(294) These corroborating views provided by Supplier E have been ignored by the CMA. The OFT also accepted this could occur in Asda/Netto. Instead, the CMA has relied on six unsubstantiated arguments, outlined in paragraph 16.94, to support its claim. Aside from the lack of evidence supporting these claims, many of these confirm a lack of understanding of the negotiating process.

(295) The approach taken with suppliers, will vary depending on the existing supply arrangements the Parties have with a supplier and their negotiating strength with that supplier.[175] [✂].

(296) The claim that differences in packaging would preclude increasing existing volumes is incorrect and misunderstands the negotiating process for own-label products. Packaging and rebranding represent a very small component of production costs ([✂]) and have no material impact on the production process (for example, not typically requiring additional capex or a separate line). [✂].

(297) It is also unreasonable of the CMA to argue that the Parties have provided no estimates of the installed and spare capacity of suppliers.[176] Unless there are specific arrangements with the supplier [✂]. Nevertheless, the Parties are aware that in many instances suppliers will have factories that involved significant capex and would welcome the opportunity to spread their fixed costs over larger volumes. The Parties respectfully suggests the CMA can ask suppliers this question themselves.

(298) For the CMA to question why the Parties would initially renegotiate (16.94(a)) or to highlight that doing so may lead to inefficiencies for the Parties (16.94(f)) is disingenuous. The Response to the Efficiencies WP made it clear [✂].

(299) The CMA also argues that the complexity of pricing structures makes harmonisation difficult.[177] This is incorrect. The Parties understand why suppliers' initial responses to the CMA have been as they are: these are the initial response the Parties' buyers would also expect from suppliers at the start of the (re)negotiation process. However, as the CMA has demonstrated in its own analysis, it is relatively straightforward to calculate a net price. The funding a supplier provides can typically be allocated back to a product quite easily. Suppliers will allocate a level of funding and, regardless of how this might be split (e.g. between unit costs and promotional support), comparison across terms is relatively straightforward.

(300) The CMA raised the example where promotional activity may not allow for harmonisation. If Sainsbury's promotes Persil (lower supplier prices, lower retail prices, higher volumes) and Asda promotes Ariel, harmonisation is not possible because both Asda and Sainsbury's cannot promote both.[178] This misunderstands how negotiations occur. If we assume the example is true: Asda sells 1,000 Persil and 10 Ariel and Sainsbury's 10 Persil and 1,000 Ariel, Sainsbury's gets better terms on Persil from Asda but the volumes obtaining Asda's lower cost are minimal (this is accounted for in the Parties' analysis). If significant volumes transfer from Ariel to lower-priced Persil, Ariel will be incentivised to offer lower prices so that it does not lose volume. The CMA must take account of the dynamic nature of conversations with suppliers.

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174 Summary of hearing with Supplier E held on 12 November 2018, paragraph 11.

175 The Combined Entity will comply with GSCOP post-Transaction.

176 PFs, paragraph 16.94

177 PFs, paragraph 16.45

178 "You cannot run promotions and offer gondola ends to everyone", John Thanassoulis, Sainsbury's Oral Hearing, 19 December 2018, transcript, page 76.

(301) In summary, contrary to the CMA's assertions, [✂]. Concerns that the complexity of the different pricing structures operated by both Parties limit the extent to which harmonisation can occur are misplaced and misunderstands the negotiating process.

V. The Purchasing Synergies Analysis is robust and the CMA's concerns misplaced

(302) The PFs assert that [a consultant's] purchasing synergies analysis did not adequately account for alternative explanations for apparent differences in cost prices between the Parties.[179] Many of these concerns – for example, relating to extrapolation, use of limited data, use of bespoke price indices in GM – have been addressed in the updated [third party] sensitised analysis (based on additional work undertaken by [a consultant]). See **Annex_001V.2_001.** These updated results confirm that earlier concerns raised by the CMA were misplaced as the updates have led to minimal changes in overall savings (overall gross synergies have increased by £[✂] (excluding fuel). As a result, the Parties only focus here on those residual areas of concern highlighted by the CMA in its PFs.

A. Residual differences in underlying products are minimal

(303) The CMA raises concerns that the criteria used by [a consultant] to identify matching own label SKUs is not sufficiently conservative as, first, products identified as matches may still be distinguishable to the customer and, second, there may be other factors important to the customer that are not captured by the criteria used.[180] These concerns are unsubstantiated.

(304) The Parties have provided additional data below to demonstrate that the matching criteria is precise, and the results are not sensitive to variation within the criteria used. In its latest analysis, <u>[a consultant] [✂].</u> The differences in cost cannot therefore be attributed to a difference in size or quantity, but instead reflects differences in commercial terms.

(305) [A consultant] acknowledged the challenges in matching complex products such as ready-meals and reflected this in the analysis: the matching rate is much lower on ready-meals. [✂].

(306) [✂]

Figure 8 Examples of matching approach for ready meals

[✂]

(307) Furthermore, it is not clear that there are a greater number of product criteria which customers care about than was included in the [consultant] matching exercise. In a number of categories (particularly in Produce, Fish & Meat, Dairy, Frozen food), a single SKU will be sourced (indirectly in many cases) from different growers / farmers from different regions of the world to meet demand throughout the year, and therefore marginal differences in products inherently exist and customers tolerate them.

(308) A key focus of [a third party's] review work was to ensure that the matching process was accurate and have significant experience doing this, particularly in grocery retail and including on the *Tesco/Booker* and *Coop/Nisa* cases. Where [a third party] did not gain significant comfort form the process followed by [a consultant], the estimates were discounted appropriately.

(309) More generally, the CMA misunderstands the process through which harmonisation in own label would occur, which confirms the [consultant] estimates are highly conservative. [✂].

(310) Second, the negotiating process is likely to result in greater alignment and convergence of product specifications that is not fully captured by [a consultant]. A given product may have different specifications (e.g. due to quality, sourcing standards). [✂].

[179] PFs, paragraph 16.90

[180] PFs, Appendix M, paragraph 52.

B. There are no significant differences in costs to serve the Parties

(311) The cost to serve both Parties are very similar and the CMA has provided no evidence to suggest they are significantly different. [A consultant] inspected a number of elements to establish an appropriate methodology to estimate the benefits. Any difference in level of service (for example, whether produce is supplied loose or pre-packed) has been captured in the [consultant's] methodology.

(312) The CMA notes Tesco's submission that differences in prices will reflect different costs to serve.[181] While this may have been true of two very different retailers such as Tesco / Booker, the Parties do not anticipate any significant differences in the costs to serve each Party. [✄].

(313) Second, possible differences in cost to serve are mainly relevant for Fresh Food, which is primarily own-label and was assessed via the SKU approach. When matching SKUs, [a consultant] included pack size (and therefore that the item was packed) in its matching criteria. [A consultant] inspected the treatment of coupons, foreign exchange rates, prior year accounting adjustments and waste. The results of this assessment are provided in **Annex_001V.2_003.**

(314) Third, the illustrative example of how differing promotional strategies may affect retailer margins does not reflect reality. It is unclear what the CMA is seeking to prove with the example. Buying efficiencies relate to the merged firm achieving better terms from a supplier due either to an improved bargaining position (as a result of more information and/or more volumes) and/or reductions in supplier's own costs due to dealing with one buyer instead of two. The CMA example rules either of these out:

(i) The supplier does not make any profit from supplying A and B so it is impossible to extract more from the supplier via any improvement in bargaining position.

(ii) There is no reduction in the supplier's fixed costs from dealing with one buyer instead of two.

(315) These two factors mean that the merger cannot lead to improved terms of supply for the retailers. It is no surprise then that an estimation methodology that is designed to estimate improved terms will lead to suppliers making losses. The example is simply not applicable to the harmonisation process.

(316) The CMA also assumes that the supplier has the same fixed cost (i.e. 50) for both retailers despite selling 300 units to retailer A and 200 units to retailer B.[182] Typically, suppliers do not allocate their fixed costs evenly across retailers irrespective of volume purchased by each retailer. Fixed costs are generally allocated across total volume (all retailers), and therefore fixed costs end up being the same per unit across retailers. The example highlighted by the CMA relies on an incorrect and unrealistic allocation of fixed costs.

(317) The CMA cannot rely upon tendentious and extreme examples that are detached from reality. If the product supplied is broadly the same (i.e. no mix effects and no difference in average variable cost of the supplier to serve the two retailers pre-merger), and taking account of volume consolidation and likely alignment of specifications, assuming that average COGs for the merged firm will be the lower of the two pre-merger average COGs is an entirely reasonable approach, which, as noted previously, addresses any concerns around differing promotional support.

C. "Serious concerns" about mix of products are entirely misplaced

(318) The CMA's concerns regarding the mix of products are misplaced.[183] *There is no clear systematic bias introduced by mix effects*. It is entirely unclear why a different mix of products would necessarily amplify the difference in margins compared to the difference in average margins with a fixed basket. It seems

[181] PFs, paragraph 16.48

[182] PFs, Appendix M, paragraph 61

[183] PFs, Appendix M, paragraph 76

that such product mixes could be just as likely to dampen the difference in margins compared to the difference in average margins with a fixed basket.

(319) Furthermore, regressions analyses conducted by [a consultant] show that the mix of the two Parties are similar so that if there is any bias in a direction that would concern the CMA, it is likely to be extremely small. As noted previously, [a consultant] included on [✂], and the R-squared and adjusted R-squared of the regressions are very close, reflecting the high number of observations (as shown below), and therefore the r-squared calculated by [a consultant] are a reliable indicator of similarity in mix.

Figure 9 [✂][184]

[✂]

(320) The CMA has presented a very extreme example, which is not representative. While carefully managing to create an R^2 above that from the [consultant] result based on a 100% SKU overlap, [✂]. As before, for the CMA to construct extreme examples that are detached from reality is unreasonable and misrepresentative of the evidence before it.

(321) The CMA has raised three concerns regarding this assessment that biases associated with mix are likely to be very limited, all of which are misplaced:

(322) First, the CMA indicated that a supplier had a high r-squared despite 40% of its SKUs not sold at Sainsbury's.[185] As explained in the Parties' Response to the WP, the relevant supplier ([✂]) generates the majority of its sales with the Parties on own-label SKUs, which by definition are exclusive. The mix analysis was conducted on branded spend only, as own-label spend is assessed separately via the SKU approach. Hence, the regression analysis conducted by [a consultant] includes almost all branded SKUs of that supplier and it reflects that the two Parties sell similar mixes of branded SKUs for that supplier.

(323) Second, the CMA flagged that no mix analyses were conducted on smaller suppliers.[186] [✂].

(324) This implies that a mix analysis is not required because differences in product mix would have almost no impact given that most SKUs have very similar gross margins.

Figure 10 [✂][187]

[✂]

(325) Third, the CMA flagged that no mix analysis was conducted on the category analysis.[188] It should be highlighted that the category approach is very conservative: it has been significantly down-weighted in the sensitised estimated and, more generally, because it operates at a more aggregated level it is more conservative than an approach that operates at a more granular level. The illustrative example below explains the reasoning behind this. When working at a granular level by calculating separately the benefit for each line (as per the supplier approach), the total saving equals six because the Parties can extract benefits from each supplier. However, when working at a more aggregate level (at the total level – as per the category approach), the benefit is only two because individual savings calculated at a granular level cancel each other.

Table 9 Example of category approach being more conservative at aggregated level

	Sales	COGS	Saving

[184] See Merger Notice, Figure 2.

[185] PFs, Appendix M paragraph 77.

[186] PFs, Appendix M paragraph 17.

[187] See Merger Notice, Figure 2.

[188] PFs, Appendix M paragraph 81.

	Retailer A	Retailer B	Retailer A	Retailer B	
A	100	100	90	92	2
B	100	100	92	90	2
C	100	100	91	90	1
D	100	100	90	89	1
E	100	100	90	90	0
Total	**500**	**500**	**453**	**451**	**2**

(326) As a result, the category approach is conservative, and the level of savings that could be generated is anticipated to be higher in a number of areas, which could offset any potential differences in mix.

VI. The CMA's conclusion on efficiencies is vague and counter to the evidence received in the case

(327) The CMA provisionally concludes that it is "*unable to place any significant weight*" on the Parties' quantified efficiencies case.[189] However, given the overwhelming body of evidence supporting the fact that the Proposed Merger will give rise to significant variable purchasing synergies, the CMA concludes that the appropriate figure to consider as rivalry-enhancing efficiencies would be £400 million.

(328) The CMA provides limited explanation for how it arrives at the figure of £400m. The CMA's 'back of the envelope' calculation results in an outcome which is vague, opaque (both to the Parties and third parties) and far less robust than the detailed empirical and case-specific analysis undertaken by two retail industry specialists.

(329) The quantification of £400m of synergies credit appears to be based on four comparators cited at paragraph 16.129. Each suffers from severe limitations (for the reasons explained in the above) and are likely to significantly underestimate the scale of synergies available for the Proposed Merger. Moreover, given that these comparators yield a wide range of potential synergies values, it is not clear why the CMA's synergies credit is at the bottom end of ranges quoted the available comparators for (i) and (ii) and below the range predicted for comparators for (iii) and (iv):

(i) Ahold/Delhaize: £[✂] million.

(ii) Comparison of percentage saving on combined baseline spend: £[✂] million.

(iii) Comparison of percentage saving on matched spend: £[✂] million.

(iv) Benefits of increasing purchasing volumes: £[✂] million.

(330) The PFs cite four "*specific circumstances*", which it implies warrants using an efficiencies credit towards the lower end of the range of comparators cited.[190] No attempt is made to quantify the impact of each of these factors. As explained below, this results in the CMA downscaling the efficiencies credit based on speculative and irrelevant countervailing factors, while ignoring compelling evidence of why the Parties' quantified synergies case is higher than in certain of the historical comparators cited.

189 PFs, paragraph 16.128

190 PFs, paragraph 16.130

A. The conclusion that the Parties' will adopt a "less cost-efficient structure" post-Merger is fundamentally flawed

(331) The CMA contends that "*by not fully integrating the businesses and brands (as generally occurred in other mergers), the Parties will reduce the potential for fixed cost savings but are also likely to affect procurement*".[191]

(332) The Proposed Merger involves a full merger of the procurement functions of both Parties . This is supported by the synergy plan reviewed by [a third party] which clearly shows central cost savings. The buying synergies that will result from bringing together procurement functions represent [✂]% of the Parties' total combined cost base) and such efficiencies offer much higher potential for savings than much smaller operational cost lines. The CMA's conclusion is unsubstantiated and directly contradicted by the historical cases cited.

(333) It is totally implausible to suggest that the Parties' will adopt a "less cost-efficient structure" than in Ahold/Delhaize. Ahold/Delhaize continued to operate separate propositions across multiple geographies (and nevertheless exceeded its original synergies estimate).[192] Similarly, Tesco/Booker achieved harmonisation synergies despite the retention of different brands and different channels.[193] The CMA clearly disregards evidence that would support a higher purchasing synergies potential compared to previous comparator transactions, notably the fact that the Parties are domestic competitors with a high degree of supplier and SKU overlap. [✂].

B. Dis-synergies are based on pure speculation and/or irrelevant considerations

(334) The dis-synergies arising from the Proposed Merger cited in the PFs, namely increased "*staff costs from harmonisation of employment terms, IT costs, and management distraction reducing focus on existing cost saving initiatives*"[194], are either speculative or entirely irrelevant to the CMA's analysis of the Parties' quantified synergies case. To downscale the Parties' synergies estimates based on vague and unsubstantiated dis-synergies is inconsistent with a robust assessment based on a "balance of probabilities" (in particular, the CMA should not apply a higher threshold to establish the existence of efficiencies on the one hand, and a weaker threshold for dis-synergies on the other hand).

(335) *Staff costs*: [✂]

(336) *IT dis-synergies*: [✂]

(337) *Ongoing BAU improvements*: the CMA cites the loss of "*counterfactual benefits*" as a potential dis-synergy, noting the potential for "*management distraction reducing focus on existing cost saving initiatives*." First, although the Parties are continuing to optimise and improve their existing operations, the purchasing synergies realised through harmonisation are above and beyond cost savings that could be achieved in the ordinary course. Allowances were made for BAU efficiency improvements when setting the base level for the synergies exercise.[195] [A third party] therefore concluded that "*as such, separation should not lead to any material adverse impact from an operational perspective*."

(338) Second, the CMA does not cite any evidence from internal documents or specific BAU initiatives to support its position. The majority of Sainsbury's BAU improvements relate to areas unrelated to purchasing (where the major part of the synergies will be delivered). Given that the Parties will continue

[191] PFs, paragraph 16.109.

[192] See the Parties' response to the Efficiencies WP, paragraph 101.

[193] See the Parties' response to the Efficiencies WP, paragraph 87.

[194] PFs, paragraph 16.111.

[195] [✂]

to operate separate brands post-Transaction, this will further limit the potential interruption to ongoing BAU work.

(339) Third, the absence of any evidence in support of the CMA's statements, must be set against the Parties' demonstrable track record of integrating acquisitions. Sainsbury's is currently delivering on HRG synergies ahead of schedule, while simultaneously executing BAU cost-savings programme. As the CMA acknowledges, Asda also successfully integrated Netto.[196]

C. The Parties have made a clear public commitment to £1 billion of annual price investment

(340) The CMA notes that the "*Parties have made a number of public statements which could impose conflicting incentives on their decisions on whether and where to invest any savings*"[197]. In particular, the CMA considers that the public commitment to deliver shareholder benefits trumps the Parties' clearly stated intentions to lower prices for customers (which forms a key part of the transaction rationale). The CMA also criticises the Parties' public statements regarding price reductions as qualified and difficult for consumers or consumer bodies to directly monitor or enforce.[198]

(341) As noted above and set out in the Parties' response to the NPR, these concerns are comprehensively addressed by the Parties' public commitment to lowering prices by £1 billion annually by the end of the third year, starting with a first year investment of £300 million. This commitment will be subject to independent review.

VII. Conclusion

(342) For the reasons set out above, the rejection of the Parties' quantified synergy case is an unreasonable interpretation of the evidence and is inconsistent with the standard of proof. While the Parties are confident of realising the £1.6 billion of synergies quantified by [a consultant], the CMA should at a minimum allow for an efficiencies credit of £1 billion. This reflects the Parties' public commitment to annual price investment and is also substantiated by [a third party's] sensitised analysis (using the highly conservative methodologies and standards which would apply if the announcement of synergies was covered by Rule 28 of the Takeover Code). While the CMA's use of comparators (as described in the PFs) is far less robust, when certain errors of interpretation are corrected for (particularly with respect to the CMA's pricing analysis) they firmly corroborate the existence of significant synergies, both consistent with the Parties' empirical analysis and considerably higher than the current CMA estimate.

[196] PFs, paragraph 16.23.

[197] PFs, paragraph 16.123

[198] PFs, paragraph 16.126

CHAPTER 3 - IN-STORE GROCERY: LOCAL UNILATERAL EFFECTS

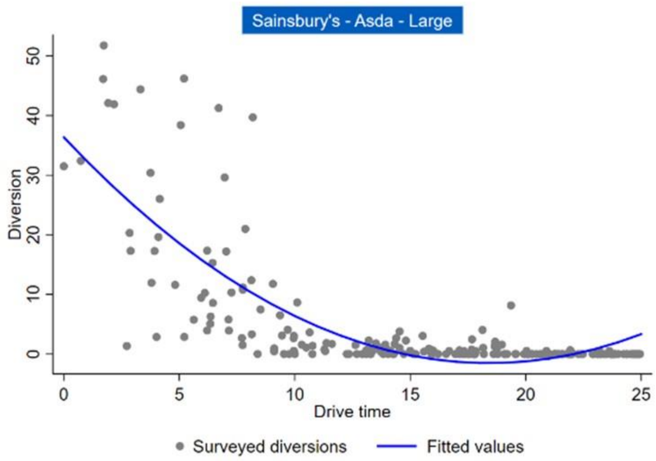
(343) In relation to the provision of in-store groceries at supermarkets, the PFs find that the Proposed Merger will lead to an SLC in 629 local areas. This is substantially higher than the 463 SLCs that were identified under the CMA's Phase I decision. This is despite the fact that, in the Phase I decision (which is also taken under more invasive "may be the case" standard), the CMA excluded Aldi and Lidl as effective competitors; whilst the PFs include Aldi and Lidl as effective competitors as part of the Phase II assessment.

(344) The primary driver for the massive increase in the number of local areas being identified as problematic, despite the CMA's acknowledgement that there are more competitors in the market, is that the CMA has adopted an unprecedentedly low threshold for considering an area to be problematic. The concerns with the CMA's 1.5% GUPPI threshold (absent efficiencies), and how little it reflects the actual evidence in this case, are set out in detail in Chapter 2. This chapter considers separately whether the CMA's methodology to calculate the local diversions estimates is robust and supported by the evidence.

(345) As we set out in this Chapter, there are a number of fundamental concerns with the CMA's methodology. An overview of these key concerns is set out below and further detail is provided at Schedule 3.1.

(346) **First**, the CMA's estimates of survey diversions using its WSS methodology is not only significantly biased upwards compared to the actual survey estimates in the same areas, but is also based on a methodology that presents a number of significant problems:

Figure 11 Estimated relationship between survey store diversions and drive-times for Asda-Sainsbury's large



(347) Whilst it is correct that the CMA only considers diversions up to 15 minutes, they cannot be considered robust if they are based on a curve that predicts negative estimates beyond 15 minutes. Second, the CMA's WSS regression suffers from heteroscedasticity, and exhibits errors around the diversions that increase with the size of the diversions, creating less robust estimates.

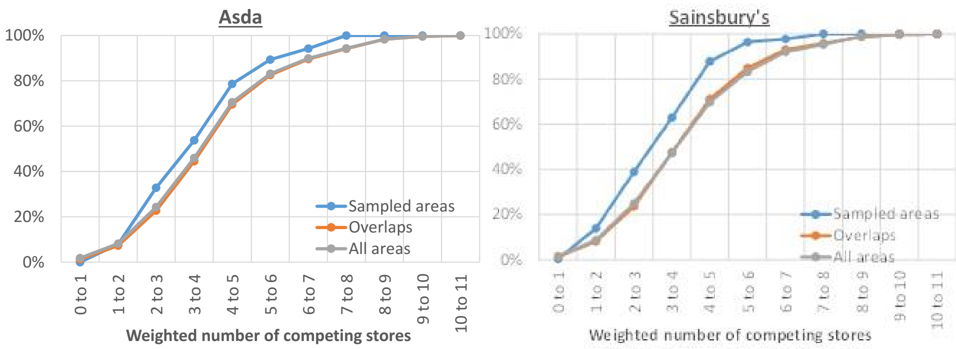
(348) **Second,** whilst the CMA's evidence is overwhelmingly based on its local survey, it makes adjustments for six brands on the basis of the CMA's entry/exit analysis. However, these adjustments have been made in an ad-hoc fashion both in terms of the brands selected and the magnitude by which their weights have been moved. For example, some brands that generate even greater differences between the CMA's survey and the entry/exit analysis have not being considered. By far the largest change has been made to the weight of Sainsbury's stores on Medium Asda stores – significantly increasing the number of local SLCs. Not only is this based on only four observations, but when CRA formally test whether there is a statistically significant difference between the entry/exit data and the survey for the CMA's adjustments,

the statistically significant difference is with respect to Asda on Waitrose stores (not Sainsbury's on Medium Asda stores). Therefore, the data does not support the CMA's up-weighting of Sainsbury's weight on Medium Asda stores.

(349) **Third,** the CMA relies almost exclusively on its survey which has a number of significant flaws. These concerns have previously been raised by the Parties, but the CMA continues to ignore them:

- The CMA continues to misunderstand/ignore the Parties' concerns with respect to the representativeness of the CMA's survey sample. Whilst the CMA shows that on a simple 'fascia' count basis (weighing all stores as identical regardless of size or brand), there is no difference in the areas being surveyed, the assumption that all stores are identical is clearly contradictory to the CMA's main evidence. When one uses the CMA's WSS weightings (taking account of brand weights, size and distance), it is clear that the CMA has significantly *over-sampled* Sainsbury's and Asda stores in relatively concentrated areas. This can be seen for Sainsbury's below:

Figure 12 Distribution of Sainsbury's and Asda stores in the local areas, by weighted number of competing stores



- This means that the CMA's survey estimates between the Parties will systematically bias the diversions between the Parties upwards, even before the CMA constructs its WSS.

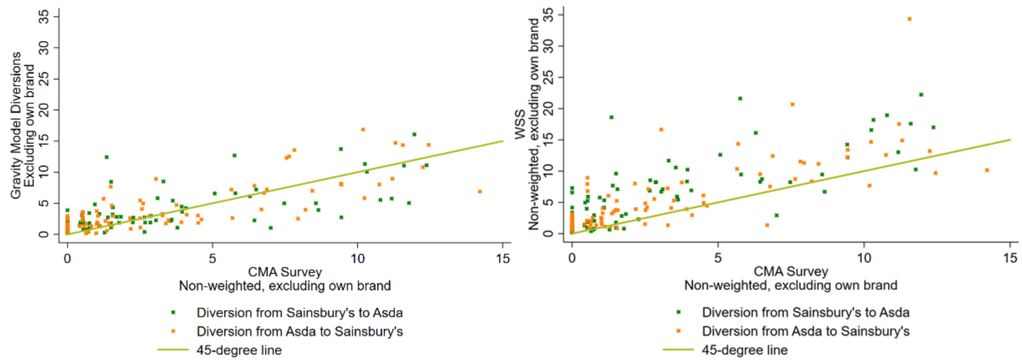
- The CMA has also ignored the Parties' concern that given the relatively small number of respondents and the large number of potential stores to which to divert in each area, the zero diversions in the Survey data are likely to be 'sampling' issues rather than true zeros. Indeed, a review of the Parties' survey which was undertaken in the same location as the CMA's survey, shows that many of the CMA's 'zero' responses actually receive positive diversions in the Parties' survey. The greatest proportion of incorrectly noted 'zeros' are associated with Iceland (17%), Aldi (16%), Lidl (14%) and Co-op (13%), suggesting that these are all incorrectly biased downwards by the CMA's survey.

(350) **Fourth,** the Parties have provided the CMA with significant pieces of additional local evidence that the CMA could have considered to make their local findings more robust, including additional local survey work, impacts data and the Parties' gravity model: however, the CMA has disregarded them all. Such an approach is unwarranted.

- The CMA is wrong to dismiss the Parties' survey on the basis that, because it was conducted in the same locations as the CMA's survey, it does not add much information. As shown above, one of the key issues with the CMA's survey is that there are relatively few respondents on which to base the estimates. Incorporating the Parties' survey data would significantly increase the number of respondents and hence the accuracy of the estimates.

- The Parties' gravity models are significantly more sophisticated versions of the CMA's WSS. Like the WSS, they provide predictions of sales values on the basis of the types of competitors, distance, and store size. However, the Parties' gravity models also include other elements that are not considered in the WSS, for example local brand preferences and demographics. The CMA is incorrect to dismiss the relevance of the gravity models on the basis that the Parties do not use them and/or they are not accurate. In fact, both Parties regularly use them in the course of business. Asda has used its model over [✂] times in the last five years, whilst Sainsbury's has used its model over [✂] times in the last four years. Most importantly, the evidence shows that the Parties' gravity models are not only more accurate in forecasting sales than the CMA's WSS is at forecasting its survey diversions, they are also more accurate at forecasting the CMA's own survey diversions than the WSS. This is shown by Figure 13 below. The CMA is therefore entirely wrong to ignore the gravity models and the PFs have misconstrued the facts and evidence submitted by the Parties in reaching its conclusion to disregard the Parties' gravity models (for the reasons explained further in Schedule 3.1).

Figure 13 Gravity model fit to CMA diversions compared to WSS model fit



Source: CRA analysis of the Parties' gravity model simulation data and the CMA data

(351) **Finally**, there are a number of other issues within the CMA's local analysis that have the result of significantly overstating the number of SLCs. These include:

- *Incorrectly omitting own-brand diversions*. The Parties provided the CMA with the methodology to correctly incorporate own-brand diversions. Whilst the CMA acknowledges that omitting own-brand diversions will bias the results upwards (thereby upward-biasing the number of SLCs), the CMA argues that the impact of this omission is minor. This is incorrect. As the CMA's own code shows, on the basis of the 2.5% threshold it reduces the number of SLC stores from 629 to 582 (i.e. by 47 stores). This is not a "minor" change. Such a conclusion is not only inconsistent with a robust and evidence-based assessment, but also fails the "balance of probabilities" Phase II legal test.
- *Incorrectly estimating the halo effect attributable to driving GM sales*. The CMA increases the Parties' local grocery margin on the basis that (i) a significant number of customers buy GM because they are buying grocery and (ii) the other merging party would capture this GM margin if consumers moved their grocery expenditure. However, the CMA has no evidence to support either of these assumptions. The CMA cites evidence that Sainsbury's consider a [✂]% uplift in grocery from Argos: however, this is evidence of a halo going the opposite way from the CMA's prediction. Even if this halo existed, the CMA's estimate of the share of GM in the Parties' grocery baskets is significantly overstated. Calculating it correctly would reduce the CMA's halo from [✂]% to [✂]% for Asda, and [✂]% to [✂]% for Sainsbury's

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CHAPTER 4 – IN-STORE GROCERY: NATIONAL UNILATERAL EFFECTS

I. Introduction and Summary

(352) This Response sets out the Parties' response to the sections of Chapter 8 of the PFs relating to in-store grocery national unilateral effects. The PFs cite the CMA's national average GUPPI calculation "*in combination with the range of qualitative and quantitative evidence*"[199] to support its conclusion that the Proposed Merger will give rise to an incentive to degrade PQRS across the Parties' national supermarket estates.

(353) This Response demonstrates that the CMA's conclusion that a national SLC will arise is fundamentally flawed: it is not supported by the quantitative evidence and relies on a manifestly unreasonable assessment of the available qualitative evidence.

(354) As a preliminary point, the CMA's assessment of national unilateral effects completely fails to account for the dynamic changes that have occurred in the UK groceries industry. Ultimately, a detailed Phase II retail unilateral effects analysis ought to be an assessment of dynamic consumer preferences and closeness of competition, not shorthand labels of the "Big 4" versus the discounters and other traditional retailers such as Waitrose, M&S, and Co-op.[200]

(355) The PFs focus disproportionately the "Big 4" results in a binary fallacy which frames the CMA's assessment of both the qualitative and quantitative evidence in the PFs.

(356) Firstly, the CMA downplays the fact that the offerings of the Parties (and other members of the "Big 4") are differentiated from each other, with Tesco exercising a materially stronger constraint on each Party than other members of the "Big 4". Whereas the CMA's local analysis now correctly captures the varying competitive constraints of different retailers, the CMA's national assessment and conclusions on the closeness of competition is inconsistent in approach (in some places finding that Tesco is a closer competitor to each Party,[201] but in others treating all members of the "Big 4" as a homogenous group in opposition to the discounters).[202]

(357) The CMA's broad-brush approach underweights or discounts, available economic data and compelling qualitative evidence including, *inter alia*, from the Parties' internal documents, third party feedback, and demographics / customer perception data, which consistently demonstrates that Tesco is a materially stronger constraint on each Party than they are on each other.

(358) Second, the singular focus on the distinctiveness of the "Big 4" leads the CMA to ignore contemporary demand-side evidence that the "Big 4" terminology no longer reflects the way consumers shop and how all retailers compete in the UK grocery sector. There is abundant evidence that customers choose retailers locally, based on convenience of location of local stores, and the price and non-price retail proposition on offer in those local stores. In this respect, the CMA disregards evidence of dynamic competition from the likes of Aldi and Lidl.

(359) (as well as Ocado and Amazon), as well as the significant constraint from more heritage household names – Waitrose, M&S, Co-op and Spar.

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[199] PFs, paragraph 8.3.

[200] The subject of review is not a merger between all of the Big 4, or an assessment of any generic permutation of merger combinations between the Big 4: a merger between Tesco and Asda is a very different proposition to a merger between Sainsbury's and Asda.

[201] PFs, paragraph 8.72.

[202] PFs, paragraph 8.77.

(360) Finally, as set out below, the fact that price and many non-price parameters are set by the Parties centrally and applied uniformly to all these local stores does not change the fact that consumer demand, and competition for that demand, is "*fundamentally local*".[203]

No standalone theory of harm: the national SLC is based on the sum of local concerns

(361) The CMA's assessment in the PFs effectively follows the approach adopted in the CC Groceries Inquiry and reinforced in the revised Commentary in concluding that the Parties' incentives to flex centrally-determined parameters of competition (notably pricing) will reflect local competition: "*any such deterioration across the Parties' estates would reflect the aggregate effect of competitive constraints that the Parties face in each of the local areas where they operate*".[204] Similarly, the PFs' conclusion of its national assessment specifically concludes that the national SLC manifests not at a discrete "national plane" independent of local markets, but at a <u>local level</u>: "[giving] *rise to an incentive to degrade PQRS across the Parties' national supermarket estates, resulting in an SLC* ***in each local area*** *where one or more of the Parties' supermarkets is present*."[205]

(362) It is incumbent on the CMA at the PFs stage to clearly articulate each theory of harm on which it seeks to rely, sufficient to provide "*a full explanation of the CMA's reasoning in reaching its provisional findings*."[206] Given that the CMA does not identify any "national" parameter of competition that is independent or a discrete phenomenon in economic terms from local competition in the PFs, this Chapter addresses the CMA's theory of harm that a national SLC arises based on the aggregation of local competition.

(363) For the avoidance of doubt, however, if the CMA's position were nonetheless to be that there are discrete national parameters of competition affected by the Proposed Merger that are non-derivative of local competition, then this conclusion would be unfounded. It would amount to a theory contradicted by all the evidence on centrally-set, uniformly-applied decision-making and the "*fundamentally local*" nature of competition between grocery retailers.

The CMA's pivotal local GUPPI analysis must also be central to the national analysis and points to no concerns

(364) The PFs note that the CMA has undertaken its assessment by considering "*a range of <u>qualitative and quantitative evidence</u> (including market share information, internal documents, third party submissions, national switching data, and pricing pressure analysis, amongst others), to form a decision in the round*."[207]

(365) Although the Parties note that there is no generic hierarchy in terms of the evidence that is informative for the CMA's assessment, the PFs rely heavily in the national analysis on (a flawed assessment of) the qualitative evidence in the case. This elides the fact that there is a coherent body of quantitative evidence demonstrating that the Parties are not particularly close competitors.

(366) This is in sharp distinction to its local analysis, where quantitative measures (namely the GUPPI decision rule) are the cornerstone of (i) the CMA's assessment of closeness of competition (captured by diversion ratios) and (ii) the economic incentives of the Parties to raise price or worsen the non-price offer (the GUPPI, capturing diversion ratios and variable margins).

(367) More specifically, in this case, the CMA cannot place decisive "decision rule" weight on GUPPI at local level, where competition fundamentally takes place, and then accord GUPPI at best supplemental weight in the national analysis. Given that the PFs acknowledge that incentives to flex national level pricing

[203] See CC *Groceries* Inquiry, para. 4.134; and 2017 Retail Mergers Commentary at paras. 113ff.

[204] PFs, paragraph 8.9.

[205] PFs, paragraph 8.70.

[206] CMA Guidance: "Mergers: Guidance on the CMA's jurisdiction and procedure", para 12.16.

[207] PFs, paragraph 8.3.

reflect the aggregation of local competitive pressures, it is inconsistent to consider the national average GUPPI as merely a tool for confirmation of an assessment based on less robust (and often highly subjective) non-economic evidence.

(368) Consistent with the approach in the Commentary (and recent decisional practice such as *Ladbrokes/Coral*), the Parties believe that a consideration of (appropriately calculated) national average weighted GUPPIs is the most appropriate way of assessing whether an incentive to deteriorate centrally-set PQRS will arise post-Transaction.

(369) For the reasons set out in the GUPPI chapter, on a proper approach, the national average weighted GUPPIs for each of the Parties (at [✂]% and less than [✂]%, respectively, absent a 1% efficiency credit in each case) evidence that the Proposed Merger will not lead to an SLC at the national level.

(370) There is no plausible basis for considering that a GUPPI of below 5% demonstrates an incentive to actually to deteriorate centrally-set PQRS, not least given the dynamic nature of the UK grocery sector in 2019.

Other quantitative evidence supports the conclusion that the Parties are not particularly close competitors

(371) If the CMA's argument is that, even without the inferences from the national GUPPI, there can be an expectation of a national SLC based on other factors, it is clear that the evidence does not support such a conclusion.

The Parties' combined shares of supply are presumptively non-problematic.

(372) Even accepting the highly conservative calculation of the Parties' national shares adopted by the CMA (at 29%), the Parties' combined shares of supply are well below the share levels that, in UK and peer regime practice, are normally associated with prima facie national unilateral effects concerns.

(373) Moreover, these shares have been progressively falling since 2011, are even lower when considered on a volume basis, and will be further reduced following a realistic local divestiture package. Given that the Parties' combined national shares are presumptively non-problematic, competition concerns can only arise on a national basis in circumstances where other quantitative evidence shows that the Parties are closer competitors than their market shares imply.

Other quantitative data shows the Parties are not closer competitors than their national shares of supply suggest.

(374) As a preliminary point, the CMA relies on a novel methodological approach to assessing Kantar switching data (which is substantiated by a single Sainsbury's internal document). This methodology results in an inconsistent approach to entry by Aldi and Lidl. Whilst Aldi/Lidl are weighted down in the CMA's assessment of Kantar switching data on account of their rapid growth, the CMA's overall analysis of national unilateral effects ignores this rapid growth.

(375) Even ignoring the inconsistency of the CMA's methodology, evidence from Kantar switching data does not support the CMA's finding of a national SLC. The constraints exercised by Sainsbury's on Asda ([✂]%) and by Asda on Sainsbury's ([✂]%) are below what would be implied by the Parties' combined national shares. Moreover, the combined constraint on Asda ([✂]%) from Aldi and Lidl together is significantly greater than the constraint on Asda from Sainsbury's ([✂]%); whilst their constraint on Sainsbury's is at a similar level as the constraint from Asda. For each Party, the constraint from Tesco is at least double that of the next strongest competitor.

(376) Similarly, the CMA's store exit survey shows significant diversions from both Parties to Aldi and Lidl. For Sainsbury's in particular, the survey diversions for Waitrose (6%), M&S (5%) and Co-op (4%) were also high. The factors identified by the CMA to show that the Parties (and other "Big 4" retailers) are

differentiated from other retailers (such as breadth of range) are not shown to be a major driver of store selection.

The CMA ignores highly probative evidence (notably from the Parties' gravity models)

(377) The CMA fails to consider highly relevant evidence used in the ordinary course of the Parties' businesses, which is inconsistent with a robust assessment of the evidence in the round. Significantly, the CMA does not place any weight on the Parties' gravity models and has ignored the Parties' offer of access to test them. These models represent key evidence for the CMA's assessment, given that they are used by both Parties in the ordinary course of business precisely to assess local conditions of competition. Moreover, the gravity models are not only accurate in their own right, but are also more accurate at predicting the CMA's own survey diversions than the WSS model on which the CMA bases its local SLC's findings (for the reasons explained in detail in Chapter 3). Similarly, the CMA fails to give due consideration to other important evidence, notably the fact that Sainsbury's is not a binding constraint on any aspect of Asda's centrally-set PQRS (unlike, for example, Aldi), and vice versa for Sainsbury's.

The CMA's analysis of the qualitative evidence is flawed

(378) The PFs' assessment of "*the range of qualitative and quantitative evidence*"[208] underplays the importance of objective quantitative evidence and is disproportionately focused on a subjective assessment of qualitative factors. Moreover, even on its own terms, the CMA's assessment of the available qualitative evidence is flawed for the following reasons:

<u>The CMA does not cite a single internal document to show that the Parties are particularly close competitors</u>

(379) Despite reviewing over 138,000 of the Parties' internal documents, the CMA has not identified a single internal document (let alone a sufficient body of documentary evidence) which shows that Asda is a particularly close competitive constraint on Sainsbury's strategic decision making (or vice versa). In fact, the CMA acknowledges that both Parties monitor a wide range of competitors (notably including Aldi and Lidl) and no evidence is adduced to suggest that either Party monitors the other Party more closely than it does other retailers (on an individual basis).

<u>Differences in business models and in-store offering are not key drivers for customers</u>

(380) The PFs cites several facets of the Parties' in-store offering (such as amenities and product range) as features which supposedly differentiate them from other (non "Big 4") competitors. On closer scrutiny, however, these features are either minor drivers of consumer purchasing decisions, are of diminishing importance, or are illusory:

- The Parties' have provided a wealth of evidence to show that the range of products offered by Aldi and Lidl clearly satisfies the overwhelming majority of customers' main shopping needs.
- The CMA's store exit survey shows that only a small proportion of respondents listed these factors as important drivers (relative to location and price) of their purchasing decisions.
- The CMA disregards clear evidence that these factors are increasingly antiquated in the face of rapidly evolving market dynamics. This was clearly demonstrated by Tesco's recent decision to close specialist food counters, citing the fact that "*the market is challenging and we need to continually adapt to remain competitive and respond to how customers want to shop*".[209]

[208] PFs, paragraph 8.3.

[209] Jason Tarry (Tesco UK and Ireland boss). As reported in Retail Week "*Tesco puts 9,000 roles in consultation amid 'challenging' market*" (Retail Week: 29 January 2019 available at https://www.retail-week.com/grocery/tesco-puts-9000-roles-in-consultation-amid-challenging-market/7031011.article?authent=1).

In any case, there can be no national SLC if there are no residual local problems once a comprehensive local remedy package is applied

(381) Finally, even if the CMA were to erroneously conclude that the Parties are particularly close competitors based on the balance of quantitative and qualitative evidence, comprehensive local divestments would solve any putative SLC at the national level. As noted above, the CMA has conspicuously failed to identify a standalone national parameter of competition. Given that it's finding of a national SLC in the PFs is predicated on an aggregation of local competition, there cannot be a national SLC if there are no local problems in aggregate.

(382) Local divestments that comprehensively remedy all plausible local SLCs will ensure that the Parties will not have any incentive to increase centrally-set prices (or deteriorate centrally-set PQRS) post-Transaction. As set out in their response to the NPR, the Parties have proposed a package of store divestments which will comprehensively address any putative national concern.

II. No standalone theory of harm: the national SLC is based on the sum of local concerns

(383) The Parties have consistently argued that there are no discrete "national" parameters of competition that exist in isolation from, and are not economically determined by, the aggregation of local pressures. This reflects the position adopted in the Commentary which clearly explains that central decision-making on harmonised parameters, such as price, is not an independent or discrete phenomenon in economic terms, isolated from what happens in stores.

(384) In Chapters 7 and 8 of the PFs, the CMA follows the position adopted in the Commentary (and reflected in the Parties' submissions) that incentives to flex centrally-determined parameters of competition (notably pricing) will reflect local competition: "*any such deterioration across the Parties' estates would reflect the aggregate effect of competitive constraints that the Parties face in each of the local areas where they operate*."[210] Moreover although the PFs note that the Parties are important "nation-wide players" and state that important elements of the Parties' offering are set centrally and applied uniformly on a national basis, it nevertheless emphasises that "*this 'national' view is informed by an aggregation of the competitive conditions in every local area in which the Parties are present*. *Accordingly, we have assessed the effect of the Merger (and any reduction in competition) in aggregate, across the Parties' national store estates*"[211]

(385) To assess the effect of a merger on the centrally set, uniform retail offer, the Commentary emphasises that the CMA would look at evidence on closeness of competition between the Parties and other retailers at a local level and the extent of geographic overlap. The Commentary provides that the CMA will assess two theories of harm associated with a reduction in national competition:

- a loss of national competition not related to the standard aggregation of local areas; and
- a loss of dynamic competition, such as the expansion of the Parties into new locations.

(386) The CMA's review of the available evidence in the present case has not identified any parameter of competition that is unrelated to and economically distinct from the standard aggregation of local areas, nor suggested any loss of dynamic competition. It follows therefore that there can be no national SLC unless there is an incentive to worsen any aspects of the Parties' centrally set retail offering (based on the aggregation of local competitive pressures).

[210] PFs, paragraph 8.9.

[211] PFs, paragraph 7.2

(387) Given that it is incumbent on the CMA at the PFs stage to clearly articulate theory of harm on which it seeks to rely,[212] this Chapter addresses the CMA's theory of harm that a national SLC arises based on the aggregation of local competition.

III. The CMA's pivotal local GUPPI analysis must also be central to the national analysis and points to no concerns

(388) The Parties believe that the CMA should place appropriate weight on robust quantitative measures (such as the national average weighted GUPPI) consistent with the CMA's local analysis, given that they allow for objective assessment. This section demonstrates that the quantitative evidence in the case shows that the CMA's overall SLC conclusion is fundamentally flawed.

(389) The CMA calculates a national average weighted GUPPI to indicate whether the Proposed Merger gives rise to an incentive to degrade PQRS across the Parties' national supermarket estates. The CMA calculates national average weighted GUPPIs of 2.5% (Sainsbury's) and 3.3% (Asda) and considers this to indicate a "*substantial*" level of upward pricing pressure.

(390) The Parties fundamentally disagree that national average weighted GUPPIs of 2.5% and 3.3% give rise to an incentive to worsen their offer with respect to centrally set parameters of competition. The Parties are unaware of any case (whether in the UK or otherwise) where a national average weighted GUPPI of this magnitude has been found to be problematic.[213]

(391) The PFs assert that it has taken into account "*the same factors as described in our local assessment*" when interpreting the national average weighted GUPPIs. For the reasons explained in detail in the GUPPI section of the Parties' response, the CMA's approach to setting the local GUPPI threshold is fundamentally flawed for three key reasons. First, the CMA's thresholds simply do not fit the facts and evidence – something the PFs do not even attempt to check. Second, the CMA's assessment fails to meet basic standards of statistical significance governing the reliability of economic evidence. Third, the CMA's chosen GUPPI thresholds are both radically out of line with all norms (whether based on GUPPI, or cross-checked against concentration thresholds) in general, and incoherent in particular when set against closely-analogous CMA inquiries, *Tesco/Booker* and *Ladbrokes/Coral*. An appropriate local GUPPI threshold would therefore be considerably higher than the 2.5% chosen by the CMA.

(392) In light of the above, the national average weighted GUPPIs for each of Sainsbury's and Asda (2.5% and 3.3% respectively) do not demonstrate that a national SLC is likely to arise. Furthermore, to the extent that local SLCs are remedied by local divestments, this will reduce the national average weighted GUPPIs even further.

(393) The CMA's generally preferred quantitative measure of assessing unilateral effects therefore clearly does not support likely unilateral effects at the national level.

IV. Other quantitative evidence supports the conclusion that the Parties are not particularly close competitors

(394) The Parties submit that the remainder of quantitative evidence similarly does not support the CMA's conclusions.

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212 CMA Guidance: "Mergers: Guidance on the CMA's jurisdiction and procedure", para 12.16.

213 The Parties note that the CMA has chosen local GUPPI thresholds at a level that are, to the decimal point, at exactly the same level as the lower of the Parties' respective national average weighted GUPPIs (for in-store groceries). [✄].

A. The Parties' national shares of supply are clearly non-problematic

(395) The Parties' shares of supply on a national basis are not sufficiently high to give rise to concern and there are many significant competitors present in the market, each of whom poses a considerable competitive constraint on the Parties.

(396) _First, the Parties consider that the CMA's estimate of the Parties' combined share (29%) overstates their competitive position in the UK grocery market_. Various industry-standard data sources consistently show that the Proposed Merger will result in a combined percentage share in the low to mid-20s (ranging from 23% to 26.2%). On a conservative basis, the Parties have consistently referred to the highest of these data sources (26.2%) in their submissions. At no point has the CMA explained why it considers its own shares to be more accurate than those submitted by the Parties.

(397) The Parties also consider that there are the following deficiencies in the CMA's consideration of the Parties' shares of supply:

- The Parties' combined shares have declined in recent years. The Kantar "Total Grocery" shares show that the Parties' combined share of supply has declined continuously from 29.9% in 2011 to 26.2% in 2018. As noted in the Issues Statement Response this is a decline of over three percentage points, equivalent to revenue shrinkage of over £3 billion or a 10% reduction.[214]
- The Parties' shares are expected to continue to fall, with Aldi and Lidl expected to continue to gain share from other retailers. For example, Aldi's share is forecast to surpass that of Morrisons by 2021.[215]
- Given that the CMA considers that there is a separate market for online delivered groceries (on which the Parties disagree), it would follow that that the shares used by the CMA overstate the shares for competitors with an online offering (such as the Parties) compared to competitors who do not currently sell groceries online (such as Aldi and Lidl).

(398) Furthermore, the Parties' combined volume shares are even lower at 23.4%, whereas Aldi and Lidl have a combined volume share of 17.6% (with a much higher share across core grocery categories such as Produce (24.5%), MFP (22.7%) and Packaged (20.2%)).[216] Bargain stores account for significant volumes in certain product categories, in particular Baby and Beauty (11.8%), Household and Pet (13.4%), and Impulse (8.3%).[217]

(399) Finally, the Parties' national shares will also be lower after the implementation of a realistic divestment package.

(400) _Second, even on the basis of the shares adopted by the CMA in the PFs, the Parties' combined shares (at approximately 29%)[218] are manifestly not problematic_. The Parties' combined share would be well below the 35-40% share levels that, in UK and peer regime practice,[219] are normally associated with prima facie national unilateral effects concerns. The Parties are not aware of any past decision in the UK where an SLC has been found on the basis of a unilateral effects theory of harm where the merging

214 See paragraph 146 of the Issues Statement Response.

215 Kantar Worldpanel, Asda vs Sainsbury's in 2019, with Aldi overtaking Morrisons in 2021 (attached as **Annex_001R_002)**.

216 Nielsen volume share data, 52 weeks to February 2019.

217 Nielsen volume share data, 52 weeks to February 2019.

218 PFs, paragraph 8.19.

219 As is the case in the US and EU regimes. For example, in the EU, the Commission said in *Codan/Hafnial*, Case No IV/M.344, decision of 28 April 1993, that 33% in itself is not indicative of market dominance. In actual fact, the EU regime (per its own Horizontal Mergers Guidance, paragraph 17) states that it generally finds mergers resulting in a 40 – 50% market share to be problematic. See also, the judgments in *Endemol v Commission* (T-221/95) [1999] E.C.R. II-1299, paragraph134 and *Gencor v Commission* (T-102/96) [1999] E.C.R. II-753, paragraph 205.

parties' share of supply has been as low as 29%. Indeed, past decisions and the CMA's Commentary acknowledge that "*market shares of less than 40% will not often give the CMA cause for concern over unilateral effects*"[220] and that shares of supply are "*a useful tool to start to assess market power*"[221] in retail mergers.

(401) The Parties disagree with the CMA's assertion "*this level of share of supply may not be expected to give rise to concern only*" in undifferentiated markets.[222] As shares of supply by revenue (in combination with other evidence) illustrate the proportion of grocery customer spend accounted for by the Parties and their competitors, they are equally a useful measure of unilateral effects in differentiated retail markets (such as the supply of retail groceries). It is therefore surprising that the Parties' national shares are not even referenced in the CMA's "*provisional conclusion on national assessment*" section.

(402) For determining whether the Proposed Merger gives rise to national unilateral effect concerns, the Parties therefore consider that their shares of supply should be used as a starting point and other evidence should then be considered to determine whether the Parties are closer competitors than their shares of supply indicate. The Parties are of the view that their shares of supply are below the level typically associated with national unilateral effects concerns and that the CMA has put forward no evidence that demonstrates that an SLC is likely to result. Given that the Parties' shares are low, and the other evidence shows that they are not closer competitors, these shares are likely to overstate their competitive position rather than understate it. The Parties address the available evidence in turn below.

B. Kantar switching data does not suggest that the Parties are closer competitors than their shares suggest

(403) In its analysis of Kantar switching data, the CMA notes that "*it is important to make some adjustments*" because it considers that the level of switching between the Parties and Aldi and Lidl shown in this data may not accurately reflect the ongoing constraint that these retailers pose. This approach is based on the fact that "*while the opening of an Aldi or Lidl store may result in an initial migration of customers, subsequent small changes in PQRS, by Aldi/Lidl or the Parties, may have much less impact on these customers*".

(404) In this respect, the CMA's case seems to be that fast-growing dynamic competitors should be weighted down versus competitors that are not expanding. The Parties also note that with respect to entry and expansion, besides accounting for known pipeline stores, the CMA has given no weight to the fact that Aldi and Lidl are expanding and opening new stores and have stated that they will continue to do so in the future. As set out above, this is inconsistent: the CMA cannot argue that because Aldi/Lidl are fast growing they should be weighted down in the switching data, and then not take account of their growth in its overall analysis. Indeed, the fact that Aldi and Lidl are continuing to enter local markets across the UK at a significant rate would imply that they should actually be up-weighted rather than down-weighted, because switching today is less than it will be in the future.

(405) Notwithstanding the above inconsistency, the CMA's approach is predicated on [✂] which disaggregates LFL and new stores growth. The CMA has not cited any Asda documents, competitor internal documents or third-party documents in support of its approach. Switching data is routinely used by the Parties and third parties (including, to the best of the Parties' knowledge, their competitors) in their ordinary course assessments of competitive conditions in the UK grocery sector (a similar purpose to the CMA) without

[220] CMA Retail Merger Commentary, paragraph 3.36 (attached as **Annex_005_006**).

[221] CMA, *Anticipated acquisition by Pearson Professional Assessments Limited of the computer-based testing business of learndirect Limited,* Case ME/6562/15, decision of 2 December 2015, paragraph 64.

[222] PFs, paragraph 8.19.

this adjustment. It is therefore not clear why the CMA has adopted a specific methodology, which is not supported by ordinary course business practice, to down weight the constraint exercised by Aldi and Lidl.

(406) The Parties pointed out a number of simple errors that the CMA had made with respect to its estimate of Aldi and Lidl's switching. The CMA states that the corrections to the CMA's adjustment have very modest results on Aldi's and Lidl's switching.[223] The Parties do not agree with this statement. The corrections to the adjustment as presented in the Parties' Response to the National Switching WP have a significant impact on the results and the assessment presented in the Parties' Response is virtually identical to the CMA's assessment presented in the PFs. The table below summarises the impact of the Parties' and CMA's adjustments on the results.

Table 10 Comparison of the CMA's adjustments to switching losses and market shares

	Asda switching losses			Sainsbury's switching losses		
Competitor	**CMA WP**	**Parties' Response**	**CMA PFs**	**CMA WP**	**Parties' Response**	**CMA PFs**
Tesco	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Asda				[✂]	[✂]	[✂]
Sainsbury's	[✂]	[✂]	[✂]			
Morrisons	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Waitrose	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Aldi	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Lidl	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Co-op	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
M&S	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total Iceland	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total Bargain	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
All Others (*)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

(*) including Farmfoods.

Source: Adjusted Kantar switching losses, 52 w/e 17 June 2018. Adjusted switching losses are obtained from the CMA's National Switching Analysis WP (para 43), CRA's Response to National Switching WP (para 28) and the CMA's PFs (para 8.42).

(407) The CMA also concludes that its Kantar switching analysis *"supports a finding that Aldi and Lidl are a constraint to some degree on both Parties, but not to the extent of Tesco, Morrisons and the other Party."*[224] Leaving aside the flaws in the CMA's methodology, the Parties do not agree with this conclusion:

- The constraints exercised by Sainsbury's on Asda ([✂]%) and by Asda on Sainsbury's ([✂]%) are each below what would be implied by the Parties' combined national shares.
- Taking Aldi and Lidl together, their combined constraint on Asda ([✂]%) is significantly greater than the constraint of Sainsbury's on Asda ([✂]%); while their constraint on Sainsbury's is at similar level as the constraint from Asda (both at [✂]%).

[223] Paragraph 8.43 of the CMA's PFs.

[224] Paragraph 8.41 of the CMA's PFs.

- The switching data demonstrates that Tesco is the strongest constraint on each Party by a clear margin. Indeed, for each of Sainsbury's and Asda, the proportion of switching losses to Tesco is at least [✂] that of the other Party. This further demonstrates the erroneous nature of an approach which considers the constraint from all "Big 4" players equally.
- The data demonstrates that M&S; Co-op and Waitrose are significant constraints. In particular, Sainsbury's switching losses to these three competitors were [✂]% (specifically, Waitrose ([✂]%), M&S ([✂]%) and Co-op ([✂]%)).
- The data shows that additional constraints from bargain stores, Iceland and other smaller independent stores cannot be ignored as the Parties lose a relatively large proportion of their grocery sales to them.

C. Survey data demonstrates the strong constraint from a range of retailers

(408) The CMA's store exit survey, which it contends was based on "*a substantial evidence-gathering exercise*" and "*a robust source of evidence*", does not support a national SLC finding.

(409) The CMA's store exit survey demonstrates the strong constraint from a range of retailers. Indeed, the CMA's survey finds significant diversions of both Parties' customers to Aldi and Lidl. For example, at slide 34, the survey finds that Asda customers are more likely to divert to Aldi and Lidl combined (19%) compared to Sainsbury's (17%). This is equally true of price-marginal customers. Combined diversions from customers shopping at Sainsbury's and Asda to Aldi and Lidl amongst marginal consumers (i.e. those most likely to switch) are even higher than average diversions (28% compared to 19% for Asda, and 13% compared to 10% for Sainsbury's). In addition, for Sainsbury's in particular, the survey diversions for Waitrose (6%), M&S (5%) and Co-op (4%) were high.[225]

(410) Finally, the survey diversion ratios do not support the CMA's focus on the "Big 4" as a distinct group, given that both Parties' customers were significantly more likely to divert to Tesco than any other competitor.

(411) For the reasons explained below, the Parties' also strongly disagree that factors (such as breadth of range) are shown to be a major driver of store selection.

D. The store overlap between the Parties is no more significant than the competition with other retailers

(412) The CMA notes that the Parties' store estates overlap to a "*significant degree*". The Parties note that this conclusion is misleading in isolation, given that the CMA has not contextualised the degree of store overlap (which is clearly relevant to a consideration of closeness of competition).

(413) *First, the CMA has failed to consider that the Parties face intense competition across their estates, with competition from each other being no more intense or significant than competition from other retailers:*

- Asda faces competition in a greater proportion of its local areas from each of Aldi ([✂]%), Lidl ([✂]%), Morrisons ([✂]%) and Tesco ([✂]%) than from Sainsbury's ([✂]%).
- Sainsbury's faces competition from Asda ([✂]%) less frequently than it faces Morrisons ([✂]%) and Tesco ([✂]%) and only slightly more frequently than Aldi ([✂]%) and Lidl ([✂]%).

(414) Post-merger, as can be seen from Table 1111 below, the proportion of the Parties' estate in which they continue to face multiple retailers is still very significant (and indeed Table 11 below is only partial, as it considers only Aldi, Lidl, Tesco and Morrisons, thus ignoring, for the sake of pragmatic illustration, the constraint from other local bricks & mortar supermarkets, online, value retailers and convenience).

[225] See Kantar, "*Consumer research to inform the Sainsbury's/Asda merger inquiry: Findings from the store exit survey*", February 2019 ("**the CMA's exit survey**").

Table 11 Intensity of competition in overlap areas

Asda Overlaps Pre- and Post-Merger	Pre-Merger		Post-Merger	
	No.	Share	No.	Share
Sainsbury's	[✂]	[✂]	[✂]	[✂]
Sainsbury's plus one of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Sainsbury's plus two of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Sainsbury's plus three of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Sainsbury's plus all of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]
Sainsbury's Overlaps Pre- and Post-Merger	**Pre-Merger**		**Post-Merger**	
	No.	**Share**	**No.**	**Share**
Asda	[✂]	[✂]	[✂]	[✂]
Asda plus one of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Asda plus two of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Asda plus three of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Asda plus all of Aldi, Lidl, Morrisons, Tesco	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]

Note: Overlaps are based on 10/15-minute catchments in urban areas and 15/20-minute catchments in rural areas. All Morrisons stores are treated as Large and all Aldi and Lidl stores are treated as Medium. Source: CRA analysis of Sainsbury's and Asda data.

(415) The overall intensity of competition across the Parties' estates post-merger is such that there would be no substantial reduction in aggregate competitive pressure on centrally-set parameters, such as pricing, and therefore no economic incentive to raise centrally-set prices post-merger.

(416) *Second, the CMA has failed to take into account the rapid expansion plans of competitors such as Aldi, Lidl and Co-op which will continue to strengthen the scale and geographic range of these retailers*.

(417) Aldi and Lidl are projected to open another 480 stores by 2022.[226] The pace of their expansion is evidenced by the fact that Aldi recently opened eight stores in a single day.[227] Analysts at Barclays point out that, at 2.5 discount stores per 100,000 people, the density of discount stores still remains low in the UK by international standards (with Germany having closer to 19 stores per 100,000, while even in France, Spain and Ireland the figure is closer to six).[228] Indeed, Aldi UK CEO, Matthew Barnes recently stated that "*we think not only could we have a store in every town and city, but for every 25,000 to 30,000 people*", equating to 2,600 stores.[229] As a result of this expansion the degree of overlap between the

[226] See the Parties' Issues Statement Response at paragraph 235.

[227] Retail Gazette, "*Aldi opens 8 new stores in one day*", 5 December 2018, available at: https://www.retailgazette.co.uk/blog/2018/12/aldi-opens-8-new-stores-one-day/.

[228] Barclays, "*UK Food Retail: discounter dynamics*", page 7 (attached as **Annex_004R_008)**.

[229] The Guardian, "*Aldi plans to open up to eight stores in some UK towns*", 12 May 2017, available at: https://www.theguardian.com/business/2017/may/11/aldi-plans-uk-supermarket-for-every-30000-people.

Parties and competitors (such as Aldi and Lidl) has increased significantly in recent years and will likely continue to do so. In contrast, the degree of overlap between the Parties has remained relatively static.

(418) *Finally, as noted above, a local divestment package that comprehensively remedies local SLC areas will further reduce the extent of overlap between the Parties*.

V. CMA's dismissal of relevant evidence is inconsistent with a robust assessment of the evidence in the round

(419) The Parties referred in their submissions to a number of sources of evidence to demonstrate that their offerings are differentiated and that other retailers exert a significant constraint on their offering. Given that this evidence is used in the ordinary course of business by the Parties (as reflected in their internal documents) and by industry analysts to assess conditions of competition in the UK grocery sector, the CMA is unreasonable in affording limited weight to it in assessing competition in the round.

1. Gravity model

(420) The Parties' gravity models are more sophisticated versions of the CMA WSS, assigning demand to stores on the basis of their brand weights, distance, but also other characteristics such as demographics. Given: (i) the close analogy between the Parties' gravity models and the CMA's WSS; and (ii) the fact that it is primary evidence used of how they consider rivals in local areas, the Parties would expect the CMA to have taken account of it. So far as the Parties are aware, the majority of (if not all) major grocery retailers use equivalent models in their businesses (which could equally have been requested and analysed by the CMA).

(421) The Parties repeatedly emphasised that they consider their gravity models highly probative for the CMA's assessment, in particular on the call with the CMA case team to discuss the gravity model on 11 January 2019 and at the meeting held with the CMA economist team of 14 January 2019. The Parties wrote two follow up letters to the CMA in this regard, in which they offered to provide the CMA with a copy of the Sainsbury's gravity model and any support needed from Sainsbury's staff to understand the model. This offer was declined.

(422) The CMA provisionally concludes that "*in the context of a large merger investigation with a tight statutory deadline where we already have a large amount of robust evidence on which to base our conclusion*" it decided not to place weight on the Parties' gravity models.[230] The PFs have misconstrued the facts and evidence submitted by the Parties in reaching its conclusion to disregard the Parties' gravity models for the reasons explained in the Parties' response to the Local Grocery analysis.

(423) The Parties therefore believe that dismissing the Parties' gravity models, which are an important quantitative measure for assessing local conditions of competition and are frequently used in the ordinary course of business by both Sainsbury's and Asda, is entirely inconsistent with an impartial consideration of the evidence "in the round".

(424) The CMA's failure to investigate a key piece of evidence is particularly unsupportable as the data shows that the gravity models are, not only accurate in their own right, but are also more accurate at predicting the CMA's own survey diversions than the WSS model on which the CMA bases its local SLC's findings.

2. Parties' centrally set PQRS

(425) The CMA concludes that the constraint posed by the "Big 4" retailers is more important than the constraint posed by Aldi and Lidl. However, it fails to consider the relative importance of different retailers in the Parties' approach to setting PQRS (or strategic decision-making more generally). For instance, with respect to centrally-set pricing:

[230] PFs, paragraph 8.156.

- [✄]
- [✄]

(426) The importance of Aldi and Lidl to the Parties' centrally set PQRS is also acknowledged by third party submissions to the CMA, such as those of Co-op and Iceland, with the latter noting in the PFs that "*they expect the Parties to improve their fresh food offering in response to the discounters' efforts in this area.*"[231]

3. Other evidence (customer demographics / OC&C index / cross-shop data)

(427) The Parties submitted a range of other data sources to illustrate that the Parties are not particularly close competitors. These data sources are frequently cited in the Parties' internal documents and in third party reports (such as GlobalData) as informative of the competitive dynamics in the UK grocery industry.

(428) The CMA cites third party evidence in its "provisional conclusion" section to show that "*third party submissions support a degree of distinction between the "Big 4*" noting earlier that the evidence shows that "Big 4" retailers have "*similar brand positioning*" and "*similar associations*."[232] There is no reason why third-party data sources (such as the OC&C data) that evidence significant differences in customer perception should be accorded less weight than third party submissions on this point. As the CMA acknowledges, both demographic data and the customer perception charts produced by OC&C demonstrate that Tesco and Morrisons are situated between the Parties. This reaffirms the views of third parties cited by the CMA such as Aldi which submitted that: "*Asda's and Sainsbury's current strategies had each sought to differentiate themselves from other "Big 4" retailers: Sainsbury's through becoming 'more premium' and Asda through strengthening its position as a value retailer*."[233]

(429) Moreover, the CMA dismisses evidence from customer demographics and OC&C customer perception data on the basis that there may "*remain a significant proportion of customers who see the Parties as close substitutes*."[234] This is inconsistent with the CMA's reliance on evidence of differences in the in-store offering of different retailers, given that these are factors for "*some customers' purchasing choices*".[235] As explained above, this evidence is equally uninformative as to whether there is a significant proportion of customers who see other retailers (including Aldi and Lidl) as close substitutes.

VI. CMA's analysis of the qualitative evidence is flawed

(430) The PFs therefore focus heavily on a subjective assessment of qualitative evidence, notably the Parties' internal documents, in-store offerings and third-party evidence. Not only is this contradicted by the coherent body of quantitative evidence detailed above, the CMA's assessment of the qualitative evidence is also fundamentally flawed.

A. CMA focuses disproportionately on the distinctiveness of the Big 4

(431) The CMA's analysis focuses disproportionately on shorthand labels that frame the "Big 4" retailers as a distinct group, noting, for example, the: "*important competitive interaction between the "Big 4" grocery retailers*."[236]

(432) The CMA's assessment does not adequately account for the fact that the Parties' offerings are differentiated in its unilateral effects assessment, with Tesco exercising a materially stronger constraint

231 PFs, paragraph 7.27.

232 PFs, paragraphs 8.15 and 8.75.

233 PFs, paragraph 8.16.

234 PFs, paragraph 8.64.

235 PFs, paragraph 8.50.

236 PFs, paragraph 8.72.

on each Party than other members of the "Big 4". Whereas the CMA's local analysis correctly accounts for differences in the constraint exercised by different retailers (including members of the "Big 4"), the CMA's national analysis oscillates between treating all members of the "Big 4" equally and recognising Tesco as a stronger competitor.

(433) For instance, whilst the CMA recognises that Tesco is a closer competitor to each Party: "*after Tesco, each Party generally acts as the other's next closest competitors (together with Morrisons*),[237] it also argues that the prominence of Tesco in the Parties' internal documents "*overstates the extent to which it represents a greater constraint on the Parties than they do to each other*".[238] This is inconsistent and is contradicted by ample evidence from the Parties' internal documents, third party feedback, and demographics / customer perception data which demonstrates that Tesco is a materially stronger constraint on each Party.

(434) Secondly, the CMA disregards evidence of the significant constraint from other (non "Big 4") retailers. The CMA frequently treats all members of the "Big 4" as a homogenous group: noting for example that the constraint from the discounters "*is less important than that provided by the other 'Big 4' retailers*".[239] It focuses primarily on the supposed distinction between the "Big 4" on the one hand, and the "discounters" on the other. This significantly understates the constraint exercised by Waitrose, M&S and Co-op. None of these retailers warrant a mention in the CMA's "*provisional conclusion on national assessment*". This is despite the fact that each of these players constitutes an important constraint on the Parties in each local area in which they are present.

(435) The qualitative evidence discussed below demonstrates that these players are a major constraint (particularly for Sainsbury's) and are routinely monitored in each Parties' internal documents. Similarly, these retailers also influence the Parties' strategic decision making. [✄]. Finally, Waitrose and M&S also offer facilities such as specialist food counters, cafes and GM that the CMA considers to be differentiating features of the "Big 4" retailers.

(436) For completeness, the empirical economic evidence noted above also clearly evidences the constraint from these retailers:

- Both Parties have experienced significant switching losses to M&S, Co-op and Waitrose in recent years. In particular, Sainsbury's switching losses to these three competitors were [✄]% (specifically, Waitrose ([✄]%), M&S ([✄]%) and Co-op ([✄]%))[240]. The CMA exit survey diversion ratios were similarly high for Sainsbury's – Waitrose (6%), M&S (5%) and Co-op (4%).
- These retailers are a particular constraint for Sainsbury's, with the CMA's WP acknowledging that [✄].[241] Given that this was noted in the CMA's WP, it is surprising that it is not reflected in the PFs.

B. The CMA's forensic review of the Parties' internal documents fails to show a single document suggesting that the Parties could increase prices post-Transaction

(437) First, the Parties consider it instructive that despite reviewing almost 3,000 of the Parties' key commercial board documents and over 135,000 emails from key custodians, <u>the CMA has been unable to find a single document which indicates that</u>:

[237] PFs, paragraph 8.72.

[238] PFs, paragraph 8.73

[239] PFs, paragraph 8.77.

[240] Kantar Worldpanel 2018 data.

[241] Coordinated Effects WP, paragraph 93.

- Asda is a particularly close competitive constraint on Sainsbury's strategic decision making or vice versa. For instance, the CMA concludes with respect to Sainsbury's internal documents that: "*Asda and Morrisons do not individually receive more prominence in regular reporting compared to other retailers*";[242] or
- following the merger (or the removal of another competitor), either Party anticipates that the removal of the competitive constraint from the other Party would allow them to increase prices (or otherwise deteriorate PQRS).

(438) *Second, the CMA's own review of the Parties' internal documents acknowledges the variety and intensity of the competitive threats facing their businesses*. Indeed, the CMA concedes that Sainsbury's documents identify a "wider market" comprising a range of competitive constraints (including supermarkets, online, bargain stores, convenience stores etc.)[243] and that Asda's documents monitor a range of competitors.[244] In addition, the CMA notes that the Parties regularly monitor a wide-range of competitors including the discounters, bargains stores and other retailers such as Waitrose, M&S and Co-op.

(439) *Third, the Parties strongly dispute the fact that they perceive the "Big 4 as a distinct group"*. The Parties' acknowledge that their internal documents use this term as a short-hand term, however this should not imply that they are more regularly or closely monitored than other retailers. As recognised by the CMA, the Parties assess their performance against a variety of competitors, and the CMA has failed to identify one metric (or aspect of PQRS) in relation to which the "Big 4" is the Parties' only or predominant focus. The Parties consider that it would be inaccurate to state that the Big 4 feature "most prominently" in their internal documents based on a questionable assessment of the positioning or sizing of competitors mentions on particular pages, when this is not reflected in the Parties' quantitative analysis of their internal documents.

(440) *Fourth, the CMA concludes that the discounters are a clear and recurrent focus in the Parties' internal documents and in particular their key strategic documents*. The CMA implies that the focus on the discounters might reflect the novelty of the threat posed by Aldi and Lidl and therefore overstate the extent to which they represent a greater competitive constraint compared to more established competitors. No support is provided for this assertion, however, despite the fact that the CMA noted that it would investigate the evolution in the focus of the Parties' internal documents over time. The Parties further note that Aldi and Lidl both now represent an established (albeit still growing) threat having both been in the market for over two decades. The Parties therefore consider that their internal documents (as reflected in the competitor counts) are indicative of current competitive conditions.

(441) *Fifth, the CMA's review has confirmed that Tesco is a greater focus of the Parties' internal documents (i.e. compared to the other merging party and Morrisons)*. This further undermines the CMA's conclusion which implicitly considers the "Big 4" as a distinct competitive group. The CMA notes that the importance of Tesco in the Parties internal documents may be explicated by the fact that both Parties [✂]. Firstly, although Sainsbury's used [✂]. The prominence of Tesco reflects its position as the strongest competitor to both Parties (as is supported by the totality of the economic evidence).

(442) *Sixth, the Parties' document counting output clearly demonstrates that the Parties are not especially close competitors and that other retailers (such as Aldi) feature more prominently in their internal documents*. For Asda, [✂]. In a subset of Sainsbury's Board and Committee documents, [✂].[245]

[242] PFs, paragraph 8.30.

[243] PFs, paragraph 8.28.

[244] PFs, paragraph 8.29.

[245] Parties' response to In-store groceries: Unilateral Effects WP, paragraph 77.

(443) Whilst the Parties accept that counting the number of competitor mentions cannot account for the significance of those references, they nonetheless note that these counting exercises were conducted over the Parties' 3,000 key performance and strategy documents which detail the commercial and strategic decision-making by the Parties. Therefore, each competitor mention was part of a wider strategic discussion and warrants appropriate weight and consideration. Counting exercises of this type are a regular feature of the CMA's recent Phase II decisions, such as *Electro Rent/Microlease* (where there was no mention of the deficiencies with this approach identified by the CMA in the present case).[246]

(444) Whereas counting references to competitors has certain limitations, it is an objective measure which allows the quantitative assessment of evidence from Parties' internal documents. Other than for Tesco (which the Parties dispute), the CMA has not identified any reason why this methodology may lead to the prominence of other competitors systematically being biased either upwards or downwards.

(445) Moreover, the CMA's qualitative assessment of internal documents has its own disadvantages and is particularly prone to confirmation bias and cherry-picking. For instance, drawing inferences from the titles of individual slides or the positioning of charts on a page is in itself an arbitrary way of measuring closeness of competition as evidenced by the following examples:

- [✄]
- [✄]
- [✄]
- [✄]
- [✄]
- [✄]

(446) Finally, the Parties note that no evidence from competitor internal documents is cited to support the CMA's conclusions. This is despite the CMA conducting analyses of third-parties' internal documents in other decisions (such as *Tesco/Booker*[247]) and the Commentary noting that competitors "*may have internal documents or research that provides useful insights*[248]". For example, it is clear from the CMA's decision in *Tesco/Booker* that Tesco's internal documents would be informative to this case. The CMA noted in this decision that Tesco's internal document showed "*some evidence...that the competition [Tesco] faces from Aldi, Lidl and Iceland is stronger for customers seeking to undertake larger shopping trips.*"[249] The Parties consider that other competitors' internal documents would be equally as informative.

(447) In summary, the Parties consider that a balanced reading of their internal documents demonstrates the intensity and variety of competitive threats in the UK grocery sector. Aside from the use of the catch-all term "Big 4" in the Parties internal documents, the CMA has failed to adduce any evidence that either Party individually affords the other Party more attention than other retailers (particularly with respect to key strategic decisions).

C. Differences in business models and in-store offering cannot be taken as a proxy for customer preferences

(448) As the Parties explained in their response to the WP, the CMA has relied on apparent differences between the business models of various players as a proxy for customer preferences. The Parties consider that

[246] CMA, *Electro Rent Corporation / Test Equipment Asset Management and Microlease merger inquiry*, decision of 17 May 2017, paragraph 6.105(a).

[247] CMA, *The anticipated acquisition by Tesco PLC of Booker Group plc*, decision of 20 December 2017, paragraph 7.136 ("**Tesco/Booker**") attached as **Annex_005_002**).

[248] Retail Merger Commentary, paragraph 3.15 (attached as **Annex_005_006**).

[249] *Tesco/Booker*, paragraph 7.47 (attached as **Annex_005_002**).

this is a manifestly erroneous approach, given customer switching preferences: the proportion of customers that would switch if the retail offer worsened is far more informative for the purposes of its assessment. Moreover, insofar as the facets of the in-store offering cited by the CMA are an important differentiating factor for customers, this should be reflected in the local level store diversions (and therefore reflected in the national average weighted GUPPIs).

(449) As the Parties' noted in their response to the WP, such an approach is the equivalent in the airline business of determining that low cost operators like Ryanair and EasyJet are not a competitive constraint against traditional high-cost airlines like British Airways and Air France, given that they don't offer services such as free baggage and inflight meals (amenities which are valued by "*some customers*"). This misses the fact that customers are prepared to make value-for-money trade-offs that fundamentally transformed the market, and indeed resulted in traditional high cost operators altering their business model to more closely resemble low cost operators. Such an approach is clearly apparent in the UK grocery industry, with customers demonstrating their willingness to shop around (including at Aldi and Lidl), and retailers adapting their business models to compete (as will be explained below).

(450) The PFs agree with the Parties' submissions that evidence from customer switching is more probative in assessing closeness of competition, but maintain that an analysis of business models is nevertheless informative given the "*significant proportion of respondents*" in the CMA store exit survey that listed factors such as range and branded goods as important elements of their choice of retailer. The Parties disagree with this analysis. The CMA's store exit survey shows that only a small proportion of respondents listed these factors as important drivers (relative to location and price) of their purchasing decisions. In the CMA's own survey, the unprompted reasons for choosing a shop were location and price. Indeed, no more than 5% of Sainsbury's or Asda customers cited range unprompted as a main driver for their purchasing decision and, within these customers, diversion rates to Aldi or a Lidl were no less than for other retailers.[250]

(451) Moreover, the Parties have submitted a wealth of evidence to show that the range offered by Aldi and Lidl suffices for the majority of shoppers' needs, that they serve a substantial portion of "main" shops, and the composition of baskets at Aldi and Lidl is very similar to those of traditional retailers.

1. In-store amenities and services

(452) The CMA identifies in-store amenities and services (such as food counters, cafes, pharmacies, and services such as ATM machines) as important differentiating features for the Parties (and other "Big 4" retailers. The CMA adduces no compelling evidence to suggest that in-store amenities and services are important factors for customers.

(453) The PFs conclude that "*the fact that the Parties choose to offer these services…indicates that they believe it to be an important part of their customer offering*"[251]. Moreover, it cites evidence on in-store offering and amenities which is extrapolated from the CC's Grocery Market Investigation (whereas it acknowledges that "*the merger is being assessed against current conditions of competition" and that "the markets' characteristics must be considered afresh.*"[252]) In reaching this conclusion, the CMA disregards significant evidence that the importance of these elements are diminishing (both in their importance to the Parties and customers).

(454) The Parties' survey data suggests that cafés, concessions or non-grocery/general merchandise retail offers are not the predominant or sole driver of store visits for more than a small fraction of customers. For instance, Asda's most recent Tracker Survey identifies store facilities (e.g. petrol station, café, pharmacy, photo processing etc.) as [✂]. As noted above, price and location are the predominant drivers

[250] The CMA's exit survey, page 25.

[251] PFs, paragraph 8.60.

[252] PFs, paragraph 4.18.

of store visits in the CMA's Exit Survey (and the CMA did not even test the importance of in-store amenities and services).

(455) First, specialist food counters only account for a small proportion of the Parties' sales in stores with counters. For Asda, counters make up on average only [✄]% of the Asda grocery sales in stores with at least one counter. Similarly, for Sainsbury's, counters comprise only [✄]% of its grocery sales in stores with at least one counter. This shows that counters are not intrinsic to a store's success, particularly as the products sold at the counter tend to be available on the shelf in any event. The Parties have demonstrated that this is reflected in their competitive strategy. [✄].

(456) Second, the diminishing importance of food counters is aptly evidenced by the strategic decisions of the Parties' competitors, notably Tesco's recent decision to discontinue specialist food counters due to customers "*shopping in different ways"* and having "*less time available to shop".*[253] When announcing the cut, Tesco's UK and Ireland boss Jason Tarry commented on the need to "*continually adapt"* to survive a "*challenging market*"[254]. The prevailing view from the press and industry analysts is that such in-store amenities are obsolete: "*marketing trickery…who is going to pay slightly more at the fresh food counter? Aldi and Lidl don't even have them."*[255] This example encapsulates the dynamic and fast changing nature of consumer preferences and neatly demonstrates the dangers of the CMA's reliance on a static and outdated view of how competition works in the UK grocery sector. It also directly contradicts Tesco's submission to the CMA that "*specialist meat and fish counters*" is one feature that differentiates the "Big 4" retailers from other competitors.[256]

(457) Third, a number of the amenities cited by the CMA do not differentiate the Parties (and other "Big 4" more generally) from other retailers. First, the CMA cites evidence from its store exit survey to show that good car parking facilities are important for some respondents. However, customer feedback is that Aldi and Lidl are perceived as convenient for customers because their stores are located on the edge of residential areas with good car parking facilities and are easier to navigate. Second, a number of other retailers offer facilities such as specialist food counters and cafes, notably including Waitrose and M&S (conversely, as noted above, Tesco is discontinuing food counters).

(458) The CMA cites a submission by Morrisons that the "Big 4" "*compete closely in terms of level of service, including in relation to store cleanliness, product availability, staff helpfulness, check out queues and facilities.*"[257] The Parties disagree, noting that they benchmark their store service levels against a range of competitors. For instance, [✄] across comparable service standards and the discounters often rate higher than traditional retailers. [✄]. Moreover, Waitrose is widely perceived as a market leader in terms of store service levels.

2. Product range and offering

(459) The CMA concludes that the "Big 4" "*unlike other grocery retailers, have Large stores with a wide range that allow customers to conduct a one-stop shop*." In reaching this conclusion, the CMA ignores the fact that a wide product range is perceived as a central driver for only a small majority of shoppers, and also irrefutable evidence that retailers such as Aldi and Lidl cater for main shops.

(460) First, only a small proportion of respondents to the CMA's store exit survey listed range or branded goods as important drivers (relative to location). The CMA's survey shows that the overwhelming driver of

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253 As reported in Retail Week "*Tesco puts 9,000 roles in consultation amid 'challenging' market*" (Retail Week: 29 January 2019).

254 *Ibid*.

255 The Guardian, Tony Naylor, "*Why I won't miss Tesco's fake 'posh' deli, fish and meat counters*", 29 January 2019, available at: https://www.theguardian.com/commentisfree/2019/jan/29/tesco-fake-posh-deli-fish-meat-counters-supermarket-fresh.

256 PFs, paragraph 8.15.

257 PFs, paragraph 8.54.

consumer choice is "convenient location", which was cited by 53% of Sainsbury's customers and 56% of Asda customers. In contrast, having a wide range of products was only an important determinant for a very small proportion (4%) of Asda customers and (5%) Sainsbury's customers.[258]

(461) Moreover, even for customers who answered that a wide choice of products was essential or important, the diversion rates are no different than the diversion rates for all customers. This demonstrates that what is key for shoppers is the sufficiency of range (i.e. customers wanting a wide range are just as happy to go to Aldi and Lidl stores as the average customer, demonstrating the sufficiency of their offering).

(462) Second, the CMA misconstrues evidence on changing shopping habits. In justifying its focus on in-store offering and store size, the CMA incorrectly (and misleadingly) claims that 89% of the population "*continue to conduct a single, main weekly shop*", and that at least a portion of these people would therefore be unwilling to shop at smaller stores (with more limited ranges).[259] The Mintel survey cited actually shows that only 45% of shoppers conducted a single main-shop a week whereas the majority of the population shop multiple times a week.[260] Moreover, the Parties do not argue that main shops have disappeared, but rather that shoppers are increasingly using a wider range of retailers (including Aldi and Lidl) to satisfy such missions.

(463) The Parties have submitted ample evidence that the smaller range offered by Aldi and Lidl caters for most main shopping needs:

- The proportion of spend through Aldi characterised as "main shop" exceeds that for traditional retailers, whilst the proportion for Lidl is similar. Based on data from Kantar Worldpanel data, 58% of spend at Aldi and 39% of spend at Lidl are main shop, compared with 44% to 48% at traditional retailers.[261]
- The average basket size at Aldi (at 18.3) is now more than 10% larger than the average basket size at Asda (16 items) according to Nielsen data. Aldi and Lidl compete closely with the traditional retailers for large baskets and main shops.
- The main shop baskets at Aldi and Lidl are highly comparable to the main shop baskets at traditional retailers.
- This is reflected by Lidl's and Aldi's submissions to the CMA that they aim to fulfil all or the vast majority of 'main shop' products (despite being a self-described "*limited range*" model).[262]

(464) Similarly, the fact that the Parties stock a wider range of branded products than Aldi and Lidl does not detract from the fact that they compete closely with a wide range of competitors:

- A wide range of retailers outside of the "Big 4" offer branded SKUs including Waitrose, Co-op, Aldi and Lidl (which have both increased the number of branded SKUs that they stock) as well as a range of convenience, online and bargain store operators.
- Customers regularly substitute own-brand goods for branded goods. This is evidenced by Kantar Worldpanel data which shows significant net switching from branded to own brand over the

[258] This also consistent with other survey evidence such as YouGov Competitor Benchmarking Tracker shows that over the three months from July to September 2018, the greatest influence on customer choice has consistently been convenience of location for Asda, Tesco, Morrisons and Sainsbury's (with 29-39% of responses). By contrast, product range is only ranked between sixth and eleventh across these retailers (with 2-5% of responses). In the same survey, the ability "*to get everything under one roof*" is also ranked as the fourth to seventh greatest influence on store choice for traditional retailers (with only 4-8% of respondents).

[259] PFs, paragraph 8.56. The respondents to that Mintel question were only stating whether they have what they define as a 'main weekly shop' where the majority of their food shop happens at one time, rather than a single shop of the week. In actual fact, the same Mintel survey found.

[260] UK Supermarkets, November 2016, Mintel (attached as **Annex_004_094).**

[261] CRA analysis of Kantar Worldpanel data, 52 weeks to 7 October 2018.

[262] Summary of hearing with Lidl held on 6 November 2018, page 1.

previous two years. It is also demonstrated by the wealth of consumer research showing that shoppers regard the own-brand range available at Aldi and Lidl as comparable in quality terms to the branded products available at traditional supermarkets.

- Aldi and Lidl's public statements also reflect this aspect, with the fact that they sell "*products comparable to the leading brands and supermarket premium ranges at the lowest prices in Britain*" forming a central part of their marketing.[263]

3. GM and fuel

(465) The vast majority of customers at the Parties' stores are visiting primarily to purchase groceries. Non-grocery offerings account for a relatively small proportion of revenue. For example, the Parties' transaction data indicate that the majority of baskets do not contain GM, with [✂]% of all Asda grocery baskets and [✂]% of all Sainsbury's grocery baskets not containing any GM items. Moreover, there is no survey evidence which suggests that the offer of specifically GM or fuel is a driver of choice of store (as there were no options on this topic beyond 'wide range of products').[264]

(466) For those customers that do purchase GM and/or fuel, the CMA's contention that this narrows the competitive constraint to just the Big Four is inaccurate. Indeed, other players can also benefit from collocation with petrol stations such as Waitrose and Shell. Additionally, plenty of other retailers offer GM alongside a grocery offer (such as M&S and Waitrose). While Aldi and Lidl use a distinct ranging method ("when it's gone it's gone") this still achieves the desired effect of generating footfall, in the same way that standard GM stocks in the Parties do (as explicitly noted in the PFs).[265] Similarly, Waitrose capitalises on the same diversion both directly and indirectly – not only does it stock its own GM range (including kitchen, dining and home products), it also offers the opportunity to pick up GM ordered from John Lewis from its shops, in order to drive additional sales into core grocery.[266]

4. Pricing levels

(467) The CMA seeks to differentiate the Parties (and indeed the "Big 4") from Aldi and Lidl by focusing on the difference in overall pricing level.[267] However, the fact that Aldi and Lidl are more price competitive than the Parties cannot be considered evidence that they impose *less* of a constraint on the Parties.

(468) Indeed, the strategic focus that the Parties have on narrowing the price gap (as acknowledged by the CMA), coupled with the fact that Aldi is an important benchmark for each Party's pricing (whereas the other Party is not), and the great attention that the discounters themselves draw to the price difference with the traditional retailers in their marketing advertising,[268] clearly demonstrates the perversity of concluding that the cheaper prices offered by Aldi and Lidl makes them less of a constraint on the Parties.

(469) Moreover, the Parties have adduced evidence to demonstrate that they are differentiated on price. Customer perceptions support this view, with customer perception data (such as OC&C chart (at Figure 14 below) demonstrating that customers perceive Asda to be closer to Aldi and Lidl on price than to Sainsbury's. This is reinforced by third party submissions cited by the CMA. For instance, Aldi submitted that Asda and Sainsbury's differentiate themselves from each other and from the rest of the "Big 4", with Asda strengthening its position as a price leader.[269]

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263 Matthew Barnes (then Aldi's UK and Ireland CEO), as quoted in the Guardian, "*Aldi's UK profits drop for third successive year despite growth*", 25 September 2017, available at https://www.theguardian.com/business/2017/sep/25/aldi-uk-profit-drops-despite-growth.

264 See the CMA's exit survey, page 25. While spontaneous choice attributes included availability of GM and/or fuel, these were grouped into 'range' and were not accounted for separated (see page 27 of the same survey).

265 Summary of Aldi's hearing with the CMA, paragraph 23

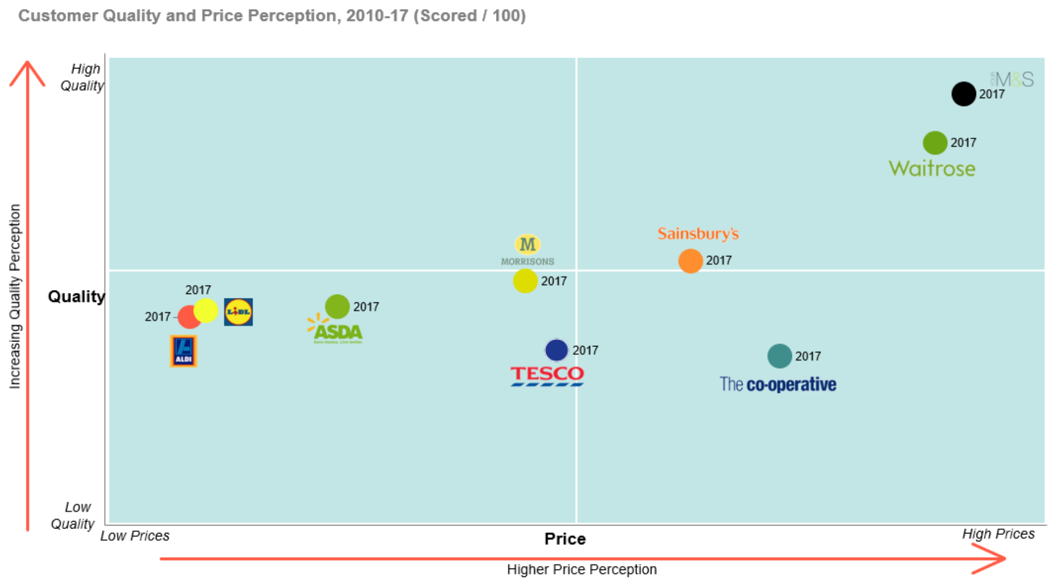
266 Summary of Waitrose's hearing with the CMA, paragraph 23

267 PFs, paragraph 8.59.

268 See, for example, the Parties' Response to the National Unilateral WP, figure 5.

269 PFs, paragraph 8.17.

Figure 14 OC&C – Customer Quality and Price Perception 2017



D. Third party submissions

(470) Finally, the CMA accepts that the views of third parties need to be carefully evaluated in light of the available evidence and notes a number of instances where third party public statements and/or prior submissions are inconsistent with their submissions in this case. For instance, Tesco notes that: "*the discounters only compete with traditional retailers over a small share of [their] range meaning that they are not yet a full substitute for customers*", which is clearly contradicted by its prior submissions in Tesco/Booker. In response to the WPs, the Parties submitted that the CMA should therefore have tested the submissions of competitors against their internal documents. There is no evidence that the CMA has done so (for example by using its formal information gathering powers under the Enterprise Act). Further, whilst the PFs acknowledge the inconsistency in Tesco's statements (and those of other competitors) when describing the competitor statements initially, the CMA's competitive assessment fails to do so, and simply notes without qualification that third parties have indicated that the discounter constraint was limited.

VII. There can be no national SLC if there are no local problems in aggregate

(471) The evidence above does not show the Parties to be particularly close competitors and is therefore clearly not supportive of the finding of a national SLC. In any case, the evidence referred to by the CMA does not pertain to a discrete national theory of harm which would not be solvable by local remedies (for the reasons explained below).

A. Local divestments will comprehensively remedy any national SLC

(472) The Parties have consistently argued to the CMA that local divestments will remedy a national theory of harm based on the aggregation of local incentives, but the CMA has not engaged with this argument in the PFs.

(473) The Parties' position is consistent with the economic reality and with the logic of the Commentary, that there can be no SLC at a national level (on the basis of an aggregation of local incentives) if SLCs at the local level are comprehensively remedied:

- If a merger does not significantly change the proportion of local areas where the Parties face limited competition, there can be no incentive to worsen any aspects of its centrally set, uniform retail offer (see *Poundland/99p*).

- Moreover, if a local store divestiture remedy package comprehensively addresses local SLC areas, there will equally be no change in the aggregate incentive on centrally-made decisions. This was exemplified in *Ladbrokes/Coral*, where the CMA granted clearance conditional upon a divestiture remedy, which would "*involve Ladbrokes and Coral divesting sufficient betting shops to one or more suitably qualified purchasers to address the SLC that the Parties found in 642 local markets, as* <u>*well as the SLC at the national level resulting from the aggregated loss of competition at the local level*</u>".[270]

(474) As set out in their response to the Notice of Possible Remedies, the Parties have proposed an extensive store divestment package which they consider will address potential concerns arising (whether at a national or local level) from the application of a conservative 5% GUPPI threshold. If the CMA's position is that there can be a standalone national SLC even if every local SLC is comprehensively remedied, this is flawed in principle and lacks any purported reasoning in support.

[270] CMA, *Ladbrokes / Coral merger inquiry*, decision of 26 July 2016, paragraph 14.13 (attached as **Annex_005_007)**. See also the decision of the OFT's decision in *The completed acquisition by Global Radio UK Limited of GCap Media plc*, ME/3638/08, 8 August 2008: *"The OFT has not found it necessary to conclude whether the merger gives rise to a realistic prospect of a substantial lessening of competition at a national level (through the creation of market power in the [two regional areas giving rise to SLC concerns i.e.] East and West Midlands). This is because, even if this were the case, the OFT considers that any remedies offered in the East and West Midlands area that are sufficient to address comprehensively the substantial lessening of competition in those regions would alleviate also any issues arising as a result of the merger at the national level".*

CHAPTER 5 – IN-STORE GROCERY: CONVENIENCE

I. Introduction and Summary

(475) The PFs find that the Proposed Merger will lead to an SLC in relation to convenience stores at both a national and local level. For the reasons set out below, the CMA's findings are entirely without foundation:

(i) The CMA's national SLC findings in relation to convenience are based solely on its findings in relation to supermarkets. As a result, the Parties' submissions in response to in-store national unilateral effects (the "**Parties' National Submissions**") apply equally here. In particular, the CMA's analysis is not supported by the quantitative evidence and relies on a manifestly unreasonable assessment of the available qualitative evidence. With no national SLC in relation to in-store groceries, there can be no SLC finding to be transferred across to Asda's convenience estate.

(ii) The CMA's local findings have been made in the absence of proper engagement with the Parties (despite their requests) and appropriate investigatory steps to properly examine the market under consideration. As a result, the CMA has failed to properly assess the constraints applicable at local level. Instead, the CMA relies entirely on the findings made in *Tesco/Booker* without giving any consideration to the relevant differences between the convenience offerings of the merging parties in that case and those of the Parties in the Proposed Merger (notably the fact that Asda's convenience stores are attached to its PFSs). Further, the CMA departs from the GUPPI threshold used in that decision without justification. As a result, the CMA's conclusions are fundamentally unsound.

II. The Proposed Merger will not give rise to an SLC on a national unilateral basis

(476) The CMA provisionally finds no "national" SLC in relation to Sainsbury's convenience stores. The Parties agree with the CMA's conclusion.

(477) However, the CMA provisionally finds a "national" SLC in relation to Asda's convenience stores (i.e. the 61 stores attached to some of Asda's petrol filling stations). Its conclusion is based solely on the fact that Asda operates the same price file for products in both its supermarkets and its limited PFS convenience stores. Because of this uniform price file, the PFs state at paragraph 8.257 that the CMA's "*provisional finding that the Merger would result in an SLC in each local area where one or more of the Parties' supermarkets is present would also mean that the merger would result in an SLC in each local area where an Asda convenience store is present*" (i.e. across Asda's national convenience estate).

(478) As set out in detail in Chapter 4, the CMA's national assessment is fundamentally flawed. In particular, the CMA's supermarkets analysis is not supported by the quantitative evidence and relies on a manifestly unreasonable assessment of the available qualitative evidence. In any event, the PFs recognise that "*any … deterioration across the Parties' estates would reflect the aggregate effect of competitive constraints that the Parties face in each of the local areas where they operate*", which means that local divestments will comprehensively address any putative national concern. In light of this, there can be no national SLC in relation to in-store groceries for supermarkets, and thus no SLC to transfer to Asda's convenience estate.

(479) On the basis of the above, therefore, a proper assessment cannot find national concerns in relation to the Parties' convenience store offerings.

III. The Proposed Merger will not give rise to concerns at local level in relation to convenience stores

(480) The CMA's local assessment of convenience stores is fundamentally flawed in a number of key respects.

(481) As a preliminary point, the Parties note the very limited nature of the CMA's engagement with the Parties with respect to convenience, which has resulted in the CMA failing to properly assess the constraints applicable at local level.

(482) Out of the 25 RFIs and hundreds of questions that the CMA sent to the Parties, only three requests were made for information or data relating to convenience stores.[271] Additionally, the CMA made no requests for internal documents relating to the Parties' convenience offerings. The requests that were made came prior to the Phase I decision and only briefly discussed the Parties' convenience offerings. The first indication the Parties received that the CMA intended to consider convenience stores in any detail was in its 'In-store Grocery' WP, where it briefly set out its proposed approach and indicated that it would apply an analysis consistent with *Tesco/Booker*.

(483) As the Parties pointed out in their response (and as referenced by the CMA in the PFs), the CMA provided none of the data, methodology or assumptions underlying the decision in *Tesco/Booker* meaning the Parties were given no opportunity to comment meaningfully on the CMA's proposed approach. The Parties requested further engagement with the CMA on this issue,[272] but their requests were ignored. Despite the CMA's *Tesco/Booker* analysis forming a key part of the PFs the CMA have still not provided the Parties with the underlying data necessary to comment on their proposed approach. This undermines the Parties' rights of the defence.

(484) In the absence of a proper investigation, the CMA's local assessment for convenience proceeds on the basis of the *Tesco/Booker* approach. However, the CMA rejects key aspects of that decision (such as the use of a 5% GUPPI safe harbour threshold) without adequate reasons. This selective reliance on Tesco/Booker is plainly insufficient for the following reasons.

A. *Tesco/Booker* cannot be relied on in lieu of a proper investigation

(485) At paragraph 8.267, the CMA states as follows:

> *In determining our approach to the competitive assessment of the Parties' convenience store overlaps, we have therefore drawn on the evidence and analytical approach adopted in the recent CMA Phase 2 investigation of Tesco/Booker. We consider that this case provides a good starting point for our own analysis, given that <u>it represents a recent, in-depth investigation focusing principally on the convenience sector (in particular, the overlap arising between Tesco's convenience stores and the symbol group and independent convenience stores supplied by Booker</u>). In view of this recent investigation into convenience stores, and taking into account the CMA's discretion to prioritise the use of its resources within the confines of the statutory timetable, <u>we did not consider it necessary to conduct an in-depth assessment of the conditions of competition with respect to convenience stores</u>. We have nevertheless assessed afresh whether certain assumptions or inputs underlying the analysis used in Tesco/Booker remain relevant in the particular circumstances of this case and have departed from them where appropriate*. [Emphasis added]

(486) The CMA is incorrect in its assumption that the adoption of the methodology employed in *Tesco/Booker* can adequately replace a proper investigation in relation to the Proposed Merger's potential impact on convenience. This is particularly the case, as the Group Chair has publicly stated: "*I'm not sure we would see Tesco/Booker as a precedent*."[273]

[271] RFI3, questions 2, 8 and 48.

[272] See email from Deirdre Taylor to Cristina Caballero dated 18 December 2018 at 17:44 and Parties' response to the CMA's In-Store Grocery WP.

[273] https://www.ft.com/content/f4acc716-34de-11e9-bd3a-8b2a211d90d5

(487) First, the CMA launched its merger inquiry into the *Tesco/Booker* transaction at the beginning of 2017. As the CMA acknowledges in the PFs the UK grocery market is "*rapidly changing and highly competitive*[274]" [emphasis added]. It is unrealistic to assume that a decision based on evidence which would predate that time and thus be at least two years old adequately captures the Proposed Merger's potential impact on convenience. Moreover, the *Tesco/Booker* and (later) *Co-op / Nisa* mergers may themselves have had a significant impact on competitive dynamics in the convenience sector.

(488) Second, with respect to Asda, the CMA's approach completely disregards the differentiated nature of the Asda convenience offering:

- Unlike standard convenience stores, which tend to be situated in high streets and other convenient locations, all of the Asda stores are attached to its PFSs (of which 43 are co-located with a supermarket).
- Because they are attached to PFSs, the Asda stores are particularly small; 48 of Asda's 61 convenience stores, or 79%, are less than 100 square metres in size.
- Whilst convenience stores on average carry a range of about [✂] SKUs per store,[275] Asda's PFS-based stores carry on average [✂] SKUs for its 18 stand-alone PFS-based stores and only [✂] SKUs for the 43 PFS-based stores co-located with a supermarket.
- Finally, as well as having a much smaller number of SKUs, almost three-quarters of Asda's PFS store range is "kiosk", "food to go" and "confectionary", whereas these ranges would comprise around a third of the range in its supermarkets.

(489) Thus, it is clear that Asda's stores are not "convenience stores" in the sense commonly understood; they are petrol station shops. They may therefore have significantly different diversions than those implied by *Tesco/Booker*.

(490) The proper competitive set by which the impact of the Proposed Merger on such shops should be assessed at local level must include local PFS shops. These are plainly the primary source of competitive constraint for Asda's PFS shops. PFS shops played no role in the *Tesco/Booker* analysis and are, as a result of the CMA's undue reliance on that case, excluded from the competitive analysis in the present case. This exclusion fundamentally undermines the CMA's approach to the assessment with respect to the Asda stores.

(491) Third, with respect to Sainsbury's, the assumptions underlying the CMA's analysis in *Tesco/Booker* would, of necessity be based on the submissions that Tesco made and market testing that the CMA undertook on Tesco convenience stores. This is clear from the list of factors identified at paragraph 8.271 as forming the basis for the *Tesco/Booker* findings.

(492) As the Parties submitted in response to the CMA's WP, given the local nature of competition and the fact that the CMA clearly understood in *Tesco/Booker* that different fascia exercise different constraints on each other, there is no basis on which to assume that the same results would hold if the CMA had undertaken market testing centring on Sainsbury's stores. Thus, there is no basis for the assumption that the Tesco/Booker brand weights apply equally to Sainsbury's. In response, the CMA notes only that in the *Tesco/Booker* case, the brand weights were applied consistently for Tesco, for Booker and for all major convenience chains, and that Tesco is each Party's closest competitor. Neither of these considerations is sufficient.

(493) As a result, the CMA cannot simply assume that the *Tesco/Booker* approach would apply equally with respect to assessing the constraint on Sainsbury's. The failure to investigate the constraints from the

[274] Paragraph 16.87(a) PFs.

[275] An average Sainsbury's convenience store will have a range of circa [✂] SKUs, excluding Newspapers & Magazines and Cards, as these are typically ranged by the supplier.

perspective of Sainsbury's therefore fundamentally undermines the CMA's approach to the assessment with respect to the Sainsbury's stores.

B. The GUPPI threshold adopted by the CMA is inappropriately low

(494) Following its approach in *Tesco/Booker,* the CMA proposes to adopt a WSS approach. However, contrary to the approach taken in *Tesco/Booker*, where the CMA used a "safe harbour" threshold of 5%, the CMA has determined that it would be appropriate to set the threshold for the GUPPI decision rule for its local assessment at 1.5% (or 2.5% post-efficiencies) (see para 2.281). Whilst for the reasons outlined above the Parties consider it would be inappropriate to uncritically adopt the approach used in Tesco/Booker, they do not consider that the CMA has provided an adequate justification to depart from the GUPPI threshold adopted in Tesco/Booker. Indeed, the Parties consider that the CMA's conclusions regarding the GUPPI threshold are fundamentally flawed for the following reasons.

(495) First, having determined that the correct approach is to follow *Tesco/Booker,* the CMA is incorrect as a matter of principle to then depart from the *Tesco/Booker* threshold in order to be consistent with its approach in relation to supermarkets (which appears to be the CMA's underlying reasoning, see para. 8.281). In particular, the CMA had previously determined at paragraphs 8.266 and 8.267 that its supermarket investigation focused only on the constraint on Medium and Large stores and was inappropriate for a convenience assessment, hence its reliance on *Tesco/Booker* in the first place.

(496) Second, the CMA asserts that the evidence it collected during the *Tesco/Booker* investigation gives it an appropriate level of certainty to choose a threshold of 1.5% (absent efficiencies). This is plainly inconsistent – if the evidence gathering in the *Tesco/Booker* investigation warranted a "safe harbour" GUPPI threshold of 5%, it cannot at the same time warrant a determinative GUPPI of less than half of that. It is also incorrect – predicating the findings on evidence gathered in Tesco/Booker (with no evidence specific to the facts of this case) must, as a matter of logic, diminish the level of certainty that the CMA can have in its GUPPI assessment.

(497) Third, the CMA's GUPPI threshold purports to take account of a number of factors applicable to the present case when it does not, in fact, do so. At paragraphs 8.277, the CMA sets out four factors that might cause GUPPIs to be understated or overstated:

- The CMA acknowledges at paragraph 8.277 that an approach which excludes own-brand diversion when the overlapping Party store is a Large/Medium store and includes own-brand diversion when the overlapping Party store is a convenience store, may be preferable to the approach it has taken. The CMA notes that its "*current approach may overstate the likelihood of the Merger giving rise to an SLC in some local markets*". As a result, it states that "*we take this into account when considering the threshold at which we set our GUPPI decision rule*".
- At paragraph 8.278(a), the CMA states that prices are higher at Sainsbury's convenience stores than at its supermarkets for the majority of products, which means that the relative price difference between the Parties may be greater for their convenience stores than their supermarkets. The CMA notes that "*adopting the same price ratio as used for our assessment of the Parties' supermarket overlaps may tend to overstate the GUPPI for Sainsbury's convenience stores*". It states that "*we take this into account when considering the threshold at which we set our GUPPI decision rule*".
- At paragraph 8.278(b), the CMA notes two points about margins. It states first that it considers the margins used in its assessment to be understated (although it provides no reasoning as to why this should be the case specifically in relation to convenience store margins) and second that to the extent that some GM sales are made in convenience stores, this would lead to the GUPPI being understated.

(498) At paragraph 8.280(b), the CMA notes that "*there are some assumptions underlying our analysis that individually may cause us to overestimate or underestimate the pricing pressure in certain cases*" and

cross refers to the above paragraphs. However, the CMA makes no attempt to determine the extent to which their assumptions might overestimate or underestimate pricing pressure or to balance those factors against each other. For instance, the Parties sell only minimal GM in their convenience stores. Indeed, in the case of Sainsbury's, GM makes up [✂]% of sales in its convenience stores. Therefore the potential understatement is in practice also likely to be very small.

(499) Similarly, there is no evidence that convenience margins have been understated and, in fact, as the evidence shows (as explained in Chapter 3) the margins used by the CMA are, in fact, overstated. Finally, the CMA has ignored the Parties' submissions on own-brand diversion, including how to properly take those diversions into account in the GUPPI analysis. Had the CMA taken the factors it mentions into account when setting the GUPPI threshold, it would not have come to the conclusion it did.

(500) Instead, it is clear that the CMA has simply applied the same GUPPI as it has done in relation to supermarkets, with no proper assessment of the factors relevant to competition in respect of convenience. The CMA's GUPPI threshold of 1.5% (without efficiencies) is therefore unsupported by the evidence and cannot hold.

C. The CMA's local analysis contains significant calculation errors

(501) Further compounding the harm from using an inappropriately low GUPPI threshold, the CMA's analysis contains two significant calculation errors which cast doubt on the robustness of the CMA's methodology and halve the number of local SLC areas.

(502) First, when creating the list of overlapping competitors, the CMA erroneously duplicated Asda's stores by adding them from two different datasets. The first dataset is the property data prepared by CRA ("De-duplicated competitor list_Phase I.dta") and the second dataset is the updated list of the Parties' stores prepared by the CMA ("Parties stores.dta"). The CRA dataset also contains Asda Living stores, which should not have been included in the convenience stores analysis. The result is that, first, every Asda store overlapping with a Sainsbury's centroid appears twice in the dataset which effectively doubles the GUPPI, and second, Asda Living stores receive a positive weight which further overstates the GUPPI for Sainsbury's centroids. Correcting for these two mistakes reduces the number of SLCs from 65 to 32 using an overall 2.5% GUPPI threshold (11 Asda and 21 Sainsbury's SLCs).

(503) Second, the CMA erroneously dropped overlapping competitors that have the same latitude and longitude as the centroid. The Stata command that calculates straight line distances returns a missing value when the centroid and the overlap are in the same location, and this was not accounted for by the CMA. The result is that when dropping overlaps beyond a 1-mile radius, stores with a missing distance are also dropped, even though they are within the catchment. Correcting for this error (on top of the corrections described above) reduces the number of Asda SLCs from 11 to 10 but increases the number of Sainsbury's SLCs from 21 to 22, so the total number of SLCs remains at 32.

D. The CMA fails to take account of entry and expansion in convenience

(504) The CMA's finding that entry or expansion in convenience would not sufficiently mitigate the impact of the Proposed Merger, such that no SLC would arise in relation to convenience is fundamentally flawed, as it fails to engage with the evidence relevant to this issue.

(505) First, the CMA's focus (as set out in paragraph 8.286) is on the barriers to entry for Large stores found in the CC's 2008 Grocery Market Investigation and confirmed by "some evidence" of the existence of barriers to entry for Large stores and the generally reduced number of openings by the "Big 4" retailers. As paragraph 8.286 itself acknowledges, the CC Grocery Market Investigation found that there were only "*limited constraints on entry or expansion by Medium grocery stores and convenience stores*". The findings in relation to Large stores therefore provide at best only a very partial picture of the possibility of entry and expansion into the market for convenience.

(506) In fact, barriers to entry for smaller stores, in particular convenience stores, are far lower. With customers more focused on convenience and location than price or range, operators require far less by way of supply network, brand and marketing, the provision of car parks and associated facilities (including planning permissions), etc. For example, there has been significant expansion in the convenience sector by operators reutilising properties formerly occupied by banks and pubs. The CMA has failed to carry out any analysis of the extent to which there could be considered to be barriers to entry or expansion for Medium or convenience stores.

(507) At paragraph 8.287 and 8.288, the CMA states that it has only considered the new store openings of supermarket competitors in its analysis, but has not taken into account the new store openings of convenience stores, despite (and, indeed, because of) the "*very large number of independent retailers*" and "*number of convenience store operators that receive a positive weighting*." In effect, therefore, the CMA has deliberately excluded from its entry and expansion analysis the "*wider range of competitors*"[276] that the CMA acknowledges operate in this market. This failure to consider the potential entry and expansion by a large range of competitors active in the market wholly undermines the CMA's conclusions.

(508) Third, the CMA has not taken into account recent examples of expansion which demonstrate the limited barriers to entry relating to convenience stores. For example, Co-op recently announced that it is intending to open 100 new stores in 2019 as part of a £200 million investment programme.[277] Similarly, Amazon has widely publicised that fact that it is developing an Amazon Go format and has already secured a number of UK sites. It has also been actively recruiting in advance of opening a chain of physical shops in the UK.[278]

(509) It is clear from the above that, rather than properly assess whether entry or expansion could mitigate the effects of the Proposed Merger, the CMA has limited its considerations to only a portion of the market and only a small number of potential entrants in any given local area. The CMA's conclusions on entry and expansion are therefore unsupported by the evidence.

IV. Conclusion

(510) The CMA's assessment of convenience cannot stand. Its national findings are based solely on an SLC finding in relation to supermarkets which, in light of the evidence, is fundamentally flawed. It cannot, as a result, be transferred across to Asda's limited PFS convenience estate in order to ground a national SLC in convenience.

(511) Further, the CMA's local findings have been made without a proper investigation and assessment of the competitive situation present in the convenience sector. The CMA's reliance on a watered down *Tesco/Booker* approach, its calculation errors, and its failure to take due account of the factors it determines to be relevant, means that the CMA's conclusions are unfounded and unsound.

[276] PFs, para 8.260.

[277] https://www.co-operative.coop/media/news-releases/co-op-to-serve-up-over-100-new-stores-in-2019-as-part-of-gbp200-million

[278] https://www.thegrocer.co.uk/movers/amazon-hires-home-bargains-store-recruitment-coordinator/590934.article

CHAPTER 6 - ONLINE

I. Introduction and Summary

(512) The PFs conclude that the Proposed Merger will lead to an SLC in relation to online delivered groceries on three counts: (i) unilateral effects at the national level; (ii) unilateral effects at the local level; and (iii) coordinated effects on a limited basis in areas in which Ocado is not present, irrespective of the number of other competitors present.

(513) For the detailed reasons set out below, the CMA's concerns on all fronts are unsupported by the evidence. Indeed, when reporting on the newly proposed online tie-up between Ocado and M&S, Bernstein Research noted that both companies operate, "*in the most competitive grocery ecommerce market in the world*".[279] [emphasis added] Any reasonable analysis of the competitive dynamics of the market shows that the Proposed Merger will not give rise to an SLC on any basis.

(514) As set out further below, the CMA's assessment of the unilateral effects of the merger at both the national and local level is fundamentally undermined by a number of factors, including: (i) the failure to recognise that online and in-store groceries compete in a single overall market for groceries, thus significantly underestimating the constraint from in-store groceries; (ii) the reliance, to the exclusion of other relevant evidence, on the CMA's online survey (which suffers from a number of inherent flaws); and (iii) the wholesale underestimation of the likelihood and significance of entry and expansion, thus completely understating the dynamic and increasing competitive constraints on the Parties. In particular, the CMA fails to identify the upcoming entry by M&S, and the expansion plans of [✄]. The unduly restrictive approach to assessing expansion in the PFs also significantly underestimates the extent and impact of expansion by [✄].

(515) The nature of the questions asked of the Parties at the response and remedies hearing indicates that, even were a remedy required in online (which the Parties dispute), the CMA may not fully appreciate the connection between the assets needed to operate an online grocery service; the fact that online grocery demand and competition is local; and how existing competitors can expand into a new area to address local online grocery demand. The necessary requirements to provide an online grocery service are (i) a website – which all existing operators obviously have; (ii) a supply point, whether that is a CFC operated themselves or by third parties (such as Ocado) or store-pick grocery stores;[280] and delivery capability (all of which is readily available from third party providers). As a result, whilst the Parties do not consider that an expectation of either national or local SLC findings in online can be sustained by the CMA, if required, a ready solution – in the form of sale of grocery store supply points to existing online operators (who clearly have their own websites and, as set out above, are either currently expanding or are poised to expand) – would remedy any residual local online SLCs. Provided the buyer is an effective competitor in online grocery, the CMA should not be concerned to ensure customer "migration" to an online service in a local area, as this will be the necessary consequence of the divestment of a supply point (just as it would be with divestment of a grocery store to remedy a local instore SLC).

(516) The CMA's assessment of coordinated effects is similarly unsupported by evidence, as the necessary conditions for coordination (namely alignment on, and monitoring of, terms of coordination, internal stability and external stability) are not met either pre- or post-merger, even on the limited basis set out in the PFs. In particular, the CMA has significantly overstated the level of transparency and understated the degree of complexity around online delivery pricing. The CMA provides no credible evidence to support its assumption that the Parties and Tesco would have the incentive to fundamentally alter the basis on

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279 Bernstein Research as quoted in: Reuters, "M&S in tie-up talks with Ocado to take its food online", 26 February 2019, (https://uk.reuters.com/article/uk-ocado-m-a-marks-spencer/ms-in-tie-up-talks-with-ocado-to-take-its-food-online-idUKKCN1QF1AW).

280 Noting that these need not necessarily be proximate to local demand.

which they each currently charge for online delivery to allow them to coordinate in the areas in which the CMA considers coordination to be possible.

II. The PFs fail to properly recognise the constraint from in-store groceries

(517) The CMA's assessment of whether online and in-store groceries compete in the same market, such that in-store is a significant constraint on online, is fundamentally flawed for a number of key reasons.[281] In particular, the CMA disregards numerous pieces of evidence provided by third-parties and by the Parties, including real-world evidence from a detailed analysis of the Parties transaction databases. Instead, it relies exclusively on its own flawed survey (which asks customers hypothetical questions), the results of which, according to a survey expert, "*are prone to a range of largely unavoidable random and systematic errors*", which means that "*there is a high risk that key estimates from the survey cannot be taken as an accurate guide to customer behaviour in the event of a merger between the Parties*".[282]

A. Failure to take account of relevant evidence

(518) The CMA notes,[283] but places no weight on, the evidence of Ocado and Amazon that they compete in an overall market encompassing both online and in-store groceries. There is no justification for doing so, not least as pureplay online providers can be expected to experience acute competitive pressure from the in-store channel[284] such that their views should be accorded significant weight. Further, the CMA provides no indication of contrary views from Tesco, Iceland, or Waitrose, noting only Morrisons' submission that competition between online and in-store channels may be limited. In circumstances where only one of the Parties' six online competitors queries the in-store constraint on online, CMA's assessment that the evidence of third parties is "mixed" on this issue is significantly overstated.

(519) Further, the evidence contained in Morrisons' submission to demonstrate the limited competition between online and in-store is flawed. This evidence comprised one estimate from the Kantar switching data, which the CMA says *"showed that 99.6% of <u>net switching</u> to its online store came from other online competitors"*(emphasis added).[285] As accepted by the CMA in the discussion of the Kantar switching data in the context of in-store diversions, the measure of net switching in isolation is not appropriate as *"net switching may mask the amount of competitive interaction between two retailers"* and *"our view is that switching losses most closely proxy for diversion and are the most informative about closeness of competition".* The Parties obtained the relevant Kantar data for the 12-week period referred to by Morrisons and these show clearly that only 22% (rather than 99.6%) of losses to Morrisons online store came from other online competitors, with the remainder 78% coming from in-store.[286] The 52-week data (which is available to the CMA) is also consistent with this finding as they show that 24% of switching losses to Morrisons online store came from other online competitors.[287]

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281 As well as the key failures discussed in sections A and B, the CMA also relies in its assessment on factors irrelevant to the issue of whether in-store groceries constrain online. The CMA's assessment commences on the basis that the question of whether there is a separate market for online delivered groceries has not been considered in detail in previous CMA cases, citing the *Co-Op/Nisa* finding that "*it is not clear how strong a constraint online shopping provides for individual stores, particularly for convenience*". Similarly, at paragraph 10.10(b), the CMA cites Kantar Worldpanel data submitted by Morrisons showing that 99.6% of net switching to its online store came from other online competitors. By approaching the assessment from these perspectives, the CMA relies on irrelevancies – the question is not whether online constrains stores or whether the diversion to online comes more from stores or other online competitors; the question is whether customers would divert <u>from</u> online to in-store.

282 Report prepared by Patrick Sturgis, Professor of Research Methodology at the University of Southampton and Specialist Advisor to the House of Lords Select Committee on polling issues, attached as **Annex_001V.6_001**.

283 PFs, paragraph 10.10.

284 The CMA's investigation would be deficient if it has not made proper enquiries of third parties' internal documents and data via the use of compulsory process in order to properly test assertions made.

285 PFs, paragraph 10.10 (b).

286 Kantar Worldpanel data for Morrisons Internet, 12 we 7 October 2018 vs 2017.

287 Kantar Worldpanel data for Morrisons Internet, 52 we 17 June 2018.

(520) In a similar fashion, the CMA notes in a footnote[288] that the Parties' internal documents show a constraint from in-store but ignores this evidence. In particular, it fails to address the fact that both Parties have invested in their online offering to reduce the likelihood of customers switching and their investment has been targeted at limiting the inconvenience of shopping online when compared to buying groceries in-store.

- For example, Sainsbury's groceries online strategy refresh in 2014 prioritised improving areas of the shopping experience that were contributing to customers lapsing back to shopping in-store, including [✂].
- Similarly, Asda's internal documents also demonstrate that [✂]. Asda also tracks switching losses of its online offering to other online grocery operators and to competitors' in-store offerings. The majority of switching losses are typically to competitors' in-store offering.

(521) This evidence of channel constraint cannot be ignored simply because the Parties' online-specific documents, which are written by discrete online teams for the purpose of making decisions relating to the Parties' online grocery offerings, unsurprisingly benchmark against and focus more closely on competitors who offer online groceries. The CMA incorrectly places no weight on the Parties' general strategy documents which frequently discuss online and in-store groceries side-by-side. For example, Sainsbury's 2020 Strategy document focuses on [✂].[289] Similarly, [✂].[290]

(522) Further, the CMA places no weight on relevant datasets and evidence submitted by the Parties, without sufficient justification:

- The CMA chooses to place no weight on Kantar switching data because some customers "*may no longer be available at home for deliveries or they may have sold their car and can no longer easily get to a supermarket*".[291] This is plainly unjustified; it is impossible for customers to <u>never</u> be at home for deliveries (which is the only circumstance in which they would need to switch from online shopping for availability reasons) and customers without car transport can and do shop easily at supermarkets. In any case, even if some customers are switching as a result of factors unrelated to the relative PQRS offers of suppliers, there is no basis to assume that such customers would represent a substantial proportion of the total number of customers switching from the Parties' online offers. Further, even though the same concerns could be said to arise with Kantar switching data for in-store grocery (for example a customer may move, their travel patterns or other circumstances may change), the CMA chooses to rely on the Kantar data as being relevant to in-store diversions, and only rejects the data when it comes to understanding diversions between online and in-store because it does not fit with the CMA's theory of harm.
- The CMA discounts the Parties' data on lapsed customers simply because it assumes that an undefined "proportion" of customers may have decided to stop having groceries delivered at all and that the data is therefore less responsive than its survey. This ignores the fact that lapser data is data that the Parties themselves use to understand the extent of switching, including to in-store, and they make commercial decisions on this basis. As such there is no justification to simply dismiss it as uninformative.
- Finally, the CMA disregards the switching and reduced spend analysis in relation to the Parties' transaction datasets on the basis that "*it is difficult to distinguish complements and substitutes in these analyses*". This objection is hard to understand: complementary products/services result in an <u>increase</u> in demand, whereas switching data relates to a <u>decrease</u> in the demand for a party's

[288] PFs, paragraphs 10.24 – 10.25.

[289] Sainsbury's 2020 Food Strategy Pre-read, slides 5, 6, 9, 25, 27, 34, 60 and 74 (Annex_001D_00449).

[290] Asda 3 year Plan 2019 – 2021, slide 14 (Annex_002D_035).

[291] However, as discussed above, the CMA does choose to place weight on the Kantar data contained in Morrisons' submission, providing no reason for the difference in treatment between the Parties' Kantar data and that of Morrisons.

offering (as it only encompasses situations where a customer either has switched its expenditure completely or reduced its expenditure significantly). Further, the CMA's argument ignores the fact that 99.4% of online shoppers also purchase groceries in-store. With almost the entirety of the online customer base also shopping in-store, the ability for those customers to flex the amount of shopping they do online at the margins clearly allows them to substitute some or all of their shopping at any given time to in-store. As a result, with respect to the question of whether two retail channels are part of the same market, such that the in-store channel constrains the online channel, the CMA is incorrect to discount the Parties' switching and reduced spend analysis.

(523) The CMA places no weight on the key fact that price and quality are common across both online and in-store (despite recognising the importance of this commonality at paragraph 11.8, where the CMA finds that competition on price and quality is captured within the CMA's in-store competitive assessment). Instead, in finding a separate market for online groceries: a world first to the knowledge of the Parties' advisers, it relies simply on the fact that there are parameters relating to website functionality and delivery that apply only to online. This is an overstatement; in particular, the full website functionality is common to Click and Collect (which the CMA considers to be part of in-store grocery),[292] and substantial parts of the website support in-store sales.[293]

(524) In any event, as the Parties have already submitted,[294] these online-specific factors go to the convenience of the online offer, a parameter of competition that is equally common to both (with customers trading off the convenience of home delivery against the convenience of shopping in-store). Should online convenience factors degrade, customers would be incentivised to shop more in-store.[295]

(525) Similarly, the CMA places no weight on the fact that the category mix shows relatively similar proportions across online and in-store, because of the possibility that customers may purchase different types of products within categories. For example, the CMA assumes that online customers may be more likely to purchase multipacks of beer, while in-store customers may be more likely to purchase single bottles of chilled beer. In fact, the Parties' data shows that [✂]% of multipack beer purchases are made in-store, which means that sales of multipack beer are split between the channels in proportion to the overall channel split, rather than being heavily weighted to online. The evidence does not therefore support a rejection of the category mix data on this basis, and the CMA is incorrect to ignore the category mix evidence provided by the Parties.

B. Reliance on the CMA's flawed survey as the only evidence base

(526) Given the CMA's decision to ignore the relevant evidence provided by the Parties and third parties, the sole evidential basis for the CMA's assessment is its own online survey, carried out on the CMA's behalf by GfK in November 2018. As the Parties explained in detail in their response to the CMA's online and survey WPs, this survey is materially flawed in a number of respects.

(527) **Annex_001V.6_001** contains a paper by Patrick Sturgis, Professor of Research Methodology at the University of Southampton and Specialist Advisor to the House of Lords Select Committee on polling issues, assessing the methodology of the CMA survey of the Parties online customers carried out by GfK

292 PFs, footnote 104.

293 As is clear from the fact that grocery retailers without online delivery services offer functional websites with product ranges and prices (e.g. www.lidl.com, www.aldi.com).

294 Final Merger Notice, paragraph 140 and Parties' Response to the Issues Statement, paragraph 181.

295 See paragraph (520) above.

in October 2018.[296] Professor Sturgis concludes that "*the CMA online survey is likely to contain a range of random and systematic errors as a result of risk factors arising from the way the survey was designed, implemented, and analysed*" and that, as a result, "*there is a high risk that key estimates from the CMA online survey cannot be taken as an accurate guide to customer behaviour in the event of a merger between the Parties*". The specific errors and flaws in the CMA survey methodology are set out in detail in the paper at **Annex_001V.6_001**.

(528) Key problems with respect to the CMA's reliance on the survey to address the question of whether in-store groceries constrain online are the unaddressed biases because of how the survey was carried out:

- First, as the Parties have repeatedly informed the CMA,[297] there is a significant difference between the frequency of orders in the survey sample and the frequency of orders in the general population, with the former being significantly higher than the latter. This means that the CMA's survey sample is not representative of the Parties' overall base of orders. On the contrary, it is biased towards orders from heavy users of online deliveries, who by their nature are less likely than the average or the marginal online customer to switch to in-store groceries. As the CMA recognises at paragraph 10.15 of the PFs, "*in a merger inquiry, [the CMA's] focus is typically on the marginal customers*". The CMA's survey, however, is weighted in exactly the opposite direction (i.e. it is weighted towards those customers least likely to switch). As a result, it significantly understates the importance of the in-store constraint for the Parties' order base in general, and for marginal customers in particular. The survey is therefore of little to no probative value on the key question it is intended to inform.
- Second, even ignoring the bias towards heavy online users, the fundamental bias of carrying out an online survey online remains unsolved. Such bias may come from two sources. First, as discussed in Professor Sturgis' paper, the non-response bias (given the CMA's survey had very low responses) is likely to be significant. Heavy online users are more likely to be familiar with online and therefore are likely to have a higher online response rate. Second, there is the potential of a framing bias. As recognised by the CMA when it considered the relevance of the online survey to the diversion from in-store to online,[298] customers being surveyed in the setting of one channel are more likely to say that they will divert to that channel than to another channel. Taking these two biases together, it is only to be expected that an online survey will find greater diversion to online than to in-store, thus artificially lowering the constraint from in-store.

(529) Aside from these fundamental bias issues, the survey was also flawed in the way in which the diversion questions were asked. The CMA acknowledges at paragraph 10.15 of the PFs that its price increase (SSNIP) question was flawed and unclear to customers, and that the CMA cannot therefore place weight on the responses to this question (although this is normally the most relevant question). As a result, the CMA bases its conclusions purely on the forced diversion question asked in its online survey. This alone cannot provide a safe basis for the CMA's conclusions, as it cannot be assumed that the in-store

[296] Professor P. Sturgis is Professor of Research Methodology in the Department of Social Statistics at the University of Southampton and Director of the Economic & Social Research Council (ESRC) National Centre for Research Methods. He has extensive experience in the design, conduct, and analysis of sample surveys and has published extensively in this area in leading academic journals. Professor Sturgis served as President of the European Survey Research Association (ESRA) from 2011 to 2015, and is currently the Chair of the Advisory Board of the European Social Survey (ESS). He has previously chaired the methodological advisory committee of the UK Household Longitudinal Survey (Understanding Society) and the Applied Quantitative Methods Network (AQMeN). Professor Sturgis also chaired the British Polling Council/Market Research Society Inquiry into the 2015 General Election Polls, and was Specialist Advisor to the House of Lords Select Committee on Political Polling and Digital Media. Professor Sturgis is also a Fellow of the Academy of Social Sciences and Honorary Life Fellow of the Market Research Society. In his report, Professor Sturgis comments on the methodology of the survey commissioned by the CMA of Asda's and Sainsbury's (together, the Parties) online customers carried out by GfK in October 2018.

[297] See the Parties' response to Q31 of RFI 12 on exit survey frequency, email from Josh Buckland dated 14 September 2018 containing the Parties' comments on the CMA's survey methodology; the Parties' response to the Online WPs dated 21 December 2018, paragraph 7 and section II; and the Parties' comments on the CMA's put backs dated 12 February 2019 concerning paragraph 49 of Appendix B (Surveys).

[298] PFs, paragraph 10.15 and PFs, Appendix B, paragraphs 50-53.

diversions would have been the same as between customers who responded to the price increase question and customers who responded to the forced diversion question.

(530) The fact that the CMA's survey diversion responses are unsound is clear from the differences between the results obtained through that single question and the results from multiple other datasets, including the ABA lapsed customer surveys, Kantar switching data and the Parties' transaction data. For the reasons set out above, the CMA's reasons for ignoring those datasets are unsupported and incorrect. Further, both the Kantar and Nielsen datasets can be calculated on the basis of orders or spend, rather than customers, making them directly comparable to the CMA's survey results. This shows that there is a significant difference between the CMA's survey results and these datasets. Re-weighting the CMA's diversions on the basis of the Kantar and Nielsen figures (to address some of the heavy user bias currently present in the CMA's results), produces diversions of 36% to 41%, thus providing what can be considered a minimum bound for the potential bias against in-store.

(531) On the basis of the above, it is clear that the overwhelming weight of evidence shows that online grocery is not a separate market to in-store grocery and that it is constrained very significantly by in-store grocery. The CMA's assessment of the competitive effects of the Proposed Merger in relation to online delivered groceries, whether at national or local level or in relation to coordination, fails to take proper account of the weight of that constraint. The CMA's conclusions are fundamentally undermined by this failure.

III. The Proposed Merger will not give rise to an SLC on a national unilateral basis

(532) The PFs find that the Proposed Merger will lead to a national unilateral SLC on two bases: (i) its in-store assessment for price and quality parameters of competition (as these are uniform across both in-store and online); and (ii) an assessment of competition for those parameters set nationally and specific to online delivered groceries (specifically, delivery pass prices and the quality of the website and apps (see paragraph 11.11 of the PFs). Neither basis is supported by the evidence.

(533) With respect to price and quality, the Parties' submissions in response to in-store national unilateral effects apply equally here. In particular, the CMA's analysis is not supported by the quantitative evidence and relies on a manifestly unreasonable assessment of the available qualitative evidence. With no national SLC in relation to in-store groceries, there can be no SLC finding to be transferred across to the Parties' online offerings in respect of price and quality.

(534) With respect to delivery passes and online websites/apps, the CMA's PFs rely heavily on four fundamentally flawed propositions, namely that: (i) the Parties are particularly close competitors; (ii) the impact of the Proposed Merger at local level would give rise to an incentive in the aggregate to deteriorate PQRS; (iii) the appropriate GUPPI threshold by which to assess the competitive effects of the Proposed Merger is 1% (post-efficiencies); and (iv) there may be some unidentified incentive to reduce online innovation. Importantly, the CMA significantly underestimates the countervailing impact of entry and expansion in online. Each of these flaws is addressed in turn below.

A. The Parties are not particularly close competitors

(535) With respect to closeness of competition, the CMA dismisses the ABA and transaction data evidence submitted by the Parties, and misrepresents the Kantar data as showing that the Parties' online offerings are each a material constraint on each other. For the reasons set out at Section II above, this evidence is both probative and should be given considerable weight in the conclusions drawn by the CMA.

(536) This data shows the lack of closeness between the Parties' online offerings. For example, the Kantar switching data shows that the Parties compete far more closely with Tesco and Ocado than with each other when it comes to switching between online providers, and that they each lose less than 5% of online customers to each other's online website. With switching rates this low, the Parties cannot be considered to be close competitors.

(537) Similarly, Nielsen share of consumer wallet data (which looks at the proportion of total customer expenditure included in the panel that is attributed to each competitor and their channels) shows that: (i) for those shoppers who have used Sainsbury's online channel, only [0–5]% of their expenditure was on Asda online; and (ii) for shoppers who have used Asda's online channel, only [0–5]% of their expenditure was at Sainsbury's online. The fact that there is such a low proportion of expenditure by Sainsbury's online shoppers at Asda online and *vice versa* is indicative of the Parties not being each other's closest competitors.

(538) Notwithstanding its significant flaws, the CMA's own survey supports this conclusion, finding that Tesco is by far the biggest constraint on both Parties and that each Party is constrained by a third party to a degree similar or stronger than the constraint from the other Party. As the CMA states at paragraph 11.32, "*[t]he evidence suggests that Tesco online is the biggest constraint on both Parties' online operations, and both Parties face another online constraint that is similar to or marginally stronger than the constraint from each other's online offering (Morrisons for Asda, and Ocado for Sainsbury's)".*

(539) Furthermore, the CMA's own review of almost 3,000 of the Parties' key commercial board documents and over 135,000 emails from key custodians lead it to acknowledge that the Parties' internal documents typically refer to at least five other competitors in online groceries, as well as recognising the constraint from in-store grocery providers.[299]

(540) On the weight of evidence, therefore, it is not possible to conclude that the Parties are particularly close competitors, and it is clear that the Parties both (i) have closer competitors than each other; and (ii) face strong competition from a large number of other online delivery providers (both cross-channel and pureplay).

B. There will be no aggregate incentive to deteriorate PQRS in relation to delivery passes and website/app functionality

(541) At paragraph 11.36 of the PFs, the CMA finds that the Proposed Merger will result in an SLC in 290 supply points, representing approximately 55% of the Parties' supply points. As this represents "*a significant proportion of the Parties' online offer*", the CMA finds that there may be an incentive to worsen the Parties' offerings across all supply points.

(542) As discussed below at Section IV, the CMA's local analysis is fatally flawed. Whilst the details are set out below, it suffices for the purpose of this national section to note that, of the 290 supply points identified as problematic by the CMA, even ignoring entry and expansion, there will be four or more third party online delivery competitors present post-merger in 217 areas (75% of the SLC areas) and three competitors present in a further 47 areas. The CMA's threshold for concern at local level cannot, in the face of this much remaining competition post-merger, be considered to be correct.

(543) Even taking a highly conservative approach and applying a 5% GUPPI threshold (plus correct margins data), <u>no local areas</u> would be identified as an SLC. The Proposed Merger plainly cannot give rise to a national concern in the aggregate on this basis.

C. The CMA's national GUPPI threshold is inappropriately low

(544) The CMA's national GUPPI assessment for online groceries threshold proceeds on the principle that, absent efficiencies, any result above a GUPPI threshold of 0% is sufficient upward price pressure to indicate a problem. At paragraph 11.49 of the PFs, the CMA states that, having taken efficiencies into account, it does "*not consider that a GUPPI of around 1% or below would be supportive of an SLC finding*". It further finds at paragraph 11.50 that broadly the same reasoning regarding substantiality as

[299] PFs, paragraphs 10.24-25.

applied to in-store grocery applies to online, and that the national diversion for online delivered groceries is robustly estimated.[300] The CMA therefore makes no adjustment for uncertainty. As a result, unlike the local online GUPPI threshold, which is set at 2.5%, the CMA effectively sets a 0% threshold (excluding efficiencies) or a 1% threshold (post-efficiencies) as "supportive of" national concerns in relation to online groceries. The difference between the national and local GUPPI thresholds can be seen from paragraph 11.98, where the CMA refers to the 1% efficiency credit that is taken into account, "*in interpreting the national GUPPIs and in setting our threshold of 2.5% for the local assessment*". The CMA's confidence in its lower GUPPI threshold at the national level is misplaced for the following reasons:

(545) First, it is mathematically impossible to have a threshold of 0% that is not biased towards incorrectly finding false positives. Diversions cannot be less than 0, which means that any errors around any diversion estimate (at estimates that are very close to 0) must be positive. This implies that any errors using a 0% threshold can only result in incorrectly identifying areas as SLCs.

(546) Second, for the reasons discussed in detail in Chapter 2 and below, the CMA's diversions are not robustly estimated. The Parties have identified numerous fundamental flaws with the CMA's survey from which these diversions are derived (details of which are set out in Section II above and Section IV below) which create substantial uncertainty around the CMA's diversion estimates. A large sample will only be reliable to the extent that it reliably measures its objective. As the CMA has already conceded, its survey does not reliably measure diversion rates to in-store given the fact that many respondents clearly did not understand the price diversion question. As such, there is likely to be considerable uncertainty around any of the estimates, no matter how large the sample. These flaws invalidate the diversions the CMA seeks to rely on and thus its approach to the GUPPI threshold. The failure of the CMA to properly test and take account of the uncertainty in its diversion estimates has been addressed in detail in Chapter 2.

(547) Third, with respect to the argument that any pricing pressure, no matter how small, will be passed on to customers, the Parties note that the online groceries impact being assessed relates purely to those elements of online delivered grocery that are not shared with in-store grocery (namely delivery passes and website/app functionality). The CMA's reasoning in relation to in-store grocery that any impact will be passed on, particularly with respect to groceries being a non-discretionary expenditure etc., are therefore irrelevant to the GUPPI consideration in this instance. In any event, the reasons discussed in detail in Chapter, the CMA's consideration of pass-on is flawed.

(548) Fourth, as set out in Chapter 2, the CMA's approach to the GUPPI threshold misapplies the "*expectation of SLC*" test under s36(1)(b) of the Enterprise Act 2002, both in respect to what can support an "*expectation"* of adverse effects underpinning the CMA's SLC findings and in relation to the requirement that any lessening of competition must be "*substantial*". The CMA's errors in this respect apply equally to the online GUPPI threshold chosen by the CMA, as the CMA proceeds at paragraph 11.50 that "*broadly the same reasoning set out in Chapter 8, paragraphs 8.236 to 8.242 applies to the interpretation of the GUPPI for online delivered groceries*".

(549) Finally, as set out below in Section IV, the CMA's GUPPI assessment is also based on an incorrect and overestimated calculation of the Parties' online margins. As the CMA itself recognises in the context of its online coordinated effects analysis, it has overstated the Parties' online grocery margins (see paragraph 12.23 of the PFs). Indeed, this overstatement is highly significant. This has significant consequences for the GUPPI, even if the margins are overstated by as little as 1%.

300 The CMA's conclusions on robustness stem from the ostensible scale and representativeness of its online survey and the fact that, whilst certain factors may lead it to consider that the online margins are overestimated, the figures used may not take into account the wider economic benefit of providing an online delivered groceries delivery service.

(550) The CMA is therefore incorrect to use a national GUPPI threshold at 0% as "supportive" of an SLC absent efficiencies, or indeed even 1% with efficiencies.[301] A more appropriate threshold, based on past practice, would be at least 5%. The Parties' GUPPIs (even calculated on the CMA's overestimated view of online grocery margins) would be below this threshold, thus precluding national concerns on this basis.

D. The CMA's innovation concerns are unsubstantiated and unfounded

(551) At paragraphs 11.51 and 11.52 of the PFs, the CMA notes that the Parties and third parties have invested in their digital platforms (including testing their websites) and considers that a national deterioration of PQRS "*may lead to a reduced incentive to innovate and continue to improve the online offering*". As noted in paragraph 591, the CMA offers no basis for this speculative concern and the PFs do not reference any evidence of how the Parties' incentives may be reduced in the future.

(552) The absence of any evidence at all is, in itself, sufficient to invalidate the CMA's conclusion. Nonetheless, for completeness, there are several reasons why the CMA's concerns in this regard are unfounded.

(553) First, innovation in respect of the Parties' online websites or apps tends to be driven by developments in the wider e-commerce retail sphere or even technology businesses outside of retail, rather than by other UK grocery retailers. For example [✂].[302] Similarly, recent [✂]. [✂].

(554) Second, innovation is also driven by international best practice in online grocery retailing, which would not be impacted by the Proposed Merger. [✂][303]

(555) Third, the costs associated with the Parties' digital platforms are not exclusive to their online delivery operations, so incentives to innovate are shared with in-store. In particular, the full website functionality is essentially common to Click and Collect[304] and it is clear that at least some parts of the Parties' digital platforms support broader in-store sales. Incentives to innovate for substantial elements of the Parties' digital platforms therefore exist irrespective of online delivery.[305]

(556) Finally, even in the UK online grocery retailing landscape, the Parties are not the leading sources of innovative pressure. Instead, innovation amongst UK online grocery retailers is driven primarily by Ocado, with Tesco, Amazon, Waitrose and Iceland also spurring industry changes. These competitors will continue to ensure the Parties will have an incentive to innovate post-merger. The Proposed Merger will not, therefore, have an effect on the Parties' incentives to innovate in this respect.

E. The CMA significantly underestimates the countervailing effect of entry and expansion

(557) At paragraphs 11.90 to 11.96 of the PFs, the CMA considers the countervailing effect of entry and expansion. It provisionally finds that only expansion by Iceland and [✂] is timely and likely, and that neither would be sufficient at national level to counteract an SLC. The CMA's assessment of entry and expansion is fundamentally undermined by the CMA's failure to identify and take account of entry and expansion plans by M&S and others. It is contradicted by the overwhelming weight of evidence and severely underplays the dynamic, constantly evolving nature of competition in this channel.

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301 The Parties not that this threshold is low enough to be breached by Sainsbury's online GUPPI of [✂], something that the 2.5% threshold used everywhere else would not do.

302 See https://inmail.doddle.com/doddle-dispatch-february-2019?ecid=ACsprvtf1x3jNEKf75iMr0z-of4HhNRPqu84mghdXImw-zPlt0V2lFxuRw8VPwHkLwjKB1-sO5AW&utm_source=hs_email&utm_medium=email&utm_content=70336946&_hsenc=p2ANqtz-9ksZFyzvMt_OghjWkmD64ke_4NmfVD-Uu0lIo6SCBAz3KL3FhTxkSLn3SHK1hRrmYqjMvH17j3sIXOptpP3psb8m7I2w&_hsmi=70336946

303 Digital Commerce, "Alibaba's Tmall Supermarket offers 1-hour grocery delivery in 6 Chinese cities", 4 January 2018, https://www.digitalcommerce360.com/2018/01/04/alibabas-tmall-supermarket-1-hour-grocery-delivery-6-chinese-cities/

304 Which the CMA considers to be part of the retail supply of in-store groceries. See PFs, footnote 104.

305 As is clear from the fact that grocery retailers without online delivery services offer functional websites with product ranges and prices (e.g. www.lidl.com, www.aldi.com).

1. Failure to identify timely, large-scale entry by M&S

(558) The CMA has failed to identify upcoming timely and large-scale entry by M&S. The CMA states at paragraph 12.81 of the PFs (dated 20 February 2019) that it was told that M&S has no definitive plans to enter online delivered groceries. This is plainly wrong, as seen from the announcement on 27 February 2019 that M&S is entering into a £750 million joint venture arrangement with Ocado which will result in M&S products being available for online delivery (alongside a wide range of branded products) within 18 months. According to the materials published by the parties on announcement, the "*JV will work as a true partnership aiming to create the UK's leading online grocery business.*"[306]

(559) The fact that M&S' plans to enter the supply of online delivery groceries were not uncovered by the CMA's investigation suggests the CMA has taken an uncritical and inadequate approach to obtaining and evaluating third-party evidence in this regard and that its investigative steps have been insufficiently robust. A transaction of the magnitude of the M&S/Ocado joint venture would have been in contemplation for some period of time, even if it had not yet crystallised into a final decision by either side and should have been mentioned in response to inquiries by the CMA regarding online entry plans. The Parties would urge to CMA to rectify its investigative failings by issuing formal requests for information under S109 of the Enterprise Act to compel M&S to provide accurate and complete information regarding the scope and timing of their intended expansion.

2. Failure to identify Ocado's expansion plans

(560) As well as providing new entry by M&S, the joint venture is well-positioned to increase Ocado's geographic coverage beyond its existing footprint. In the PFs, the CMA states "[✂]" …but "[✂]".[307] However, the jointly published materials from Ocado and M&S on the announcement of their deal reveal that Ocado's previous statements to the CMA were either misleading at the time or have since been superseded.

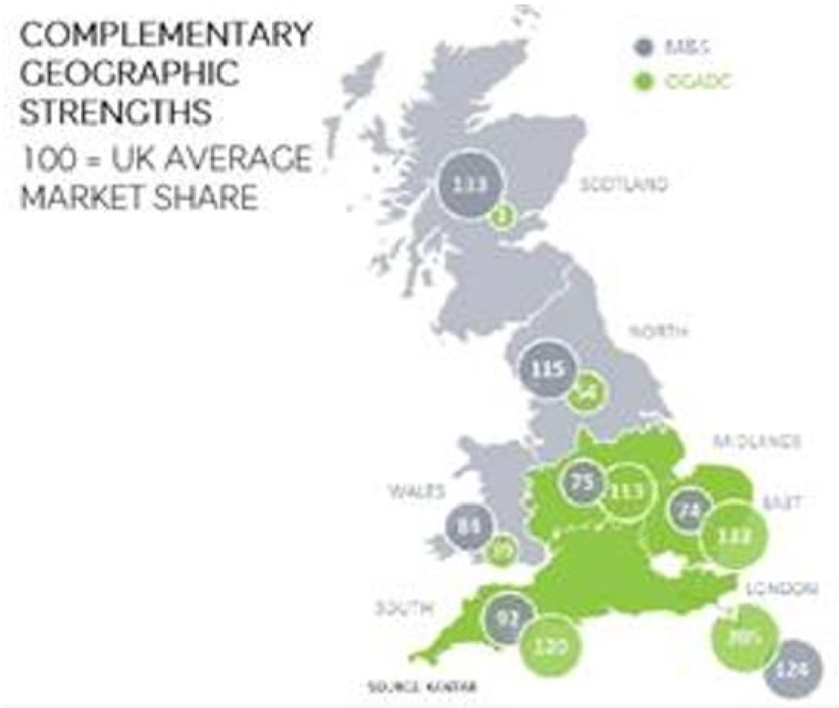
(561) Notably, Ocado and M&S have stated that their joint venture will "*[u]se M&S's complementary geographic strengths to develop the JV outside London and the South*",[308] with this statement being accompanied by the following graphic:

[306] Marks and Spencer press release "*Bringing the best together: transforming UK online grocery shopping M&S and Ocado announced new joint venture*", 27 February 2019, p.4, attached as Annex_004v.6_001.

[307] PFs, para 12.81.

[308] Marks and Spencer press release, "*Bringing the best together: transforming UK online grocery shopping M&S and Ocado announced new joint venture*", 27 February 2019, p.4, attached as **Annex_004V.6_001**.

Figure 15 M&S and Ocado complementary geographic strengths



Source: M&S and Ocado transforming UK online grocery shopping, p.6, attached as **Annex_004V.6_002**

(562) More specifically, during a public call with investors on the morning of the joint venture's announcement, representatives of Ocado and M&S committed to developing eight CFCs (of the size of Ocado's Andover CFC) over the next few years. With an indicative value of £450-£500m of annual sales per site, this implies annual sales growth of £3.6-4.0 billion.[309]

(563) These statements suggest that the new Ocado/M&S joint venture does intend to expand into geographic areas beyond those currently served by Ocado and may leverage M&S's store footprint throughout the UK as part of this process. It can reasonably be expected that such expansion will be a priority in the areas where M&S over-indexes and Ocado under-indexes: namely the North of England and Scotland.

(564) [✂]

3. Failure to recognise the extent of Amazon's expansion plans

(565) The CMA has similarly failed to recognise the extent and importance of Amazon's expansion plans. At paragraph 11.92, the CMA finds that AmazonFresh, which launched in 2016, has very small market shares [✂]. Similarly, at paragraph 12.81, the CMA notes that Amazon [✂].

(566) As with M&S and Ocado, the CMA's findings are fundamentally undermined by publicly available information showing that Amazon in fact has substantial expansion plans. As widely reported, it has recently hired John Farrell, "*a senior figure from Tesco who is a veteran of retail transformations",* to support its expanding grocery offering.[310] Further, as reported by the Sunday Telegraph, data it has compiled suggest that "*Amazon has been growing its Fresh team substantially over the past year. Around a third of the current Fresh UK team appear to be new employees, and over the past month, Amazon has*

[309] Morgan Stanley, "Marks & Spencer '*10 Questions for Management*'" 28 February 2019, p. 1, attached as **Annex_004V.6_003**.

[310] The Grocer, "Amazon hires senior Tesco figure as UK grocery focus intensifies", 5 March 2019, (https://www.thegrocer.co.uk/movers/amazon-hires-senior-tesco-figure-as-uk-grocery-focus-intensifies/590891.article).

advertised for six new roles. It has also appointed a new UK country manager for the business, Russell Jones, in December, as well as hiring a number of people in research, marketing and operations. In job posts, it said the unit was one of those it was looking to grow in Europe".[311]

(567) Further, Amazon has confirmed plans to launch Amazon Go bricks and mortar grocery stores in the UK as soon as Q4 of 2019, and that it has already progressed steps to secure retail sites to support this expansion, with reports of a location near Oxford Circus under consideration for the first UK flagship store.[312] It has hired the previous Home Bargains recruitment coordinator, whose previous responsibilities included supporting new store openings through bulk hiring of management and teams.[313] Similarly, Amazon Pantry has been aggressive with its pricing in order to establish a foothold in the UK market.[314]

(568) These recent developments, together with Amazon's investment in fulfilment centres in the UK,[315] indicate that Amazon has serious designs on the UK grocery market. Indeed, Amazon's UK grocery sales grew 16% in the last three months of 2018.[316]

(569) Further, it is clear that Amazon's size, experience and reputation mean it is uniquely positioned to expand its presence in the UK grocery market at an unprecedented pace.

- Amazon's acquisition of Whole Foods transformed its grocery strategy and gave it range, capabilities, infrastructure and institutional knowledge on how to operate a successful grocery retailer in the UK.[317] Similarly, Amazon has been at the forefront of technological advances in online shopping since it was founded in 1994. As noted in paragraph (553), there is a significant overlap in the technology and policies employed in online grocery shopping and online shopping more generally.

- Amazon's existing good standing with customers mean it does not have to overcome the same reputational hurdles as other competitors to convince customers to switch to its offering. Indeed, a recent report by Decision Technology noted that if Amazon increased its presence in the UK grocery market, a greater number of customers would choose Amazon stores over Sainsbury's.[318]

- The CMA has not taken into account the size disparity between Amazon, the Parties and other UK grocery retailers. Indeed, one analyst noted that "*[UK] groceries represents one market where Amazon may be more Goliath than David.*"[319] Amazon is consistently the most valuable online retailer in the world with a market capitalisation around 65 times larger than the Parties. In 2018, Amazon spent over $13 billion on property, plants and equipment (over 21 times greater than

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311 The Sunday Telegraph, "Amazon readies for UK-wide grocery push as it grows local teams", 2 March 2019, (https://www.telegraph.co.uk/technology/2019/03/02/amazon-readies-uk-wide-grocery-push-grows-local-teams/).

312 Reuters, "Amazon secures London retail space for checkout-free stores - The Grocer", 14 February 2019, (https://uk.reuters.com/article/uk-amazon-store-london/amazon-secures-london-retail-space-for-checkout-free-stores-the-grocer-idUKKCN1Q31TC).

313 The Grocer, "Amazon hires Home Bargains' store recruitment coordinator", (https://www.thegrocer.co.uk/movers/amazon-hires-home-bargains-store-recruitment-coordinator/590934.article).

314 Daily Express, "Supermarkets' wake-up call as Amazon slashes food bills", 16 August 2018, (https://www.express.co.uk/news/uk/1004081/Supermarket-Amazon-slashes-food-bills-tesco-online-shopping-news).

315 The Grocer, "Amazon to open Bolton fulfilment centre in 2018", (https://www.thegrocer.co.uk/people/hiring-and-firing/amazon-to-open-bolton-fulfilment-centre-in-2018/558873.article).

316 The Guardian, "Morrisons cheapest supermarket for online shopping, says Which?", 12 January 2019 (https://www.theguardian.com/business/2019/jan/12/morrisons-cheapest-supermarket-for-online-shopping-says-which).

317 Response to Online WPs, Annex 1, paragraphs 119-122.

318 Decision Technology, "Primed for domination: The threat of Amazon as a challenger brand", (https://www.dectech.co.uk/assets/briefs/dectech_primed_for_domination.pdf).

319 Decision Technology, "Primed for domination: The threat of Amazon as a challenger brand", (https://www.dectech.co.uk/assets/briefs/dectech_primed_for_domination.pdf).

Sainsbury's comparable investment over the same period).[320] Amazon has the financial resources to expand in the UK grocery market at an unprecedented pace.

(570) In light of the weight of evidence, the CMA has no basis for discounting entirely the possibility of speedy and widespread expansion by Amazon and appears naïve at best in doing so.

(571) [✂].

4. Failure to recognise ongoing Waitrose expansion

(572) The PFs do not address or place weight on Waitrose's ongoing expansion. As pointed out by Waitrose in response to the announcement of the M&S/Ocado joint venture, "*its in-house online operation was expanding rapidly, with growth of 12.8 per cent over Christmas, and reached four-fifths of UK postcodes.*"[321] Not only should this recent expansion feature in the CMA's assessment, but Waitrose now has an even stronger commercial incentive to grow its online volumes through its own platform as rapidly as possible, to replace the volumes it will lose when its arrangement with Ocado ends.

(573) Moreover, Waitrose is well-placed to achieve this goal, due to its considerable geographic coverage, and ability to leverage learnings from its long relationship with Ocado. Indeed, Waitrose managing director Rob Collins reported that Ocado "*was* '*well-positioned for growth*' "*due to the investment it had put into its online offer over the past three years in preparation for its separation from Ocado*".[322]

(574) Further reports on the Waitrose reaction to the M&S/Ocado deal point to the fact that "*the supermarket has instead invested hugely in Waitrose.com, spending around £80 million over five years. It aims to double the website's share of overall sales from 5% to 10%, and grew online sales 14% last year*".[323] Similarly, Waitrose has reported that downloads of the Waitrose.com grocery delivery app have increased by close to a third since the M&S and Ocado joint venture was announced and that Waitrose is "*planning a second fulfilment centre to support [its] growing volumes in London*".[324]

(575) Waitrose has also revealed that it has [✂] for preparing its stores for online operations, and is able to prepare a store for online operations within [✂] months.[325] Coupled with [✂], the capital costs incurred by Waitrose are also [✂]. To this extent, Waitrose has indicated that it requires [✂] vans at a cost of [✂] each, while specific equipment required for the picking and deliveries costs no more than [✂].[326]

5. Failure to recognise the scale and scope of Morrisons' expansion plans

(576) The CMA has underestimated the plans and impact of further expansion by Morrisons. Morrisons' interim results for the half year to August 2018 state:

> "*In online too, Morrisons is serving customers better. Morrisons.com is adding substantial new capacity, and has now extended its reach to over 75% of British households. Through a combination of more store-pick capability and transitioning to the newly opened Ocado CFC in Erith, we have significantly expanded our online delivery catchment area to include South London, Surrey, and Kent, plus the south coast and Devon. We have also taken Morrisons.com*

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[320] Amazon, Form 10-K Annual report 2018, page 36 and Sainsbury's Annual Report 2018 page 108.

[321] Financial Times, "Ocado and M&S in talks over UK retail joint venture", 26 February 2019, (https://www.ft.com/content/2303a532-39ba-11e9-b856-5404d3811663).

[322] The Grocer, "Waitrose app sees rise in downloads following Ocado/M&S deal", (https://www.thegrocer.co.uk/waitrose/waitrose-app-sees-rise-in-downloads-following-ocado-mands-deal/591095.article)

[323] Evening Standard, "Exclusive: 'Conflict' furore after M&S adviser worked for Waitrose on Ocado deal", 5 March 2019, (https://www.standard.co.uk/business/exclusive-conflict-furore-after-ms-adviser-worked-for-waitrose-on-ocado-deal-a4082921.html).

[324] The Grocer, "Waitrose app sees rise in downloads following Ocado/M&S deal", (https://www.thegrocer.co.uk/waitrose/waitrose-app-sees-rise-in-downloads-following-ocado-mands-deal/591095.article)

[325] PFs, Appendix H, paragraph 31.

[326] PFs, Appendix H, paragraph 35.

to Scotland for the first time, now serving our customers online in Edinburgh and Glasgow. As we increase our Morrisons.com capability and scale, we expect our CFC/store-pick hybrid model to enable us to plan better for more profitable online growth…"[327]

(577) Morrisons' strong focus on its online offering was reiterated in its latest quarterly trading statement, in which Morrisons observed:

"*We continue to improve both our digital and online offers for customers. During the period, we launched the Morrisons More app, allowing customers to collect and redeem Morrisons loyalty points digitally. The app is easy to use, avoids paper coupons and plastic loyalty cards, and allows customers to receive personalised offers and useful recipes direct to their mobile phones. In addition, we started to fulfil Morrisons.com home deliveries from a second customer fulfilment centre (CFC) at Erith and launched our store-pick online service from a further six stores taking the total to 20.*"[328]

(578) Morrisons' expansion of its store-pick online service from 14 to a total of 20 stores during its third quarter represents a 43% increase – and reflects the ease with which Morrisons could rapidly expand its geographic coverage in response to an attempt by the Parties to worsen their online offering post-merger. Indeed, the Parties' internal analysis shows that, based on Morrisons' store coverage and tie-in with Ocado, it has the potential to reach 96% of the UK population with its online offering, which is comparable to the current offerings of Sainsbury's, Asda and Tesco.[329] As noted on the Morrisons' website "*We don't deliver to the whole of the UK yet, but we're constantly expanding our delivery areas so we may be soon*".[330]

(579) [✂]

(580) Further, the data shows that where Morrisons has expanded in recent years, it has gained significant share at local level, on the CMA's own analysis rising to [✂] in some areas. The CMA discounts the disruptive effect of this expansion. However, it is incorrect to do so; Morrisons' entry into new local areas as it expands its online delivery capabilities has had a significant impact in those local areas and further expansion can be expected to have a similar impact, with a significant cumulative effect on competitive constraints across its areas of coverage.

(581) [✂]

6. Failure to take account of Iceland's expansion and other online trends

(582) For the reasons discussed below, whilst the CMA recognises Iceland's growing online offering at local level, the manner in which it takes this into account is flawed and results in the wholly contradictory finding that entry by Iceland would result in increased switching between the Parties.

(583) In any event, the Parties consider that the CMA underestimates the extent to which entry by Iceland would be sufficient to address any SLC concerns. Prior to this year, where it was ranked second, Iceland was named the UK's top online store by Which? for the three previous years.[331] Iceland has also opened a new dark store in the West Midlands to increase its online capability.[332] IGD's view is that "*Iceland will*

327 See: https://www.morrisons-corporate.com/Documents/corporate2018/morrisons-interim-results-announcement-2018-09-13.pdf

328 See: https://www.morrisons-corporate.com/Documents/corporate2018/q3-trading-statement-2018-11-06.pdf.

329 Based on Morrisons existing supermarket estate. This analysis takes Morrisons supermarkets larger than 20K sq. ft (to reflect a credible size for an online offering) and assumes a 45-minute drive time. See **Annex_004V.6_005**.

330 See: https://groceries.morrisons.com/webshop/scontent/customerServicesFAQ#

331 Iceland named Britain's best store online for third year running, Iceland, 12 February 2018 available at http://about.iceland.co.uk/wp-content/uploads/2018/02/Iceland-named-Britains-best-online-store-12.2.18.pdf, attached at **Annex_004_069**.

332 Iceland's online service reached 84% coverage within the first year of its operation.

benefit from [online] channel growth as it continues to invest in its online capabilities, evolve its offer and attract new shoppers. We forecast the retailer's online sales to exceed £500m by 2023".[333]

(584) Iceland has also indicated that the cost of online expansion [✂]. To this extent, Iceland gave online capability to [✂] in April 2018 for a total cost of no more than £[✂].[334] Indeed, coupled with the fact that Iceland is able to (i) expand an existing online offering in as little as four to six weeks and (ii) create a brand new online offering in as little as three months, Iceland is in a strong position to undertake rapid online expansion without [✂].[335]

(585) Finally, the CMA ignores the growing trend of grocery retailers partnering with delivery companies to provide groceries online. Of most relevance, Co-op has recently partnered with Deliveroo to offer online food delivery across London (again, directly contradicting the CMA's finding at paragraph 12.81 that Co-op has no entry plans for online delivery).[336] Similarly, Lidl has entered an arrangement with Buymie to provide online delivered groceries across Dublin.[337] This follows similar moves by Aldi to partner with Instacart in the United States. These types of arrangements enable grocery retailers to quickly establish an online presence with minimal investment. Indeed, IGD notes that "*the rise in third-party delivery services is opening doors for supermarkets allowing them to satisfy the online demand, whilst not having to pay out for the infrastructure developments it requires.*[338]" Given the active testing of online delivery options by these competitors, there is no reason to believe that their use in the UK will not grow in the near future.

(586) In light of the above, it is clear that new entry and further expansion by competitors is both likely and timely, and will have a substantial impact on competition, sufficient to constrain the merged firm at the national level.

IV. The Proposed Merger will not give rise to SLCs on a local unilateral basis of the scale identified in the PFs

(587) The CMA applies the in-store GUPPI methodology to its local assessment of online delivered groceries. This involves calculating GUPPIs for each Supply Point using diversions based on the survey evidence and then combining these with the Parties' national online margins and the average price ratio between the Parties' offerings. The CMA applies a GUPPI threshold of 1.5% for a presumption of an SLC absent efficiencies, and 2.5% with efficiencies. Using this threshold, the CMA finds that the merger will result in an SLC in 290 of the Parties' total of 530 Supply Points. Whilst this section addresses issues with the CMA's local methodology in online, Chapter 1 on the GUPPI threshold sets out why the CMA's choice of GUPPI threshold more generally at 1.5% is fundamentally flawed both in terms of the evidence and the legal practice.

(588) As this section shows, the CMA's methodology provides estimates of local diversions that cannot be relied on: the main inputs into the GUPPI are either incomplete (Sainsbury's and Asda's online margins) or not accurately estimated (survey diversions), resulting in significant uncertainty regarding the accuracy and the robustness of the estimates:

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333 IGD, Strategic Outlook for Iceland (December 2018), attached as **Annex_004V.6_006**.

334 PFs, Appendix H, paragraph 34.

335 PFs, Appendix H, paragraph 30.

336 Retail Sector, "Co-op partners with Deliveroo to trial food delivery service", 21 January 2019, (https://www.retailsector.co.uk/2278-co-op-partners-deliveroo-trial-service/).

337 IGD Retail Analysis, "Discounter update: Ireland", 24 January 2019, (https://retailanalysis.igd.com/news/news-article/t/discounter-update-ireland/i/20956).

338 IGD Retail Analysis, "Discounter update: Ireland", 24 January 2019, (https://retailanalysis.igd.com/news/news-article/t/discounter-update-ireland/i/20956).

- With respect to the main input into the GUPPI – diversions - the CMA extrapolates from only 42 surveyed areas to 530 areas, even though the extrapolations are based on small sample sizes. This means that, not only do the CMA's estimators have very large sampling errors, but they predict essentially the same level of diversions independent of the degree of competition in an area.
- With respect to the second input to the GUPPI – variable margins – both the variable margins for Sainsbury's and Asda used by the CMA significantly overstate the variable profitability of their online businesses. This is because the CMA has assumed that the cost structure of in-store and online are identical. However, this assumption is unwarranted and, as set out in Schedule 6.1, more accurate margin estimates significantly reduce the CMA's GUPPIs at the local level.

(589) The following sections detail the issues with diversions and margins used in the GUPPI calculations, and demonstrate why the SLCs identified by the CMA based solely on these calculations are perverse when compared to other measures of competition, such as the number of competitors present in an area and diversions based on the Parties transaction data.

A. Issues with the CMA's approach to estimating diversions

(590) The CMA relies entirely on its survey evidence to derive diversion ratios for the GUPPIs associated with each Supply Point, ignoring all other evidence provided by the Parties. However, for the vast majority of Supply Points there are very small numbers of respondents to the survey. The CMA correctly identifies this and acknowledges that it cannot rely on any samples below 100 respondents. As a result, it only uses actual survey diversions for the Supply Points where the sample size is over 100. Thus, for the overwhelming majority of the Supply Points (488 of the 530), the CMA does not have a sufficiently large sample to calculate a direct diversion and instead constructs a proxy diversion ratio. The proxy is constructed using information on the competitor set present at the Supply Point as follows:

- The CMA assumes that customers diversions to other online grocery providers are based exclusively on the brands of retailers that deliver to their address, but does not provide any evidence to support this presumption. Therefore, it groups together postcode units into 23 'Bands' using the identity of competitors within each band,[339] and calculates an average diversion between the Parties for each Band using all the survey diversions from respondents in a given band.
- The CMA uses each Band's diversion estimate to estimate the overall diversion for each Supply Point. For the Supply Points that are encompassed by a single band across the supply point, the estimated diversion is taken as the direct survey diversion for that Band. For Supply Points that encompass multiple bands within their delivery area, the CMA calculates a revenue weighted average diversion for each of the Bands present across the Supply Point's delivery postcodes.
- Finally, because the diversion estimates do not reflect the expansion areas for brands that are expanding, the CMA makes an adjustment to the diversion estimates for those Supply Points affected by expansion.

(591) The Parties have a number of concerns with this methodology both with respect to the reliability of the CMA's estimated diversions, and the reliability of the CMA's SLC findings in each of the local areas.

1. The CMA's survey does not generate robust diversion estimates

(592) As a starting point, the Parties continue to have significant concerns regarding the CMA's survey. Given that the CMA's entire online local analysis hinges on this survey, these problems undermine the CMA's entire local analysis. These concerns are set out below.

339 [✂]

(593) **First**, as discussed in the previous section, the wording of the price rise question makes it unclear whether both the online and in-store prices of the Party would be increasing. The unusually high rate of "Don't Know" responses to the question (around 23%) demonstrates this ambiguity. The CMA accepts that the own-brand in-store diversions are likely to have been biased downwards due to this ambiguity, and therefore excludes responses to the price rise question when estimating the diversions to in-store options.[340]

(594) However, even though the CMA agrees that own-brand in-store diversions should be included in the analysis,[341] when estimating the diversions between the Parties, the CMA effectively reduces their impact by including the biased price diversion version of the question rather than just using the forced diversion question. This is likely to materially bias upwards the Parties diversions to each other.[342] The CMA justifies this on the grounds that *"we would lose valuable information if we completely ignored the responses of marginal customers in the calculation of diversion ratios and doing so would also reduce sample sizes for estimates feeding into our Supply Point analysis."*

(595) As Professor Sturgis observes, given that the CMA accepts that the price diversion estimates for the marginal customers are biased, the value of the additional information they provide for accurate estimation of Supply Point level diversion ratios is questionable: *"Inclusion of price marginal customers introduces a downward bias to the rate of within Party in-store diversions and, as a consequence, an upward bias in the remaining channels, including the rate of between Party online diversions. These are biases and, so, will not be offset by the increase in sample size obtained by including the price marginal respondents."*[343]

(596) **Second**, the CMA's survey is likely to suffer from a bias whereby either respondents are focused on thinking about online rather than in-store shopping (i.e. a framing bias) or, as Professor Sturgis considers, non-respondents are more likely to be those that are more frequent users on in-store (i.e. a non-response bias).[344] Either of these biases would result in relatively low in-store diversions and high online diversions between the Parties when compared to other sources.

(597) The existence of these biases can be seen when the CMA survey diversions are compared against the spend weighted Kantar switching data, which are directly comparable to the CMA's survey. As discussed in section II.A above, there is no reason for the CMA to ignore this data. The table below compares the CMA survey diversions to online and in-store between the Parties, with the Kantar switching data. In addition, the table also compares the Parties spend weighted switching data, based on their transaction databases. The CMA attempts to dismiss the transaction data analysis in favour of the flawed survey on the basis of speculation that seasonal variation may distort the results, or that there may be lower switching amongst more frequent customers. However, as set out in Schedule 6.2 (*Additional sensitivities on the Parties' transaction data*), CRA verified that neither of these significantly impact the conclusions.[345]

Table 12 Comparison of the diversions between the Parties in different sources

	CMA Survey (1)	Spend Based Kantar switching losses (2)	Spend based switching (transaction data) (3)
Sainsbury's diversion to:			
Asda Online	8%	[✂]	[✂]
Asda In-store	2%	[✂]	[✂]

340 PFs, Appendix B, paragraph 59.

341 PFs, paragraph 11.43.

342 PFs, Appendix B, paragraph 21.

343 See **Annex_001V.6_001**, paragraph 51.

344 See **Annex_001V.6_001**, paragraphs 13-23.

345 These data have been submitted to the CMA and have been used by the CMA in the PFs.

	CMA Survey (1)	Spend Based Kantar switching losses (2)	Spend based switching (transaction data) (3)
Total Asda	10%	[✂]	[✂]
Asda diversion to:			
Sainsbury's Online	12%	[✂]	[✂]
Sainsbury's In-store	2%	[✂]	[✂]
Total Sainsbury's	15%	[✂]	[✂]

Source: (1) Spend-weighted diversions including own-brand; (2) CRA analysis of Kantar Worldpanel data, Total Grocery 52 w/e 17 June 18 for Great Britain; (3) Switching of lapsed customers using Party Transaction data 1st July 2016-19th October 2018 – prior twelve weeks of spend on one Party before lapsing compared to subsequent twelve weeks of spend on the other Party after lapsing.

(598) As seen in the table above, both alternative sources of information show significant lower, and consistent, diversions between the Parties online business, suggesting that the CMA's survey is significantly overstating diversion between the Parties. In particular, Sainsbury's diversion to Asda online is [✂]% in [✂], whilst the CMA's survey predicts 8%. Similarly, Asda's diversion to Sainsbury's online is 4% in the Kantar switching data and [✂]% in the Parties' lapsing switching data, but is as high as 12% in the CMA survey. The fact that the Kantar switching data and the Parties switching data are both consistent but different from the CMA's survey, combined with the flaws in the CMA's survey implementation and design, fundamentally questions the results of a local analysis built solely on the CMA's survey results.

2. The CMA's methodology of grouping areas into Bands is not supported by the data

(599) [✂].

Figure 16 [✂]

[✂]

Source: [✂]

Note: [✂].

Figure 17 [✂]

[✂]

Source: [✂].

Note: [✂]p.

(600) The figures show there are large variations in the diversions between the Parties in different areas within the same Bands. [✂].[346] This is inconsistent with the CMA's assumption that the identity of competitors in an area can be used as a predictor for the level of diversion between Asda and Sainsbury's within the area.

(601) The CMA accepts that the estimated diversions based on Bands do not capture the local differences and this is a limitation of the analysis but does not appear to view this as a significant issue.[347] However, the fact that it significantly distorts the CMA's analysis can be clearly seen by the fact that in many cases <u>adding another competitor to a band actually increases diversions rather than reduces it</u>. [✂]These results suggest that simply using the existence of competitors in an area does not provide a good predictor for the Parties' diversions to each other.

(602) [✂].

[346] [✂]

[347] PFs, Appendix I, paragraph 45.

Table 13 [✂]

Source: [✂]

3. [✂]The CMA's estimated diversions for local supply points are neither robust nor informative

(603) All of the above issues should give the CMA significant concern regarding its Supply Point based estimates. However, the CMA asserts that the estimated diversion ratios are informative and are the best estimates available for our analysis where our Supply Point sample sizes are below 100.[348] The CMA comes to this conclusion on the basis of two pieces of analysis – both of which are flawed.

(a) The CMA's first robustness test is flawed

(604) As a first robustness test, the CMA compares its estimated diversion ratios with the direct survey diversion ratios for different sample sizes and states that where the Supply Point sample size is larger, there is more correlation between the estimated online diversion ratios and the direct survey diversion ratios. On the basis of this, the CMA states that it has confidence in its estimates.[349] However, as the test shows, there are significant reasons to doubt the estimates:

(605) First, the CMA is simply incorrect in the claim that, the larger the sample size, the greater the correlation between the estimated diversion ratios and the direct survey diversions ratios. Re-running the CMA's code and calculating the correlation coefficients between the CMA's estimated diversion ratios and direct diversion ratios for different sample sizes shows that, with one exception, there is actually lower correlation in the higher sample sizes than in the lower sample sizes.

Table 14 CMA's correlation between the estimated diversion ratios and direct survey diversion ratios for different sample sizes

	Diversion to online	Diversion to in-store	Number of Supply Points
Asda diversions to Sainsbury's online and in-store offerings			
Less than 50	0.60 (*)	0.63	21
50 or more	0.26	0.18	264
Sainsbury's diversions to Asda online and in-store offerings			
Less than 50	0.54	0.34	157
50 or more	0.37	0.40	87

(*) There appears to be an error in the CMA excel output file (GUPPI Output.xls) for one of the data-points, which produces a significantly lower correlation of 0.07. This has been corrected in the table.

Source: CRA analysis of the CMA data

(606) Most importantly the correlation coefficients remain very low regardless of the sample size. Particularly for the Asda diversions, on which the CMA has relied more heavily (finding as many as 273 SLCs), the correlations between the direct and estimated diversions to Sainsbury's online and in-store offerings are 0.26 and 0.18 respectively.

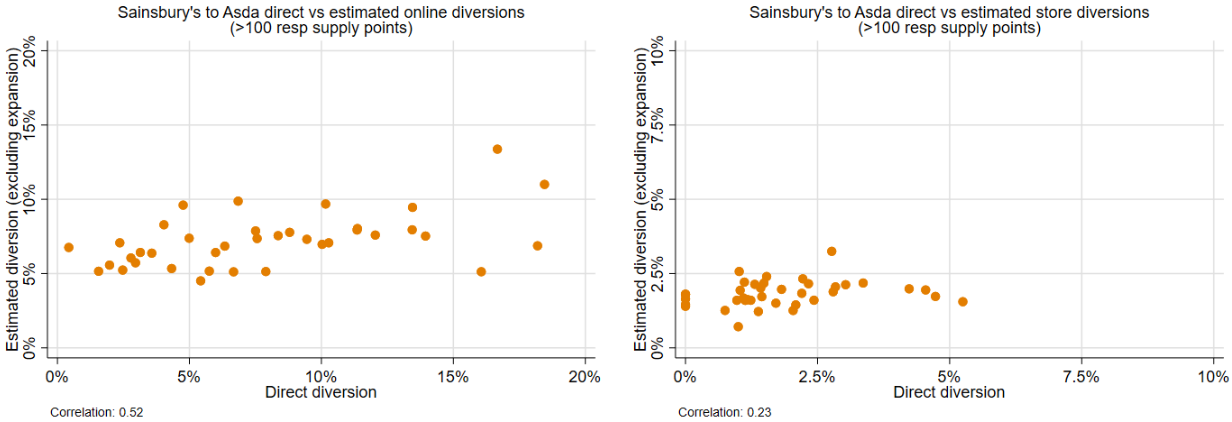
(607) Second, in considering the robustness of its estimated diversions, the CMA states that it is appropriate to use the measure of direct diversion for Sainsbury's 38 Supply Points where the sample size is above 100 because the direct diversions are assumed to be informative and robust. This provides a benchmark on which to gauge how robust the CMA's diversion estimates are using its bands analysis.

[348] PFs, Appendix I, paragraph 47.

[349] PFs, Appendix I, paragraph 46.

(608) If the estimated band diversion was a good measure of the actual survey diversions, we would expect the two measures to be highly correlated. However, as the graph below shows, the survey and estimated diversions to both online and in-store are highly dispersed and poorly correlated. Further, the correlation coefficients, even with greater than 100 respondents, are low (at 0.52 for online and only 0.23 for in-store). Indeed, the in-store correlation coefficient is so low that we cannot reject the hypothesis that there is no correlation between the survey and estimated diversions to in-store.

Figure 18 : Sainsbury's diversions to Asda for supply points with over 100 respondents



(609) The results for Asda are even weaker, as the comparison is based only on three observations. The CMA appears to accept the weak results for Asda, noting there is stronger correlation for Sainsbury's compared to Asda. Nonetheless, it uses its extrapolated estimates for Asda to estimate the diversion in each Asda area.[350] However, a correlation of a mere 3 data points is not meaningful, and so cannot be used to make any inferences about the accuracy and robustness of the estimated diversion ratios of Asda.

(b) The CMA's second robustness test is flawed

(610) For its second robustness check, the CMA looks at whether there are any Bands with particularly small sample sizes that have a large impact on the results. The CMA concludes that there is no concern in this respect, as it finds only seven Supply Points where the Band has both a sample size of less than 100 and the Band accounts for over 30% of revenue in the Supply Point.[351] However, this robustness check is flawed.

(611) First, as demonstrated above, grouping areas into Bands is not meaningful, as these groupings fail to capture the variation of diversions across different areas. As shown above, even if the Bands have sample sizes greater than 100, unless they capture and explain the variation in diversions seen within the band, they are highly unlikely to provide meaningful predictions of the diversion of individual areas within the band.

(612) Second, there is no reason for the 30% threshold used in the CMA's robustness check. Given the very large measurement errors in the estimated diversions and the tight distribution of the GUPPIs around the CMA's 2.5% threshold, small changes can have a large impact on the results. [✂].

(613) Given the large uncertainty around the estimated diversions in general, the fact that some of these estimates rely on Bands with very small sample sizes it is not reasonable or consistent with the CMA's best practice in survey design to rely on these estimates.

[350] PFs, Appendix I, paragraph 46.

[351] PFs, Appendix I, paragraph 41.

B. Concerns with the CMA's variable margin estimates for online delivery

(614) The CMA's GUPPI assessment is based on an incorrect and overestimated calculation of the Parties' online margins. As the CMA itself recognises, it has overstated the Parties' online grocery margins (see para 11.41). This has significant consequences for the GUPPI, even if the margins are overstated by as little as 1%.

(615) The national variable online margins used by the CMA (including an uplift for efficiencies) are [✂]% for Sainsbury's and [✂]% for Asda. Schedule 6.1 (*Variable Margins*) contains an assessment of the Parties' online margins and the extent to which these have been overstated by the CMA. This shows that a proper allocation of costs produces lower margins of [✂]% for JS and [✂]% for Asda (these again include an uplift for efficiencies). Using the corrected margins (even using the CMA's incorrect 2.5% GUPPI threshold), the number of Sainsbury's SLCs are reduced from 17 to 1; while Asda's SLCs are reduced from 273 to 71.

C. The CMA GUPPI predictions do not accord with real-world evidence

(616) The problems with the CMA's GUPPI analysis are clear when the predictions arising from the analysis are compared to the CMA's evidence on competitor bands and the Parties' evidence using their transaction data (see Section A.1 above).

(617) The CMA's GUPPI predictions show that the overwhelming majority of SLCs are found in areas where there is a wide set of competitors covering the area. This is counterintuitive as one would expect the upward pricing pressure on the Parties post-merger to be lower in areas where customers have a wider set of alternatives for their online delivered groceries. [✂].[352]

Table 15 [✂]

[✂]

D. The CMA's incorporation of third party expansion is flawed

1. The CMA's adjustments for [✂] Iceland entry/expansion are wrong and generate more SLCs rather than less SLCs

(618) The CMA accepts that the estimated diversions do not reflect the expansion for Iceland [✂] and makes an adjustment to the diversion estimates between the Parties for the Supply Points affected by expansion to reflect the increased competition expected in these areas. The adjustment is done by using for these expansion areas a Band diversion that corresponds to the set of competitors that is already operating in these areas, plus the expanding party (i.e. [✂] Iceland).

(619) However because the CMA's estimated diversions are fundamentally flawed, so too is its methodology for including expansion. Consequently, using the estimated diversions results in diversion between the Parties *increasing* with new entry not decreasing. This means that a number of areas that were not SLCs based on the CMA methodology prior to the expansion become SLCs as a result of Iceland [✂] expansion into the area. This is clearly a perverse outcome.

(620) [✂].

Table 16 [✂]

[✂]

Source: CRA analysis of the CMA data

(621) [✂].

352 [✂]

Table 17 [✂]

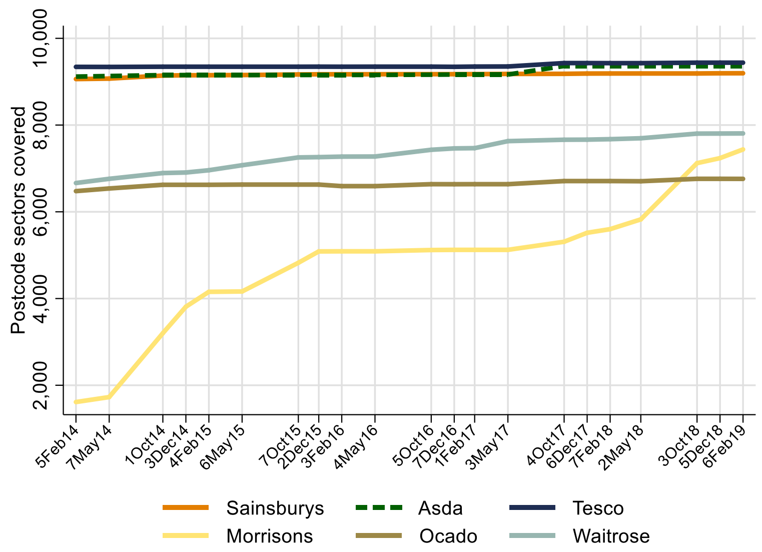
(622) The overall impact of the above erroneous adjustments is to find that the overall number of SLCs incorporating the expansions of [✂] Iceland for Asda is greater than the number of SLCs without these adjustments.[353] The adjustment does not find that any of the Asda SLCs become unproblematic after [✂] Iceland's expansion is incorporated. In contrast, it finds that 2 Supply Points that were not SLCs become SLCs simply due to the counter-intuitive application of the adjustment.

2. Even corrected, any adjustments for entry/expansion must consider the full impact of expansion rather than just short term impacts

(623) In addition to the significant error in the application of [✂] Iceland expansion, the CMA fails to consider the expansion plans of other entrants. As discussed in Section III.E, these should be incorporated given they will be likely, timely and significant. Further, the CMA's overall approach to expansion by competitors fails to properly recognise the dynamism of the market and the cumulative effect of expansion. An approach that properly addressed entry and expansion would result in significantly lower GUPPIs for the Parties.

(624) For example, Morrisons has massively increased its coverage of online in the last 3-4 years, as shown by the chart below.

Figure 19 Coverage (number of postcodes covered) by online operator



Source: CRA analysis of Parties' data from Netvide.

Figure 20 [✂]

[✂]

(625) The static approach taken by the CMA, which focuses only onthe current market share data, is therefore highly likely to underestimate the dynamic and increasing impact of entry and expansion by competitors.

E. The CMA's GUPPI threshold is unreasonably low and inconsistent with relevant legal standards

(626) As discussed in detail in Chapter 2, the CMA's low GUPPI threshold is unprecedented and results in a Phase II test, purportedly on the balance of probabilities, that is more invasive than the Phase I "realistic

[353] [✂]

prospect" standard. Neither the CMA, its predecessors, nor the US or EU has ever found a problem based on GUPPI as a threshold (or simply an input) anywhere near as low as that chosen by the CMA. The CMA's Tesco/Booker horizontal and vertical safe harbours presumed no problem below a 5% GUPPI. Further, in Ladbrokes/Coral, the SLC threshold was equivalent to a GUPPI of over 10%.

(627) The legal consequence of the CMA's approach is that the CMA has misapplied the "expectation of SLC" test. The CMA's reference to the scale of harm of a 1% national grocery price rise (cf. PFs paragraph 8.239 and note 153, relied on by reference at paragraph 11.50) appears to suggest that it can adopt a standard of risk that is more cautious due to market size, which is clearly wrong. Rather, the test the CMA must apply is not "plausible risk" but "more likely than not". Further, and in any event, even if market importance were relevant to the question of what amounts to "substantial" (which is not supported by the Act, the CMA's guidance, any UK grocery merger case, or even the 2007 Groceries inquiry), the CMA's GUPPI analysis in this case does not allow the necessary confidence in predicting the risk of adverse effects.

F. Conclusion

(628) For the reasons outlined above, the CMA's local analysis is fundamentally flawed. Correcting for the CMA's overstatement of online variable margins and using a conservative GUPPI threshold of 5%, the analysis would identify no local areas in which the Proposed Merger would lead to an SLC.

V. The Proposed Merger will not lead to coordination in respect of online grocery delivery

(629) The CMA provisionally finds that the Proposed Merger would be expected to result in coordination in 108 local markets. Given the competitive constraints that exist and will continue to be felt post-merger, the CMA has accepted that, even on its assessment, there would be limitations on the nature of any such coordination.

- First, the CMA has accepted (paragraph 12.8(a) of the PFs) that all competitors other than Tesco and the Parties would have no incentive to coordinate and would thus not form part of the hypothetical coordinating group – the hypothetical coordination would therefore be limited to coordination between the Parties and Tesco.
- Second, the CMA has accepted that price (because it is a parameter of competition that is common across in-store and online groceries), as well as capacity would not be part of any coordination (paragraph 12.8(b) of the PFs). The CMA further accepts that, even within delivery pricing, coordination could not arise with respect to delivery passes, as acknowledged in paragraph 12.54 of the PFs. The hypothetical coordination would therefore be limited to coordination on delivery charges, including slot length and minimum basket size, but excluding delivery passes.
- Third, even within those parameters that are locally flexed, the CMA accepts that there would not be coordination in local areas where Ocado is present, given that Ocado does not have the incentive to coordinate. As such coordination would only take place in the 108 local markets where Ocado is entirely absent (paragraph 12.58 of the PFs).

(630) The Parties note that, at paragraph 12.9, the CMA states that its conclusions do "not mean that other forms of coordination, for example over a wider area or among a wider hypothetical group, would be implausible." However, as set out below, the conditions necessary for coordination even on the limited basis specified in the PFs are not met. As a result, coordination on a wider basis cannot be anything but implausible.

(631) The sections below set out why coordination, even on the limited basis put forward in the PFs, could not arise.

- First, there is no basis for the CMA's underlying assumption that the Parties and Tesco would have the ability or incentive to fundamentally amend the way they each set delivery charges in order to coordinate in 108 local areas where Ocado is not present.
- Second, the evidence shows that there are numerous factors that curtail the ability of the Parties and Tesco to reach and monitor the terms of coordination on delivery charges now or post-merger, including a lack of transparency that has been significantly underestimated by the CMA.
- Third, the condition of internal stability is not met now and will not be met post-merger, because members of the hypothetical coordinating group would have the ability to deviate from coordinated pricing of delivery charges and would find it profitable to do so.
- Fourth, the condition of external stability is not met now and will not be met post-merger, because of the considerable scope for large and/or growing competitors including Morrisons, Ocado (with its new joint venture partner, M&S), Waitrose, Iceland and Amazon to disrupt any hypothetical coordination.

A. The CMA's mechanism for coordination (flexing of delivery pricing in 108 local areas) is unfounded.

(632) As set out above, the CMA's coordinated effects theory centres on the possibility that, post-merger, the Parties and Tesco will raise delivery prices (excluding delivery passes) in 108 local areas where they do not compete against Ocado. The underlying premise for this mechanism is fundamentally flawed. Neither the Parties nor Tesco currently have the ability to flex local pricing in the way envisaged by the CMA. It would entail significant expense for them to change their pricing approach to do so, and they have no incentive to do this, as even if co-ordination were possible, the potential additional revenue available from coordinating on delivery prices in only 108 local areas would be very limited.

1. Parties and Tesco lack the ability to coordinate in the geographic areas identified by the CMA

(633) As summarised above, the hypothetical coordination proposed by the CMA encompasses those elements of delivery charges that are or could be flexed locally post-merger. The CMA notes at paragraph 12.14 that, at present, Asda does not vary delivery prices according to the geographic location of the customer, but that Tesco and Sainsbury's do. The CMA implies (on the basis of this) that it would be relatively easy to move to a much more locally flexed system, dependent on the presence or otherwise of Ocado. The CMA's proposition significantly overstates the extent to which delivery prices are or could be locally flexed.

(634) Whilst Sainsbury's has [✄] sets of prices, these are based on clusters that cover numerous local areas and postcodes. [✄]. The postcodes within the clusters are grouped together on the basis of [✄]. As a result of the way in which the clusters are determined, amending the pricing for those clusters in which the 108 areas identified by the CMA are present would clearly have a negative impact on the functioning and pricing of those clusters (including the many areas other than the 108). Moving to locally flexed pricing contingent on the absence of Ocado would create a significant cost for Sainsbury's (as is clear from the fact that it does not currently flex pricing at a local level) – and it would be a significant departure from its preferred business model.

(635) Tesco, unlike Sainsbury's, has [✄].

(636) Thus, the evidence shows that, contrary to the CMA's underlying assumption that the Parties (and Tesco) would flex delivery pricing by local area, it is clear that only one of the hypothetical coordinating group,

Sainsbury's, currently flexes pricing across different areas to any real degree and that even this is limited by factors which restrict its ability to vary prices at the individual store level.[354]

2. The Parties and Tesco would have no incentive to coordinate in the areas identified by the CMA

(637) The CMA's theory assumes that the Parties and Tesco would have the incentive to fundamentally alter the way in which they each currently set delivery prices in order to allow them to amend their pricing in 108 local areas. This is implausible given the significant costs and complexities of altering their current delivery pricing systems versus the small potential benefit from doing so.

(638) As set out above, the CMA has expressly found no evidence that either Tesco or Sainsbury's currently vary delivery prices locally by reference to competition.[355] Indeed, Sainsbury's has explicitly noted to the CMA on numerous occasions that [✂] .[356] [✂],[357] [✂]. For this reason it would be very costly/difficult for Sainsbury's to amend its clustering approach.

(639) Similarly, [✂].[358] Therefore, moving away from its preferred strategy towards local delivery pricing would entail high costs.

(640) In light of the above, there would therefore need to be a significant benefit from coordination to incentivise the Parties and Tesco to do so. Coordination of delivery prices across 108 local areas would simply not give rise to a sufficiently large benefit:

(641) First, the coordination could cover only a small proportion of the online delivery business. 108 areas amount to only one-fifth of the Parties' combined online delivery areas.[359] On the basis that Tesco offers online delivery in more areas than the Parties, it must be assumed that it has an online network of similar or greater size. Neither the Parties, nor Tesco, would have the incentive to change their entire pricing models for the potential benefit of higher delivery pricing in a fifth or less of their online network.

(642) Second, the coordination could cover only a minimal proportion of online revenues. Delivery charges in the 108 areas identified by the CMA amount to no more than [✂]% of total delivery charges for Asda and [✂]% for Sainsbury's. More strikingly, they account for less than [✂]% of both Asda's total online revenues and Sainsbury's total online revenues. This shows that the potential benefit when weighed against the substantial cost of changing their preferred strategy and implementing an ability to flex by local area is highly unlikely to be profitable (even leaving aside the difficulties in sustaining any coordination discussed below).

(643) Third, although delivery charges represent a small proportion of overall basket size (accounting for [✂]% of the average basket for Asda and [✂]% for Sainsbury's), they are an important factor for consumers in choosing online delivery generally and in choosing a supplier and have a significant reputational factor.[360] For example, an OC&C presentation prepared for Asda in 2018 notes that [✂].[361] Customers react badly

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354 [✂].

355 PFs, paragraph 12.15.

356 Sainsbury's response to Q.9 RFI 6 dated 27 July 2018.

372 Sainsbury's Sales Review 2016P04W2, attached as **Annex_001V.6_002**.

358 Asda Online Grocery Pricing Proposition (March 2019), noting "Changes to the ASDA Online Grocery pricing proposition will provide a consistent nationwide offering and provide customer and business benefits", attached as **Annex_002V.6_001**.

359 The limits on the areas involved can also be seen from the fact that, of Asda's 285 Supply Points, only 82 have no overlap with Ocado, and, of Sainsbury's 244 Supply Points, only 39 have no overlap with Ocado.

360 For example, Doddle notes in its February 2019 update that: "*Delivery charges are second only to TV licences in the things Brits most hate paying for. A third of us (34%) resent paying for a TV licence in a time dominated by streamed services but we also resent absorbing delivery costs. 31% of us resent paying for delivery – more than resent paying for overdraft charges (26%) and parking tickets 23%!*"

376 OC&C presentation for Asda – Online Loop, attached as **Annex_004V.6_007**.

to increases in delivery price, [✂].[362] and Sainsbury's has also found as a result of its slot price trials that [✂]. [363]

(644) As already submitted by the Parties, the availability and price of delivery is a key element of the "convenience" of online delivery in the customer's decision making. Should the Parties attempt to increase delivery charges in specific areas, customers would be strongly incentivised to reduce or stop their online shopping. As importantly, the Parties would likely be labelled in consumer and trade press as giving consumers a "bad deal" on online shopping. For example, when Asda increased minimum spend requirements in some postcodes, the Sun covered with increase with the tagline "*BAGGED UP Asda has quietly upped it* [sic] *minimum delivery spend for some shoppers from £25 to £40 – and customers are FURIOUS*".[364] Thus, a significant knock-on reputational effect across the Parties' estates could be expected from a selective increase in pricing. The risks associated with increasing delivery charges in 108 local areas would therefore significantly outweigh any limited benefit that could be obtained.

(645) The importance of delivery charges can be seen from the reaction to Tesco's delivery price increase in 2016, which reduced Tesco's online growth by 20% and caused the channel to lose momentum, with Tesco noting that "*destroying value by deliberately targeting disproportionate growth in a small part of our business is something we don't think is sustainable*".[365] Similarly [✂].

(646) Despite the above, the CMA provides no evidence to suggest that the considerable cost of implementing the CMA's coordination mechanism would be outweighed by the small benefit such that the parties would have an incentive to raise delivery prices in a coordinated manner across the 108 areas identified.[366] To the contrary, as summarised above, the evidence shows that no such incentives would arise.

B. The conditions for aligning on online delivery prices are not present now and will not be present post-merger

(647) As recognised by the CMA, a prerequisite of coordination is the ability to reach and monitor the terms of coordination, which, under the CMA's analysis, would require alignment and monitoring with respect to delivery charges. However as this section shows, the Parties compete on many parameters of delivery pricing, including the number of delivery slots available at a price, and vouchering, neither of which can be viewed or monitored by rivals. Coordination on just one aspect of delivery pricing (such as the price per slot) without the ability to view and monitor other aspects is not feasible.

1. Online delivery pricing is significantly less transparent and more complex than acknowledged by the CMA

(648) The CMA's views that "the transparency of delivery pricing would assist in reaching a common understanding" and that the "high degree of transparency would also allow for monitoring of any coordination on delivery pricing…" reflect a fundamental misunderstanding of the different aspects of online delivery pricing.[367]

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362 Sample comments received by Asda's customer contact centre include [✂]

378 Sainsbury's internal document, "*Slot Pricing Update & Dynamic Pricing Strategy Introduction"* dated September 2018, attached as **Annex_001V.6_003**.

364 The Sun, "*Asda has quietly upped it* [sic] *minimum delivery spend for some shoppers from £25 to £40 – and customers are FURIOUS*", 4 October 2017, (https://www.thesun.co.uk/money/4609546/asda-has-quietly-upped-it-minimum-delivery-spend-for-some-shoppers-from-25-to-40-and-customers-are-furious/).

365 OC&C presentation for Asda – Online Loop, attached as Annex_004V.6_007.

366 [✂].

367 In this respect, transparency regarding the availability and pricing of delivery passes is irrelevant, as nationally available delivery passes would not form part of any hypothetical coordination.

(649) For instance, the CMA suggests that "the delivery prices available to consumers on online delivered groceries retailers' websites are transparent".[368] Whilst this is true in the most simplistic sense, in that a customer wanting to place an online order can at any given moment log into the website of a particular retailer and check the pricing of the available delivery slots, it is erroneous to conflate this with a degree of transparency that would enable coordinating firms to reach and monitor terms of coordination. This is because: (a) delivery pricing varies depending on which delivery slot a customer chooses; and (b) neither customers nor other retailers have any visibility of how many delivery slots are available at any given time.

(650) In other words, whilst it is possible for the Parties to see if Tesco is currently offering a delivery slot at a particular postcode by manually checking, they are unable to ascertain the number of additional slots that are available at each time period. This lack of transparency means that any member of the hypothetical coordinating group could effectively lower their online delivery prices in a local area – by increasing the availability of lower-price slots and/or decreasing the availability of higher-price slots – without the other members realising.

(651) Further, whilst the CMA acknowledges that "vouchering may make the effective charges paid by customers less transparent",[369] it underestimates the extent to which it does so. The CMA suggests that vouchering use is monitorable to "some extent", noting that there are "external companies, such as Kantar, that monitor voucher use".[370] However, as is clear from the Kantar data provided by Sainsbury's to the CMA at the outset of the Phase 2 investigation,[371] Kantar monitoring is at a high level. It monitors only a limited number of voucher metrics at the overall retailer level on a monthly basis. It provides no information in relation to the use of vouchers at local level or on the type of voucher being used. As a result, there is no way of ascertaining the extent to which any of Sainsbury's, Tesco or Asda are engaging in targeted vouchering activity in a particular local area or on different elements of the cost. For example it would be easy to cheat on an understanding to increase delivery prices by providing customers with vouchers that discount delivery prices or indeed their entire basket. Even if it was possible to monitor whether such vouchers exist it would be impossible to monitor the quantity provided.

(652) The CMA also recognises at paragraphs 12.49 to 12.55 of the PFs that there is complexity around delivery pricing, and finds that this complexity "may be a challenge to reaching a common understanding". Nonetheless, the CMA understates the complexity of delivery pricing in a number of respects, and erroneously concludes that this complexity "could be simplified to facilitate coordination".[372] However, the CMA makes no attempt to explain how this could be done and provides no evidence that a reduction in complexity would be feasible.

(653) Further, as is clear from the CMA's PFs, the Parties are not even aware of how many sets of delivery pricing are operated by Tesco (nor is Asda aware of the sets operated by Sainsbury's). This, coupled with the variations in pricing with respect to basket sizes and slots (set out in paragraph 12.52 of the PFs), and the possibility of targeted vouchering, renders it impossible to reach alignment on delivery charges.

(654) In light of the above, the only reasonable conclusion to draw is that the lack of transparency and the extent of complexity with respect to delivery pricing would prevent the hypothetical coordinating group from reaching or monitoring a common understanding on delivery prices.

[368] PFs, paragraph 12.44.

[369] PFs, paragraph 12.44.

[370] PFs, paragraph 12.44.

[371] Kantar – Coupons, (Annex_004J_001).

[372] PFs, paragraph 12.55.

2. The changes brought about by the Proposed Merger would not significantly increase the ability to align on terms of coordination

(655) The CMA argues that the merger would increase the symmetry between the members of the hypothetical coordinating group, and therefore align the incentives for these retailers to compete. However, the CMA's provisional finding is that coordination will take place at a local level, and only in those areas where Ocado is not present. Therefore the relevant question is whether the merger increases the symmetry within local areas – a question the CMA has not considered.

(656) Furthermore, even if coordination was on a national basis, as the CRA submission in response to the Coordinated Effects WP showed, it cannot be assumed that the increased symmetry will increase coordination. This is because pre-merger, punishment from the larger brand (Tesco) is more effective when there are two smaller brands, than when there is only one large firm that can weather that punishment more easily – this can imply that coordination would be harder to sustain with two parties.[373] As the CRA paper shows, whether this effect dominates depends upon the discount factor, and it is not possible to simply assume – as the CMA does – that incentives across the hypothetical coordinating group will necessarily be more aligned.

(657) The CMA also suggests that, post-merger, decisions on delivery pricing could be taken collectively within Asda and Sainsbury's whilst maintaining two brands. This would, according to the CMA, remove the "*hindrance to coordinating*" that currently exists because of the different approach taken by Asda to delivery pricing. Further, knowing that Asda and Sainsbury's are under the same management would allow Tesco to anticipate a consistent approach to delivery pricing. These considerations are unfounded and insufficient.

(658) First, consistent delivery pricing across the UK is an important part of Asda's customer proposition and therefore there is no intention to harmonise the delivery prices of the two Parties. If Asda were to significantly change its approach to delivery pricing (as the CMA's mechanism suggests) this would significantly change its customer proposition and thus could not remain purely "*internal to the merged firm*". As set out above, such a move would be picked up by the trade and consumer press, and Asda would face a negative customer reaction. As such there is no intention to have a single delivery policy and such a policy would be contrary to the Asda brand proposition. In the circumstances, there can be no basis to assume that the "hindrance" to collusion would be removed.

(659) Second, the mere fact that both Asda and Sainsbury's would be under the same management could not give Tesco sufficient information to allow it to align on delivery pricing. As set out above, there is no reason to believe that Tesco currently has any understanding of the complexities of Sainsbury's current approach to pricing. As a result, even if Tesco were to expect Asda to price more consistently with Sainsbury's, this would not provide sufficient transparency to allow alignment on or monitoring of the terms of coordination.

C. The conditions for internal stability are not present now and will not be present post-merger

(660) As recognised by the CMA at paragraph 12.61 of the PFs, internal stability requires that the additional profit from coordination is sufficiently high, and that deviation from a coordinated outcome can be easily identified and swiftly punished. These conditions are not currently met in relation to delivery charges and will not be met post-merger. The limited additional profit from coordination (given the Parties' (and Tesco's) current delivery pricing) has been addressed above at paragraph (642). It is clear that this would be insufficient to provide an incentive to coordinate in the areas identified by the CMA. The paragraphs below therefore focus on the inability to punish deviation.

[373] See Response to Coordinated Effects WP, Schedule 1, paragraph 35.

(661) There are a number of ways in which the members of a hypothetical coordinating group composed of the Parties and Tesco could deviate from a coordinated outcome in relation to delivery charges:

- First, as explained in paragraph (650) above, any of the members could effectively lower their online delivery prices in the specific local areas covered by the hypothetical coordination by increasing the availability of lower-price slots and/or decreasing the availability of higher-price slots. Given the lack of transparency over slot availability, this could be achieved without detection by other members of the hypothetical coordinating group.
- Second, any of the members could increase its use of vouchering in the specific local areas covered by the hypothetical coordination. Vouchering provides an immediate and tailored deviation mechanism to reduce the overall price of online groceries to customers in the local area and thus attract customers away from the other hypothetical coordinating firms. The Parties can, and do, target customers in local postcodes with vouchering activities. [✂]. As set out above, local vouchering of this type would be very difficult to detect by rivals.
- Third, any member could reduce the price of delivery passes, which would not be part of the hypothetical coordination. Although the CMA considers that this is unlikely, given the national pricing of delivery passes (see paragraph 12.68), it would nonetheless provide an obvious means for a party to cheat by retaining the higher price on the coordinated elements of pricing and yet attract and retain the highest frequency highest value customers who care most about delivery pricing. Given that the customers will be locked-in for the period of the delivery pass, this would provide a definite benefit for the specific period of time. The deviating party could expect that additional customers outside the hypothetical coordination areas would also be attracted to their delivery pass, thus providing additional revenues to offset the reduced revenues in other areas. Thus, the CMA is incorrect to consider that deviation by reference to delivery pass price decreases would not destabilise coordination.
- Fourth, there is no delivery "product" that can be purchased without purchasing groceries (ie delivery charges are, as the name suggests, merely charges for the service of having the "product", a basket of groceries, delivered to one's home). Therefore, unless it is also possible to coordinate on grocery prices, it will not be possible to sustain coordination on delivery pricing. Since the CMA rules out the ability to coordinate on grocery prices, there is limited incentive to coordinate on delivery prices, given that it is not possible to effectively increase the total price of groceries plus delivery to consumers. This is because any member of the coordinating group could at any point decrease the price of one or more grocery items, in order to gain increased volumes (across all areas and in-store) from the lower total price paid by the customer. Such a tactic would disrupt the coordinated equilibrium. This is set out more formally in Schedule 6.4 (*Modelling coordination on delivery prices*).

(662) Of the methods of deviation outlined above, only the third is capable of being detected by other members of the hypothetical coordinating group. However, regardless of how many methods could be detected, it is clear that the members of the hypothetical coordinating group do not have the ability to respond quickly and effectively to any such deviation. The CMA's assumption that the members of the hypothetical coordinating group have "*the ability to respond rapidly to any deviation*" appears to rest solely on the basis that [✂].[374] In so doing, the CMA ignores the fact that Asda has changed its delivery pricing only four times in the past three years (see paragraph 12.66), giving no consideration to the fact that this is plainly insufficient to allow Asda to respond to any deviation. The CMA similarly gives no consideration to whether Tesco could change its delivery pricing frequently, although the evidence suggests that Tesco has increased its delivery prices very infrequently (see Figure 12.1 and paragraph 12.21 of the PFs). Again, there is no evidence that Tesco could respond swiftly to any deviation.

[374] PFs, paragraph 12.66.

(663) On the basis of the above, it is clear that, contrary to the CMA's assumptions: (a) the members of the CMA's hypothetical coordinating group would have the incentive and ability to deviate from a coordinated outcome and (b) there would not be an easy or swift means of punishing that deviation.

(664) With respect to the impact of the Proposed Merger, the CMA simply asserts that there would be less incentive to deviate because each of Tesco and the merged entity would be more certain of the other's actions. There is no basis for this assertion. First, as set out above, the simple fact of the Proposed Merger will not increase transparency to the degree necessary to allow the parties to the hypothetical coordinating group to be more certain of each other's actions. Second, even if they were to become more certain, this (in itself) would not decrease deviation incentives – the financial benefit of deviation would remain significant, especially given the many ways in which the Parties could deviate without being caught.

(665) There is therefore no evidence to suggest that post-merger, the members of the hypothetical coordinating group would be able to respond swiftly to deviation.

(666) On the weight of evidence, it is therefore clear that the conditions necessary for internal stability are not met currently and that there is no reason to believe that they would be met post-merger.

D. The conditions for external stability are not present now and will not be present post-merger

(667) The CMA provisionally finds that the conditions for external stability would be met in relation to 108 local areas where Ocado is not present as a constraint on the hypothetical coordinating group, and that the Proposed Merger would not change this. The CMA's provisional finding is incorrect, as it substantially underweights the external constraint of in-store shopping and other competitors in these areas, as well as the impact of entry and expansion given the dynamism of the online channel.

1. In-store constraint is significantly underestimated

(668) With respect to in-store shopping, the CMA has significantly underestimated the constraint it places on online shopping (including in the 108 identified areas) for the reasons set out in Section II above. As a result, the external constraint facing the hypothetical coordinating group is considerably bigger than the 30 to 40% identified by the CMA at paragraph 12.77.

(669) It is clear that the Parties have now (and would have post-merger) limited incentives to coordinate due to the loss of sales to in-store. Not only would the loss to in-store be considerably greater than surmised by the CMA (being more accurately estimated at 40%), but the Parties could be expected to capture no more than around 13% each or 26% of those lost sales (based on the CMA's national market share estimates).

2. Existing external constraints from third-parties are significantly underestimated

(670) The CMA has placed no weight on the external constraint provided by *existing* third-party online operators (save for the Parties and Tesco) in the 108 local areas that fall within the scope of the hypothetical coordination. This is plainly incorrect. Not only does Morrisons reach up to [✂] market share in some local areas where it is present, but other online providers, such as Iceland, are highly rated by customers in the local areas in which they are present. This is clear from the most recent consumer rankings of online grocery providers by Which?, as reported in the Grocer:[375]

[375] The Grocer, "How shopper expectations around online grocery are changing", (https://www.thegrocer.co.uk/online/how-shopper-expectations-around-online-grocery-are-changing/590608.article).

Figure 21 Which? consumer rankings of online grocery providers

Here are the online rankings from Which?, in case you missed them:

1. Ocado
2. Iceland
3. Waitrose
4. Tesco
5. Morrisons
6. Sainsbury's
7. Asda

It's no surprise that the only pure-play operator in the list, Ocado, is top. It was awarded five-star ratings by respondents for delivery slot availability, range of products and drivers' service. However, Iceland's own online offer was ranked a high second (79%).

(671) The impact of these competitors in the 108 areas identified by the CMA is plainly relevant to the question of whether coordination in those areas would be externally stable.

(672) In fact, in over two-thirds of the local areas identified by the CMA as conducive to coordination, there are two or more of these third-party operators present, and one additional competitor in all but two of the remaining areas. The constraint posed by these operators cannot be discounted entirely and must be viewed as a hindrance to the external stability of any coordination attempts.

3. Only a small proportion of the total market in each relevant local area is potentially susceptible to coordination

(673) Given the above, a large proportion of the switching options for online customers in each relevant local area (i.e. those where Ocado is not present) is outside of the hypothesised coordinating group. As a result, the CMA greatly over estimates the external stability of the hypothetical coordinating group. If one considers the total possible extent of options for customers:

- on average, around 30% of sales will be through the in-store supply of groceries. Thus, even if the CMA does not accept that in-store and online form part of the same market, it is still necessary to allow for a significant out-of-market constraint of at least 40% when considering the online channel in isolation; [376]
- on average, in each area around [✂]% of the Parties' orders are made through delivery passes, which the CMA has accepted that delivery passes are not susceptible to coordination. The potential for customers to use delivery passes functions as another external constraint on the ability of a hypothetical coordinating group to coordinate on delivery pricing; and
- a certain proportion of online sales will also be made to competitors other than the Parties and Tesco, which the CMA conservatively estimates to be approximately [✂]% on average across the 108 local areas. This estimate is based on data for 2017 and does not reflect recent expansion.

(674) On the basis of these factors, well over 50% of demand in any area is currently accounted for by external competitive constraints. Given the size of those external to the group, this makes it insufficient for a finding that the hypothetical coordination would be externally stable.

[376] We have used the Kantar and Nielsen weighted instore diversion based on the CMA survey of 40%, which is equivalent to a market share of about 30%.

4. Dynamic entry and expansion is ignored without reason

(675) The CMA has failed to give adequate weight to the highly dynamic and constantly evolving competitive landscape for the supply of online delivered groceries in the UK as reflected by the recent announcement of a new joint venture between Ocado and M&S. The significance of this new developments is explored at length in section III.E above. However, the key points for the assessment of external constraints in the 108 areas identified by the CMA are that:

- The M&S/Ocado joint venture is well-positioned to increase its geographic coverage beyond Ocado's existing footprint through the construction of eight new CFCs. Ocado and M&S have specifically highlighted the "*Potential to convert M&S Food customers who currently account for c. one third of online grocery spend – only £400m of that spend is with Ocado*[377]" and that the joint venture's aim is to create "*the leading online grocery business.*"[378] As the CMA has recognised that Ocado is a key constraint on the Parties, such that coordination would not be feasible in those areas where Ocado is present, it is plain that expansion by Ocado will significantly undermine any hypothetical coordination.
- Morrisons is rapidly expanding the coverage of its online offering through the roll out of its store-pick model. The Parties' internal analysis shows that based on Morrisons' store coverage and tie-in with Ocado, it has the potential to reach 96% of the UK population with its online offering, which is comparable to the current offerings of Sainsbury's, Asda and Tesco.
- Amazon's size, experience and reputation mean it is uniquely positioned to expand its presence in the UK grocery market at an unprecedented pace. As noted in paragraph (565), recent reports indicate that it is planning to significantly increase its in-store and online presence in the UK grocery market.

(676) The Proposed Merger would not reduce the above factors in any way, thus ensuring that the conditions for external stability will remain unmet post-merger. Doubtless as a result of the dynamism of digital channels, the Parties note that there are no previous cases in the UK or Europe finding coordination in a digital market of the type the CMA has provisionally found here.

VI. Conclusion

(677) As the above analysis sets out clearly, the CMA's PFs in relation to online delivered grocery are not supported by the evidence. Contrary to the assumptions made by the CMA, the relevant evidence base shows that the market (whether national or local) is highly competitive and that the Parties face significant constraints from a number of competitors (both multichannel and pureplay).

(678) Properly assessed, the extent of the constraints present in the market mean that the Proposed Merger cannot give rise to an SLC on a national basis, nor on the basis of any hypothetical coordinated effects. Further, the evidence simply does not support a finding that the Proposed Merger could give rise to SLCs at a local level on the scale identified in the PFs.

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[377] Marks and Spencer presentation, "*Bringing the best together: transforming UK online grocery shopping M&S and Ocado announced new joint venture*", 27 February 2019, p.1, attached as Annex_004V.6_002.

[378] Marks and Spencer press release "*Bringing the best together: transforming UK online grocery shopping M&S and Ocado announced new joint venture*",27 February 2019, p.4, attached as Annex_004V.6_001.

CHAPTER 7 - FUEL

I. Introduction and Summary

A. The CMA's approach to identifying local level concerns is considerably more interventionist than established Phase I decisional practice

(679) In the PFs, the CMA applies a wholly determinative "decision rule" to identify local areas[379] where the Proposed Merger is likely to give rise to an SLC in the supply of road fuels.[380] This decision rule automatically generates an SLC finding in every local area where either the GUPPI or the "Pricing Indicator" are above the respective thresholds set by the CMA (the "**Decision Rule**").

(680) By comparison, in previous Phase I retail supply of road fuel merger decisions, once overlaps were identified, the CMA/OFT typically used a series of initial filters to identify local areas warranting further investigation. This was then followed by a "deep dive" analysis of those areas, relying on a mix of evidence specific to each relevant local area. The advantage of this approach is that it allows the CMA to take account of all available evidence for each local area in the round, which is why it is the standard approach used in retail merger cases.[381]

(681) Crucially, no Phase I decision-maker in a previous retail supply of road fuel merger case has ever adopted a determinative decision rule to establish SLC findings, or concluded that all the local areas captured by its initial filters gave rise to a realistic prospect of an SLC. Indeed, Phase I decision-makers have found – in every single fuel retailing merger where initial filtering identified local areas of potential concern – that after conducting a "deep dive", the significant majority of those areas did not give rise to a realistic prospect of an SLC.[382]

(682) By contrast, of the 166 PFS in 117 areas that the CMA claims fail the established initial filters in this case, the wholly determinative Decision Rule is used to conclude that 129 PFS (78%) give rise to an SLC in 95 local areas.[383] Moreover, once the error with the CMA's coding of its initial filters is taken into account (discussed below), there are in fact only 70 PFS (in 49 pairs, which could be reviewed by conducting a deep dive on 43 local areas) that fail the initial filters – i.e. substantially fewer areas than those in which the CMA then identifies an SLC.

(683) As the CMA is aware, the Phase II "balance of probabilities" test sets a higher bar for establishing an SLC finding than at Phase I.[384] Accordingly, a Phase II investigation would be expected to adopt a less interventionist approach than a Phase I investigation. Yet as the above results clearly show, the CMA has

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379 Throughout, areas have been defined as unique "pairs" of PFS, where a pair of stores consists of a PFS giving rise to a provisional SLC and the other Party's nearest neighbouring PFS. Note that, in some cases, both PFS in an area will be a provisional SLC. There will also be cases where a PFS appears in multiple areas. As a result, the number of areas does not necessarily indicate the number of divestments required to resolve an SLC.

380 PFs, paragraph 14.147.

381 Retail mergers commentary, paragraph 3.2 (attached as **Annex 005_006**): "*The CMA mainly uses filters as a screen. When there are many overlaps between the parties' stores the CMA uses filters to screen out overlap areas where there are unlikely to be competition concerns. This allows the CMA to focus on the remaining overlap areas, which are each analysed in more detail in an assessment that is informed by an understanding of the nature of competition and reflects the factors discussed in this and later sections.*"

382 The high-water mark for converting local areas caught by initial filters into SLC findings only came with the CMA decision of 31 August 2018 in *MFG/MRH*, where 29 out of the 84 areas caught by the CMA's filters (35%) were ultimately found to give rise to a realistic prospect of an SLC. Before that decision, the previous high-water mark was 1 out of 5 local areas (20%) in the OFT decision of 20 October 2011 in the anticipated acquisition by Rontec Investments LLP of petrol forecourts, stores and other assets from Total Downstream UK plc, Total UK Limited and their affiliates, Case No. ME/5139/11 ("***Rontec/Total***", attached as **Annex_005_063**).

383 The original PFs identified 132 fuel SLCs, but after correcting an error in the code, this was reduced to 129. [✄].

384 According to the CMA's Merger Assessment Guidelines, "*[i]n answering the two questions the [CMA] will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that an SLC will result? It must therefore form an expectation which has a higher level of probability than that required*" of the CMA at Phase I. See paragraph 2.12 (attached as **Annex_005_010**).

inverted this convention, and adopted a stance that is far more interventionist than any recent Phase I merger decision concerning the retail supply of road fuel.

(684) It is also not the case that this more interventionist approach can be justified by reference to some "special feature" of the present case. The importance of fuel to household budgets, and the ability of households to avoid such expenditure (or not), is clearly the same in every retail supply of road fuel merger investigation.

B. The rationale for rejecting the established Phase I filters is based on significant coding errors

(685) The PFs suggest there are 166 PFS failing the initial filters, making an in-depth, area-by-area assessment exercise "*impractical*".[385] No other reason is given as to why this exercise should not be done, and the CMA does not appear to dispute that it is a superior method of determining local SLCs.

(686) However, this is based on several errors in the CMA's code (primarily, a significant miscalculation of fascia counts). Once these are corrected, there are only 70 PFS failing the filters, which would require an area-by-area assessment in only 43 local area maps/data packs (provided at Schedule 7.6).[386] This is fewer than the number of areas failing such filters in *MRH/MFG* (84 areas) and in *Shell/Rontec* (68 areas) – and in both those Phase I cases, an area-by-area approach was nonetheless pursued.

(687) If the CMA determined that it *still* could not feasibly conduct a detailed area-by-area assessment of those 49 areas despite having the luxury of a substantially longer Phase II timeframe, it could use straightforward rules to further reduce the number. For instance, the CMA could identify and remove either:

- areas which are clearly SLCs (i.e. "red" areas – as was done in *MRH/MFG* to reduce the number of areas examined from 84 to 61); or
- areas which are clearly not SLCs (i.e. "green" areas – as was done in *Shell/Rontec*),

before subjecting a smaller set of remaining "amber" areas to a detailed analysis.

C. The PI and GUPPI thresholds are unjustifiably low given the unreliability of these measures

(688) The Parties also have serious concerns with both of the measures underpinning the provisional Decision Rule, which the CMA has developed to avoid conducting "a manual assessment of a large number of local areas".[387] Neither achieve a standard of accuracy and reliability that should be considered reasonable to determine an SLC finding – particularly when applied with the extremely low thresholds set by the CMA.

(689) In relation to the Pricing Indicator ("**PI**"), the CMA has shifted the threshold at which it raises concerns down since the Fuel WP, from 1ppl to 0.75ppl. The Parties note that this followed their identification of an error in the CMA's code, which reduced the number of sites with a PI value of over 1ppl by a factor of around 10. The PFs do not offer any explanation for this shift in the CMA's thinking. Of course, using the lower 0.75ppl threshold only exacerbates the Parties' concerns over the inaccuracy of the underlying models, which fail to take into account many important features of the Parties' actual pricing policies. The level of accuracy of the CMA's models in predicting the actual outcomes of the Parties' pricing policies falls from an already low 75-80% using a 1ppl threshold in the Fuel WP, to less than 50% using a 0.75ppl

[385] PFs, paragraph 14.65.

[386] Some of these area pairs may also overlap in ways that allow for a single assessment of multiple areas, resulting in even fewer areas that need to be reviewed.

[387] PFs, paragraph 16.66.

threshold in the PFs.[388] Using such a low standard for accuracy means that the analysis simply cannot discriminate between competing hypotheses. As such, it is completely inappropriate to apply such a low threshold for identifying concerns.

(690) In relation to the GUPPI, the CMA draws confidence in its measure by showing a high correlation between two different methods of calculating the underlying WSS: one based on a Price Concentration Analysis ("**PCA**"), and one based on the survey. However, obtaining high correlation between measures that are constructed in fundamentally the same way (declining weights over distance, low weights on non-supermarkets) is inevitable and not a reason for confidence. In previous cases, the CMA has generally relied on strong predictive power of actual survey diversions to confirm that its WSS methodology is correct. In this case, however, the combined WSS adopted by the CMA explains very little of the variation in survey diversions.[389]

(691) Moreover, both underlying WSS measures are biased against non-supermarket rivals. This is evident in relation to the PCA (which the CMA accepts) on the basis that most of the variation in relation to non-supermarkets comes from the exit of small failing PFS.[390] These exiting sites <u>typically have only a *third* of the fuel and shop sales of a continuing non-supermarket PFS</u>, and far worse metrics for site quality. As such, the impact of their exit will be significantly smaller than the competition that would be experienced from an established, successful non-supermarket PFS. Moreover, despite this clear bias, the weight that the PCA places on non-supermarkets (even before the corrections that we make below) is actually *higher* than the weight on non-supermarkets in the survey:

- the weight on non-supermarkets located up to five minutes away is 14% in the CMA's survey-based WSS versus 20% in the PCA-based WSS; and
- the weight on non-supermarkets located five to 10 minutes away is 17% in the survey-based WSS versus 18% in the PCA-based WSS.[391]

(692) It therefore cannot be the case that the PCA is biased against non-supermarkets but the survey is not.

(693) The appropriate way to take account of the PCA, survey and other evidence in the round would be to upweight non-supermarkets accordingly, and not simply to average two biased measures to create a third biased measure.

(694) Both the GUPPI and PI measures therefore have serious weaknesses that cannot reasonably be reconciled with the use of extremely low thresholds.

D. Adopting an "either/or" decision rule leads to a substantial overstatement of SLCs that is inconsistent with the weight of evidence

(695) The key weakness of the Decision Rule approach adopted in the PFs goes beyond the weaknesses in the individual underlying measures, and results from the fact that the two measures used by the CMA simply produce inconsistent results most of the time.

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388 Fuel WP, paragraph 123: "*Overall, the pricing rules appear to capture c. 75-80% of the Parties' pricing behaviour to within +/- 1ppl. We view this as a sufficient degree of accuracy to place weight on this analysis as being informative of the Parties' actual pricing behaviour*."

389 For example, in *Celesio/Sainsbury's Pharmacy Business merger inquiry, decision of 29 July 2016,* , the CMA referred to a relationship between WSS and survey diversion ratios for the UK at 69% (and for England at 79%) as support for using a linear decline to weight impacts by distance in the WSS, describing this as "*a strong relationship*" (Appendix I, paragraph 20). By contrast, in the following paragraph, a 48% R2 is described as "*not particularly strong*" and "*suggests that the more complicated methods of weighting distance give a worse relationship between diversion and the concentration measure than using linear distance, and that weighting by volume does not improve the analysis*." The equivalent R2 in this case is a mere 13%.

390 PFs, paragraph 14.111.

391 Both WSS assume zero weight on non-supermarkets located more than 10 minutes away.

(696) This is despite the fact that these measures are described in the PFs as, respectively:

- PI: "*a reliable indicator of the likely Merger effect at each PFS*";[392] and
- GUPPI: "*a direct estimate of the incentive to raise prices"* based on *"robust diversion estimates*";[393]

(697) The CMA suggests that both measures are informative because they have different strengths and weaknesses – but it cannot reasonably be the case that both measures are treated as deterministic when a site fails on *either* metric. Only 34 of the 129 SLCs identified exceed both the PI and the GUPPI thresholds. Outside these local areas, even if the individual metrics and thresholds were accepted as meaningful, one or other of the measures must be incorrect – or (more likely) both must be partially but not perfectly informative. But under these circumstances:

- it cannot be correct to say that the PI is entirely reliable and sufficient in isolation to justify an SLC finding – to the exclusion of all other evidence – when it is greater than 0.75ppl, but should be entirely ignored when it is less than 0.75ppl; and
- similarly, it cannot be correct to say that the GUPPI is entirely reliable and sufficient in isolation to justify an SLC finding – to the exclusion of all other evidence – when it is greater than 1.5%, but should be entirely ignored when it is less than 1.5%.

(698) By always selecting the metric that indicates an SLC where the two measures are inconsistent, the PFs systematically and substantially overstate the true extent of plausible concerns.

(699) Consequently, the CMA must at the very least either:

- adjust the Decision Rule so that it takes into account *both* measures in every local overlap area – i.e. balancing them against each other to yield an outcome which gives appropriate weight to both sources of evidence; or
- only use the Decision Rule as a basis for SLC findings where the thresholds of *both* measures are exceeded, and undertaking an in-depth area-by-area assessment of those local areas which are only caught by one of the two measures,

in each case, in addition to increasing the thresholds applied for each measure, as outlined above.

(700) Alternatively, and more robustly, the CMA should choose to undertake an in-depth area-by-area analysis for local areas caught by the initial filters, and take into account both the GUPPI and PI measures in relation to each such local areas in a more holistic manner. This would allow the CMA to make a more balanced judgment on whether the Proposed Merger is likely to give rise to an SLC in those local areas, based on all the evidence in the round (which is the reason this in-depth area-by-area approach is favoured in retail mergers).[394]

E. Many of the SLC findings are contradicted by the local evidence

(701) The scope for the CMA's provisional Decision Rule to unreasonably generate "false positive" SLC findings is made very clear when looking at evidence for individual local areas in greater detail. This can be seen from the examples set out below (and in greater detail in Schedule 7.5).

F. The CMA has erroneously dismissed the evidence on merger specific efficiencies

(702) Efficiencies in respect of fuel are rejected outright – primarily on the basis of a single argument already addressed by the Parties in response to the Fuel Efficiencies WP – but the PFs do not engage at all with

[392] PFs, paragraph 14.138.

[393] PFs, paragraphs 14.149 and 14.154(e).

[394] Retail mergers commentary, paragraph 3.3 (attached as **Annex_005_006**).

that response. In this response, the Parties set out a very clear example which shows why the existence of non-price benefits (e.g. security of supply), which are provided by both Parties' business models, does not undermine the incentive to combine the Parties' procurement activities for fuel post-merger, or the ability to make 0.4ppl of variable cost savings by doing so. The CMA has simply ignored the Parties' previous submissions on this point.

G. The Decision Rule, particularly when applied on an "either/or" basis, is at odds with the Phase II "balance of probabilities" standard and SLC test

(703) The points outlined above, as explored in more detail throughout this chapter, illustrate that the CMA's provisional Decisional Rule does not provide adequate grounds to support the SLC findings it automatically generates (ostensibly to a balance of probabilities standard). These shortcomings alone should be enough to dissuade the CMA from adopting the unmodified Decision Rule in a final report. However, there are also significant legal and policy reasons for either drastically altering the Decision Rule, or abandoning it in favour of a more robust approach. Many of these reasons are also explored in Chapter 2, which sets out the Parties' position on the use of GUPPI in the grocery sector. In particular, see sections V and VI of that chapter.

H. Constructing a reasonable approach to identifying local SLCs

(704) For the reasons set out in this Chapter, the CMA's provisional Decision Rule cannot be considered a reliable or robust assessment of which horizontal PFS overlaps generate an SLC finding to a balance of probabilities standard. Unless the CMA significantly increases the intervention thresholds and abandons its reliance on an "either/or" approach to the GUPPI and PI measures, the Decision Rule will remain a considerable overstatement of the true level of SLCs. If the CMA is not willing to follow established Phase I decisional practice, and engage in the application of initial filters followed by closer scrutiny of evidence concerning local areas flagged by those filters, an alternative determinative methodology will by necessity be required.

(705) If a reasonable measure is used (in particular, one free from the bias against non-supermarket PFS underlying the current WSS/GUPPI approach), and is set against a reasonable threshold for identifying an SLC, this should identify a much smaller number of PFS of concern than the provisional position set out in the PFs. For instance, one could take a well understood and accepted measure used in previous cases, such as the initial filters used in previous Phase I cases, diversion ratios, or some combination of the two, as the basis for a decision rule. As shown by Table 19 below, a 40% diversion threshold when applied as a decision rule would generate 38 SLCs in 32 areas. This uses the actual survey diversions where available and the estimated diversions the CMA has calculated for its WSS methodology in all other instances (notwithstanding that both should, for the reasons set out above, overstate diversion between the Parties).

(706) This would be consistent with the diversion filter applied in *Shell/Rontec*, albeit far more conservative (and interventionist), given: (a) here, the survey results underpinning the CMA's diversion estimates underweight non-supermarket PFS, (b) *Shell/Rontec* was a Phase I case subject to the more easily satisfied "may be the case" legal test; and (c) the diversion threshold in that case was only used as an additional filter to identify a sub-set of local areas that had already been identified as warranting closer scrutiny (many of which were then found not to give rise to an SLC). In fact, SLCs were ultimately only identified in areas where the diversion ratio exceeded 50%.[395]

[395] OFT, *Completed acquisition by Shell of 253 petrol stations from Consortium Rontec Investments LLP*, Case No. ME/5191/11, decision of 3 February 2012 ("***Shell/Rontec***", attached as **Annex_005_064**), paragraphs 103-106.

II. CMA's approach to identifying local level concerns is considerably more interventionist than established Phase I decisional practice

A. Inconsistency with previous Phase I fuel retailing merger decisions

(707) The CMA and OFT have conducted numerous Phase I retail supply of road fuel merger reviews since the Enterprise Act 2002 came into force.[396] Before the Proposed Merger, however, no fuel retailing merger has ever been referred to a Phase II investigation.

(708) As the CMA is aware, the legal test for reference at Phase I is met if the CMA has a reasonable belief that it "may be the case" that a merger will substantially lessen competition. At Phase II, the Inquiry Group is required to base its decisions "on the balance of probabilities", which requires a higher level of certainty than that needed to support an SLC finding at Phase I.[397] Accordingly, a Phase II investigation would be expected to yield a less interventionist outcome than a Phase I investigation. Yet an examination of previous Phase I fuel retailing merger decisions clearly shows that the CMA, in its PFs, has inverted this convention – and adopted a stance that is far more interventionist than any recent Phase I decision.

(709) As discussed above, the CMA's provisional Decision Rule is used in the PFs to identify local areas where the Proposed Merger is likely to give rise to an SLC in the retail supply of road fuels.[398] The Decision Rule automatically generates an SLC finding in every local area where either the GUPPI or the PI are above the respective thresholds set by the CMA. The specific shortcomings of the Decision Rule and its constituent parts are explored in sections IV, V and VIII below.

(710) By comparison, in the previous Phase I cases, once overlaps were identified, the CMA/OFT typically used a series of filters to identify local areas warranting further investigation.[399] This was then followed by a "deep dive" analysis of those areas, relying on a mix of maps and local characteristics, GUPPIs/WSS/local market shares, and survey evidence (where available).

(711) Schedule 7.1 summarises the Phase I decisional practice in retail supply of fuel mergers, showing: the initial filters used to identify local areas warranting "deep dives", the number of sites captured by those filters, the number of SLCs ultimately found, and the thresholds at which those SLCs were identified.

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[396] See for example OFT, *Anticipated Acquisition by Tesco Stores Limited of former BP/Safeway petrol forecourts and stores from Wm Morrison Supermarkets plc*, Case No. ME/1287/04, decision of 24 October 2004 ("***Tesco/Morrisons***", attached as **Annex_005_072**); OFT, Completed merger between Co-operative Group Limited and Lothian Borders & Angus Co-operative Society Limited, Case No. ME/393308, decision of 6 March 2009 ("***Co-op/Lothian Borders & Angus***"); *Rontec/Total* (attached as **Annex_005_063**); *Shell/Rontec* (attached as **Annex_005_064**); OFT, *Anticipated acquisition by J Sainsbury plc of 18 petrol stations from Rontec Investments LLP*, Case No. ME/5407/12, decision of 7 June 2012, ("***Sainsbury's/Rontec***", attached as **Annex_005_065**); CMA, *Anticipated acquisition by Asda of three grocery stores and three petrol stations from Co-operative Group Limited*, Case No. ME/6466-14, decision of 28 November 2014 ("***Asda/Co-op***", attached as **Annex_005_066**); CMA, *Completed acquisition by Motor Fuel Limited of 228 petrol stations and other assets from Murco Petroleum Limited*, Case No. ME/6471-14, decision of 16 February 2015 ("***MFL/Murco***", attached as **Annex_005_067**); CMA, *Anticipated acquisition by Motor Fuel Limited of 90 petrol stations from Shell Service Station Properties Limited, Shell UK Limited and GOGB Limited*, Case No. ME/6534/15, decision of 26 August 2015 ("***MFL/Shell***", attached as **Annex_005_068**); CMA, *Anticipated acquisition by MRH (GB) Limited of 78 service stations from Esso Petroleum Company Limited*, Case No. ME/6563/15, decision of 19 January 2016 ("***MRH/Esso***", attached as **Annex_005_069**); and *MFG/MRH*.

[397] See *OFT v IBA Health Ltd* [2004] EWCA Civ 142. See also the Merger Assessment Guidelines, paragraph 2.12 (attached as **Annex_005_010**): "*In answering the two questions the [CMA] will apply a 'balance of probabilities' threshold to its analysis, ie it addresses the question: is it more likely than not that an SLC will result? It must therefore form an expectation which has a higher level of probability than that required*" of the CMA at Phase I.

[398] PFs, paragraph 14.147.

[399] In all cases since *Rontec/Total* in October 2011 (attached as **Annex_005_063**), these filters consisted of a combination of two or more of the following elements, referred to together as the "**Established Filters**":

- **Price marker:** whether the parties' sites were each other's main price markers, or one of three or fewer markers;
- **Closest proximity:** whether the parties' sites were the closest to each other in terms of drive time;
- **Fascia:** whether the merger would lead to a reduction in fascia count of 4:3 or worse; and
- **Supermarket:** areas where only one rival supermarket PFS would remain.

(712) Crucially, no Phase I decision-maker in a fuel retailing merger case has ever:

- adopted a determinative decision rule to establish SLC findings; or
- concluded that all the local areas captured by the Established Filters gave rise to a realistic prospect of an SLC.

(713) Indeed, Phase I decision-makers have found – in every single case where initial filtering identified local areas of potential concern – that after conducting a "deep dive", the significant majority of those areas did not give rise to a realistic prospect of an SLC.

(714) The high-water mark for converting local areas caught by Established Filters into SLC findings only came with the *MRH/MFG* decision in 2018, where 29 out of the 84 areas caught by the CMA's filters (35%) were ultimately found to give rise to a realistic prospect of an SLC. Before that decision, the previous high-water mark was 1 out of 5 local areas in *Rontec/Total* in 2011 (20%), followed by 17% (*MFL/Murco*, 2015), 11% (*MRH/Esso*, 2015), 9% (*Shell/Rontec*, 2012) and 0% (in both *MFL/Shell*, 2015 and *Sainsbury's/Rontec*, 2012).

(715) By contrast, of the 166 local areas that the PFs claim fail the Established Filters in this case, the CMA's provisional Decision Rule concludes that 129 (78%) give rise to an SLC on the ostensibly less interventionist "balance of probabilities" Phase II standard. The proportions of overlap sites found to actually give rise to a realistic prospect of an SLC when assessing local characteristics in previous decisional practice suggests that 129 out of 166 is far too high a proportion. Many of those 129 local areas, if they were subject to a "deep dive", would very likely not be found to give rise to an SLC even under the more easily satisfied Phase I legal test.

(716) The scope for "false positive" SLC findings revealed by this comparison is drastically compounded when one takes into account that the number of local areas the PFs claim fail the Established Filters – 166 – is based on a significant coding error. The actual number of PFSs that fail the initial filter once errors are corrected is 70 – as explained in section III below.

(717) Moreover, it is clear that the wide range of factors considered by decision-makers in previous Phase I fuel retailing cases effectively created a higher – and more robust – bar for establishing an SLC finding than the CMA has applied in its PFs. This is particularly striking in the case of *Shell/Rontec*, where the OFT surveyed all 68 sites that failed its "cautious filtering methodology".[400] The OFT then considered a range of other evidence to assess the impact on competition around those sites.[401] In particular, for those areas where diversion ratios were over 40%, the OFT decided (at Phase I) that most of even those areas caught by this additional test did not in fact meet the test for reference, "*on the basis of all the evidence considered in the round*" (as can be seen from Schedule 7.1).[402]

(718) For a sense of the impact of this inconsistency between the CMA's approach in the PFs compared to previous decisional practice at Phase I, consider Figure 22 below. Figure 22 compares the SLC findings in the PFs with the approach taken in *Shell/Rontec* (2012), which was the first large-scale fuel retailing merger considered at Phase I since the Enterprise Act 2002 came into effect, and remained the largest fuel merger to have been considered by the OFT or the CMA until the *MRH/MFG* case in 2018.This comparison shows that the CMA's provisional Decision Rule:

(a) automatically declares SLC findings in the vast majority of the local areas that would merely have been identified in *Shell/Rontec* as worthy of closer investigation; but also

400 *Shell/Rontec*, paragraph 99 (attached as **Annex_005_064**).

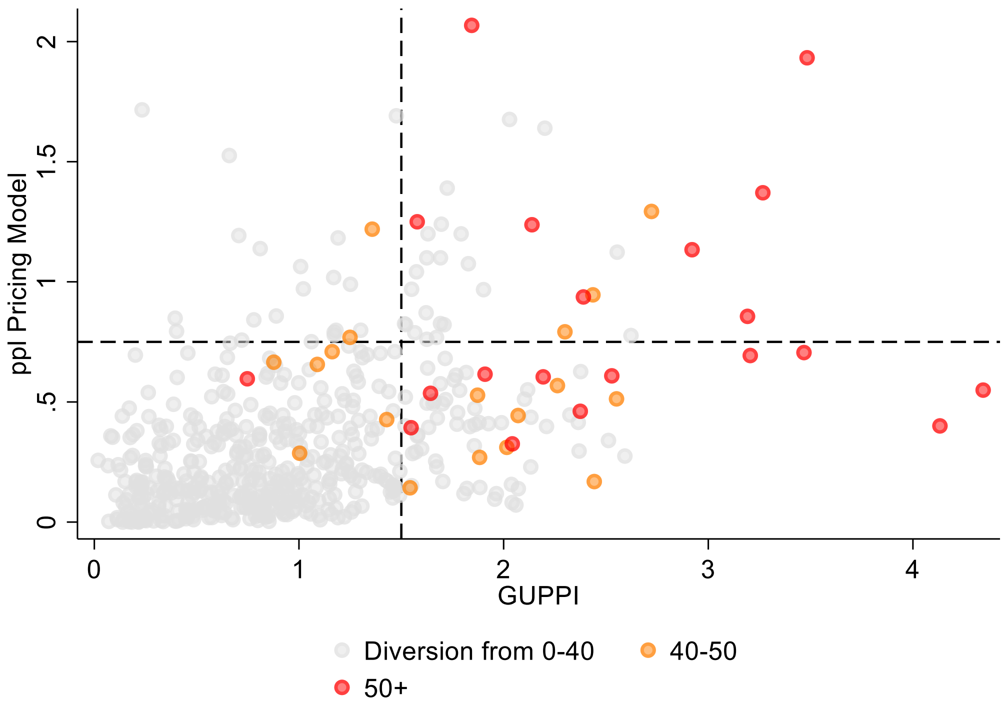
401 *Shell/Rontec*, paragraph 99: "*The OFT then considered Shell's estimates of pricing pressure and the calibration of these estimates as a potential price increase in each of these 68 local areas in the context of other evidence such as fascia analysis, as well as the site operating model, and diversion between the parties.*" (attached as **Annex_005_064**).

402 *Shell/Rontec*, paragraph 107 (attached as **Annex_005_064**).

(b) automatically declares SLC findings in many local areas that would not even have received a detailed Phase I review following the approach in *Shell/Rontec*.

(719) Specifically, of the 129 SLC findings generated by the provisional Decision Rule, only 32 have an actual or estimated diversion over 40%. That implies that only 29 of the 49 local areas failing the initial filters (on a corrected basis, see section III below) would have been subject to a "deep dive" to see if they met the test for reference in *Shell/Rontec*, let alone being found to be SLCs at the end of a Phase II.[403]

Figure 22 Relationship between GUPPI, PI and Diversion results



B. Comparison with other commonly used measures

(720) In order to reach a more informed view of the robustness of the CMA's provisional Decision Rule, it is also useful to consider how the fuel SLCs that have been automatically generated by that Decision Rule compare with additional measures of competition, many of which have typically been adopted in previous Phase I fuel retailing mergers cases. With that goal in mind, Table 19 below calculates how many of the provisional fuel SLC local areas would "fail" other measures of competition.

(721) This comparison clearly demonstrates that the provisional Decision Rule identifies SLCs in local areas that other metrics suggest would remain highly competitive following the Proposed Merger – which necessarily calls into question the robustness of the Decision Rule and its ability to support SLC findings to a balance of probabilities standard.

(722) A corollary to this is that the Decision Rule should either be abandoned in favour of an alternative approach that is more consistent with certain of the Established Filters – or substantially amended to avoid generating "false positives". The latter could be achieved by safe harbouring local areas that are identified as non-problematic by one or more of the Established Filters.

[403] We note that several sites are also not found to be SLCs despite having a diversion ratio above 40%, but this is also consistent with the approach in *Shell/Rontec*, where the OFT stated that it cleared areas with diversion ratios above 40% (and indeed the areas where SLCs were found all had diversion ratios above 50%, reflecting the low margins and intense competition characterising the sector).

Table 18 Other competition metrics for Provisional SLCs

Alternative measure	Fail PI only	Fail GUPPI only	Fail both PI and GUPPI	Number of Provisional SLCs	Number of non SLCs	Total
Total Provisional SLCs	22	73	34	129[404]	.	129
Fail (corrected) Established Filters	7	26	15	48	22	70
Diversion > 40%	2	19	11	32	6	38
No rival s/m within 10 minutes	6	19	5	30	34	64
No rival s/m within 20 minutes	0	1	1	2	0	2
10-minute fascia counts 5:4 or lower	1	3	1	5	2	7

(723) It can be clearly seen from the table above that using a standard "filter, then assess" approach would inevitably result in far fewer SLCs. For example, if the (corrected) Established Filters were used as a starting point – i.e. to identify a long list of local areas in which closer scrutiny is warranted – then even retaining the CMA's flawed Decision Rule would result in 48 rather than 129 SLCs.

(724) If the Decision Rule were also altered to consider both the PI and GUPPI indicator "in the round", rather than placing all weight on whichever one indicates an SLC (and entirely ignoring the other), then the number of SLCs identified would be yet lower. This approach is discussed further in section V below.

(725) Similarly, if the CMA were to use a focus on sites with diversions over 40% (as in Shell/Rontec) then only 32 such sites would also be identified as SLCs under the CMA's Decision Rule (out of 38 PFS with implied diversions over 40% in total).

(726) This comparison of metrics illustrates again the clear clash between the extremely interventionist stance taken by the Decision Rule as applied in the PFs and the approach to assessing SLCs taken in previous cases where an "area by area" assessment has been undertaken.

III. The rationale for rejecting established Phase I filters is based on a significant coding error

A. Errors in applying the Phase I filters

(727) In the PFs, the CMA argues that the established approach of applying initial filters, followed by an in-depth assessment of local areas flagged as warranting closer scrutiny (i.e. a "deep dive"), cannot practically be undertaken in this case. The CMA states at paragraph 14.65 of the PFs: "*Given the large number of overlaps between the Parties' PFSs … including after the application of the above filters … we concluded that it would be impractical to use the above initial filters*".[405]

(728) Specifically, the PFs assert that 85 Sainsbury's PFS and 81 Asda PFS would fail the Established Filters (166 PFS in total). The CMA also claims in the PFs that this list of 166 PFS was used as the pool from which the 32 survey sites were selected.[406]

[404] After updating the data to reflect new, cancelled, and postponed pipelines, there are 128 SLCs under the current CMA criteria. [✄]

[405] PFs, paragraph 14.65.

[406] PFs, paragraph 14.85.

(729) This is simply incorrect. The CMA previously sent the Parties a list of 75 sites failing these filters – and explained the surveys had been drawn from a subset of 65 of those sites where there were no pipeline PFS.[407] Specifically, the CMA stated that *"[t]hese initial filters were used to obtain a set of 75 potentially problematic PFS (including pipelines PFS), which are listed in Appendix A. We also ran the filters excluding all pipeline PFS from the analysis, which produced a set of 65 PFS for planning the CMA fuel exit survey. From this set of 65 PFS, we selected 32 PFS to survey*".[408]

(730) The higher figure in the PFs is driven almost entirely by a major error in the way the CMA calculates fascia counts (set out in greater detail in Schedule 7.2). For a large number of areas, the CMA wrongly identifies areas that have a 3:2 supermarket fascia count as a 2:1, and wrongly identifies areas that have a 5:4 PFS fascia count as a 4:3.

(731) In addition to this error, the approach to the filters is inconsistent with its broader approach in other analyses. First, the CMA does not treat Co-op as a supermarket PFS (which is inconsistent with its approach more broadly, and specifically in calculating the WSS on which its provisional SLC findings are based). Second, the CMA includes sites that fail the filter based on a 25-minute catchment (as well as 10 minutes and 20 minutes), despite rejecting the validity of a 25-minute catchment in the PFs.

(732) Once these errors are corrected, the number of sites failing the initial filters is only 70 (including pipelines), which are located in 49 local areas (so would require, at most, 43 in-depth area-by-area assessments using the packs provided at Schedule 7.6).

B. No practical barriers to conducting detailed local area assessments

(733) Based on past practice, a deep dive on the 43 areas failing initial filters should have been entirely feasible: for example, 61 local areas were recently reviewed in detail in *MRH/MFG* at Phase I. In any event, the CMA could have used (and still could use) the approach of additional filters to "rule in" obvious SLC areas and/or "rule out" clearly non-problematic local areas – leaving a shorter list of "amber" local areas to review in greater detail. This approach was adopted in *MRH/MFG* (where 84 areas failed initial filters) and *Shell/Rontec* (where 68 areas failed the Established Filters).

(734) There is no reason why the CMA could not have done (and still could not do) the same here. In light of the flaws, internal contradictions and inconsistencies between the measures the CMA has used (as set out in sections IV and V below), this approach would have the striking advantage that it would allow the judgement of whether each area is an SLC to be made "*on the basis of all the evidence considered in the round*",[409] as was done in all previous investigations in this sector.

(735) Indeed, as shown in Schedule 7.5, a deep dive analysis on a selection of the local areas identified by the CMA's provisional Decision Rule clearly shows that these sites should not in reality trigger competition concerns. The Parties submit that it is highly likely that rolling out a similar analysis to a wider selection of areas would generate a similar result – meaning that the CMA's approach is highly likely to be generating "false positive" SLC findings.

(736) In order to assist the CMA, the Parties attach a summary of the evidence available for each local area together with a map for all 43 areas containing PFS that fail the Established Filters set out at paragraph 14.56 of the PFs (provided at Schedule 7.6).

[407] Fuel WP, paragraph 63.

[408] *Ibid*.

[409] *Shell/Rontec*, paragraph 107 (attached as **Annex_005_064**).

IV. GUPPI and PI thresholds are unjustifiably low given the unreliability of these measures

(737) The PFs identify a fuel SLC when *either* the CMA's GUPPI is greater than 1.5%, or its PI is more than 0.75ppl.

(738) To justify these highly interventionist thresholds (which, as explained in section II above, automatically generate an SLC finding in far more instances than the approaches applied in recent Phase I fuel cases would have even flagged for an in-depth review), the CMA claims:

(a) it is confident in the reliability of the WSS measures underlying the GUPPI analysis;[410]

(b) its diversion estimates are robust;[411]

(c) the level of accuracy achieved by its pricing rule gives it confidence that the PI accurately reflects the Parties' approaches to pricing;[412]

(d) the threshold chosen reflects the accuracy of its PI; and

(e) it is appropriate to take into account the fact that fuel "*is for many consumers a non-discretionary expenditure that accounts for a significant share of household spend*".[413]

(739) As we will show below, there is nothing in the CMA's analysis that should instil any degree of confidence in its results that would justify applying very low thresholds. Most notably:

(a) the diversion ratios based on the CMA's estimated WSS measures significantly underweight non-supermarket PFS, and are almost uncorrelated with the diversion ratios from the survey, which the CMA considers to be the most reliable measure of diversion available for surveyed areas;[414] and

(b) fewer than half of the prices predicted by the PI are within 0.75ppl of the actual price (where 0.75ppl is then considered to be indicative of a SLC).

(740) Given these shortcomings, the CMA's thresholds are guaranteed to identify a large number of "false positive" SLC findings (along with the small number of "true positives" that could reasonably be expected). The remainder of this section explores the deficiencies of the CMA's WSS and PI measures in greater detail, and demonstrate that the thresholds the CMA has set for these measures under its wholly determinative Decision Rule are incompatible with the legal standards for decision-making in a Phase II merger investigation.

A. The diversions underpinning the CMA's GUPPI measures are biased and uninformative

(741) The CMA bases its GUPPI on diversion ratios derived from its survey where available. Where survey diversions are unavailable, it uses the average predicted diversion from two WSS: a PCA-based WSS and a survey-based WSS. While both WSS have their individual shortcomings, they also have two key shortcomings in common:

(a) they are biased in a way that overstates the closeness of competition between the Parties; and

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410 PFs, paragraph 14.109.

411 PFs, paragraph 14.154.

412 PFs, paragraph 14.136.

413 PFs, paragraph 14.154(a).

414 PFs, paragraph 14.146(b).

(b) they are not predictive of survey diversions (which the CMA considers to be the most reliable measure of diversion – notwithstanding the bias point above).[415]

The CMA's confidence in the reliability and robustness of its GUPPI measure is therefore unjustified.

The diversions are biased

(742) As submitted in response to the Fuel WP,[416] and discussed further below, both the survey and the PCA suffer from fundamental biases. In particular:

(a) the survey is biased, notably because a clear error in design effectively prompted interviewers to record all diversions only to competitors within 10 minutes, and because conducting the survey on a supermarket petrol forecourt will have inevitably primed respondents to tend to say they would divert to another supermarket petrol forecourt; and[417]

(b) the PCA is biased because it measures the competitive pressure exerted by non-supermarket competitors primarily based on what happens to prices when a non-supermarket PFS closes. These closing PFS are weak competitors, on average selling only one-third the volume of fuel as the average non-supermarket PFS, and having poorer locations. Because these PFS are weak competitors, their closure will have less effect on price than would an average/representative non-supermarket PFS.[418]

(743) The CMA accepts that the survey is biased to at least some degree.[419] The CMA also acknowledges the scope for bias in the PCA,[420] but claims that it is less concerned over the bias because of the close correlation between its PCA and survey based-WSS. In the Parties' view, it is clearly not correct to take comfort in the reliability of one measure simply because it is correlated with another measure that is plausibly biased in the same direction.

(744) The bias in the PCA analysis is absolutely clear (as summarised in the table below). Variations in the number of non-supermarket PFS present in the analysis are primarily (around 80%) driven by exits: yet these exiting PFS typically have only *around a third* of the fuel volumes and shop sales of an ongoing PFS, and substantially lower scores on factors such as quality and visibility.[421] These are not small differences that are unlikely to affect the analysis: the resulting downward bias in the weight placed on non-supermarket PFS is likely to be substantial.

Table 19 Weakness of non-supermarket PFS driving the PCA findings

	Open PFS	**Entering PFS**	**Exiting PFS**
PFS Fuel Volumes	2,903	2,483	1,010
PFS Shop Sales	596	626	203
Quality	0.51	0.63	0.07

415 As discussed in section IV(C) of the Response to Fuel WP, there are strong reasons to believe that the CMA's survey overstates diversion between the Parties. However, it is clear that the CMA views its survey as the "gold standard" so it seems reasonable that it be the yardstick that the CMA's other measures of closeness of competition are measured against.

416 As discussed in sections IV(B)(1) and IV(C) of the Response to the Fuel WP.

417 These and other biases were laid out in Response to the Fuel WP, Annex 1.

418 As explained in Response to Fuel WP, paragraphs 211 to 213.

419 PFs, paragraph 14.94. An additional 1.5% is added to the out-of-market adjustment in acknowledgement of the first potential bias in the survey. It is unclear how this figure of 1.5% was reached (based on the Parties' surveys, which did not suffer this bias, the appropriate adjustment would appear to be higher – as set out in Schedule 7.3) and no allowance is made for the second bias at any stage of the CMA's analysis.

420 PFs, paragraph 14.111.

421 A more complete version of this table was provided in Response to the Fuel WP, paragraph 34 and Annex 2.

Visibility	0.50	0.47	0.08
Number of PFS	6,820	51	191

Source: CRA calculations based on Catalist, previously submitted at paragraph 213 of the response to the Fuel WP.

(745) It is also clear that this bias does indeed extend to the survey, given that the weight placed on non-supermarkets *is even lower in the survey*:

- the weight on non-supermarkets located up to five minutes away is 14% in the CMA's survey-based WSS versus 20% in the PCA-based WSS;
- from five to 10 minutes the weight on non-supermarkets is 17% in the survey versus 18% in the PCA; and
- both WSS place zero weight on non-supermarkets more than 10 minutes away.

It therefore cannot plausibly be the case that the PCA is biased against non-supermarket PFS but the survey is not.[422]

(746) Furthermore, because the inputs to both WSS are similar – closer PFS are given more competitive weight than those further away and non-supermarkets are given a fraction of the competitive weight of supermarkets – it is not surprising that the two measures are correlated. Any two WSS which had these features would be correlated. Therefore, more generally, the CMA should take no comfort from the correlation between the two measures.

Excluding own-brand diversion will overstate competition between the Parties

(747) The PFs also only consider GUPPIs that are measured excluding own-brand diversion. The PFs concede that this could lead to an overstatement of GUPPI – and suggest taking this into account in the GUPPI threshold (although no details are provided of how this has been done).[423] The Parties submit that a better approach would be to consider in an area-by-area assessment whether the GUPPI including or excluding own-brand is likely to be a better indicator (in which case, this should be clear from the local geography which is likely to be a more reliable measure in that area).

The diversions are uninformative

(748) When calculating the GUPPI, the CMA uses estimates of diversion from the survey where available on the grounds that it accounts for "*all non-observable local factors that affect customers' preferences and diversion beyond price (sic) and location*" as well as location and PFS type. As the CMA views the survey diversions as more accurate than the WSS diversions, it is unclear why they are not used as the yardstick to assess the reliability of the WSS diversions.

(749) Neither the PCA nor the survey-based WSS diversions are closely correlated with those directly calculated from the CMA survey. The survey based-WSS diversions explain just 25% of the variation in the survey diversion (despite being directly based on the survey itself). The PCA-based WSS explains less than 1% of the variation in the survey diversions.[424] These are correlations that in previous Phase II

422 PCA weights based on PF Table K5 (with results corrected for a typo in the CMA's code indicated in e-mail from Matthew Weighill on 25 February 2019). Survey weights based on integrating over the function estimated in PF Table K3.

423 PFs, paragraph 4.88, footnote 64.

424 Based on the R-squared of a linear regression between the two variables. As the CMA explains in paragraph K9 of the PFs, the R-squared indicates the proportion of the variation in one variable that can be explained by the other. Throughout we focus on the adjusted R-squared, which includes an adjustment to allow for the fact that in a finite sample, adding additional variables, even if unrelated, will always improve the goodness of fit of the regression.

cases have been relied on to evidence the accuracy of the WSS and the form of WSS chosen (see paragraph (750) below) – yet the CMA does not comment on the lack of correlation embodied in its measures in the PFs.[425]

Incoherency of dual WSS approach that takes a simple average

(750) The CMA does not use either the PCA-based WSS or the survey-based WSS to determine provisional SLCs independently. Instead, it averages them to obtain a combined WSS (except in surveyed areas, where a WSS is calculated on the survey directly). The combined WSS also performs very poorly, explaining just 13% of the variation in the survey diversions. This is the measure of diversion which apparently provides the "*robust diversion estimates*" and that the CMA is "*confident in the accuracy of [the] estimates*"[426] – confident enough to set a threshold for identifying SLCs far below that used in previous cases. We note that by contrast in *Celesio/Sainsbury's* the CMA rejected a measure of WSS generating a 48% R2 on the basis that this was "*not particularly strong*."[427]

(751) As explained in paragraph 89 of the response to the Fuel WP,[428] all evidence should be considered when choosing weights for the WSS: particularly when there are major weaknesses in the survey and PCA evidence, significant weight should be placed on other evidence, including national average volumes, Nectar card analysis and the representations of third parties – all of which point to a stronger constraint from non-supermarkets and larger catchment areas.

(752) A simple average of two biased measures does not constitute taking all evidence into consideration, even though – as the CMA states in the PFs (at footnote 817) – the Parties agree that both the survey and the PCA provide useful evidence on the extent of local competition.[429] In this particular case, given that both measures place a significant downward bias on non-supermarket PFS, these rivals need to be upweighted in any measure used if it is to be accurate.

There is no evidence that the threshold applied takes account of the biases and uncertainty in the underlying analysis

(753) The PFs suggest that biases arising from excluding own-brand diversion, from focusing solely on the multi-product GUPPI and from the bias against non-supermarkets in the PCA are taken into account when setting the GUPPI threshold. However, the discussion of how the threshold is set suggests only more generally that "*there is inevitably some uncertainty around any estimates*" rather than explicitly recognising the areas of bias acknowledged elsewhere in the PFs.[430] Moreover, there is no discussion of how the various elements of bias and uncertainty resulted in a 1.5% GUPPI, or why the analysis in this case is so much more certain and less biased than in previous fuel and retail merger cases that it would justify a much lower intervention threshold (when the evidence in fact strongly indicates that the opposite is true).

[425] See CMA, *Celesio / Sainsbury's Pharmacy Business merger inquiry*, decision of 29 July 2016, paragraph 7.217 and paragraph 20 of Annex I. (attached as **Annex_005_008**) and CMA, *Ladbrokes / Coral merger inquiry*, decision of 26 July 2016, paragraph 7.115 (attached as **Annex_005_007**).

[426] PFs, paragraph 14.154.

[427] See CMA, *Celesio / Sainsbury's Pharmacy Business merger inquiry*, decision of 29 July 2016, paragraph 21 of Appendix I (attached as **Annex_005_008**).

[428] See also Response to the Fuel WP, paragraphs 117 and 121.

[429] Even though there are good reasons to think both measures overstate diversion between the Parties, it is likely the case that, on average, true diversion between the Parties would be higher when the diversion indicated by the survey or PCA is higher.

[430] PFs, paragraphs 14.154 and 14.154(e).

B. The conversion of the WSS into a multi-product GUPPI adds further bias and uncertainty

(754) The Parties' response to the Fuel WP explained that customers who buy fuel and grocery together are less likely to switch in response to a small increase in the price of fuel than a fuel-only customer. Because of this, the multi-product GUPPI – which is based on a forced diversion question in the survey – overstates the upward pricing pressure due to the Proposed Merger.[431]

(755) The CMA recognises this argument, but claims that no adjustment is required on the basis that current fuel-only customers may also begin to buy groceries at their destination, and that this would work in the opposite direction.[432] However, this does not follow. While this is plausibly the case for some customers, the opposite is true for others. Just as a customer who currently buys fuel at Asda and groceries at Tesco could become a joint fuel and groceries shopper at Sainsbury's, a customer currently buying fuel at Asda and groceries at Sainsbury's could become a joint shopper at Tesco. There is no reason to think that the first effect is stronger than the second.

(756) There is therefore no reason to think that there should be any countervailing/balancing bias that "cancels out" the bias the Parties identified in response to the Fuel WP (and which the CMA does not dispute). As such, an allowance or adjustment should be made to allow for the lower degree of switching by joint-fuel and grocery customers, resulting in a true GUPPI between the multi-product and fuel-only versions.

Uncertainty over grocery diversions should also be accounted for

(757) Because margins in fuel are low, only 10 of the 129 of the SLCs in fuel would be SLCs on a "fuel-only basis" even using a 1.5% GUPPI threshold and, on average, almost half of the estimated GUPPI is due to grocery. This can be seen in several of the examples set out in section VI below, where areas fail a GUPPI threshold at 1.5% based on a multi-product margin excluding own-brand diversion, despite having a fuel-GUPPI of less than [✂]% (or even [✂]% – as is the case in [✂] examples below). The additional margin earned from groceries is therefore crucial.

(758) The CMA uses its grocery WSS to identify which grocery locations diverted customers that split their fuel and grocery missions would shop at. This is therefore subject to the issues of noise and bias, as discussed in detail in Chapter 3 and Schedule 3.1. Moreover, the customers sampled in the grocery survey are a quite different sample to these mission-splitting customers and may well have different characteristics. For example, we note that customers in the fuel survey who said they would divert their grocery as well as fuel shopping in response to a fuel price rise were most likely to name Aldi as the alternative brand to which they would divert their grocery shopping (inevitably splitting their mission, given that Aldi does not have PFS). This may well suggest that these mission-splitting grocery customers have different preferences in relation to grocery alternatives, compared to the wider population of grocery customers. As a consequence, the diversions, and hence the increment to the GUPPI due to groceries, is particularly uncertain. This uncertainty should be recognised in the GUPPI threshold applied to this multi-product GUPPI.

C. Shortcomings of survey-based WSS

(759) The CMA has recognised and accepted the importance of many of the Parties' comments on the approach to calculating the survey-based WSS laid out in the Fuel WP. In particular, the CMA has: (i) accepted that a formulation of the WSS which up-weighted the closest supermarket rival was not reliable due to the unrepresentativeness of the CMA's surveyed areas; (ii) made a (likely inadequate) adjustment for a clear

[431] Response to Fuel WP, paragraph 138.

[432] PFs, paragraph 14.128.

bias resulting from a flaw in the design of their survey;[433] and (iii) made an (inadequate) allowance for out of market diversion.[434]

(760) The CMA has, however, ignored other aspects of the Parties' comments. In particular, the CMA has:

(i) persisted in applying a zero-weight to non-supermarket PFS outside a 10-minute catchment, despite its own analysis indicating positive weights for these rivals;[435]

(ii) continued to treat Costco PFS and [✂] as non-supermarket PFS, despite the evidence submitted by the Parties that these rivals price like other supermarket PFS;[436] and

(iii) made no allowance for the clear bias towards supermarket diversion that will have occurred as a result of the survey taking place at a supermarket (as confirmed by a comparison of survey weights for these rivals against those arising from the clearly biased PCA analysis, as set out above).[437]

(761) These failings lead the survey-based WSS to overstate the strength of competition between the Parties.

D. Shortcomings of PCA-based WSS underestimate the strength of non-supermarket competitors

(762) The CMA has partially or wholly accepted a number of suggestions and corrections to the PCA highlighted in the response to the Fuel WP. Most importantly, the CMA has: (i) corrected an error in its construction of the competitor counts;[438] (ii) recognised that in situations such as these, where the number of entry and exit events is limited, it is appropriate to focus on specifications that pool the data in order to improve statistical power;[439] and (iii) analysed petrol and diesel jointly, consistent with its market definition.

(763) However, there are several issues that the CMA has either not dealt with, not addressed, or dismissed on weak grounds. These issues, and their consequences, are discussed in more detail in Schedule 7.4, but in particular:

- although the CMA accepts the exit of weaker non-supermarket PFS is likely to lead to its PCA underestimating the constraint from non-supermarkets, it has not adjusted its WSS to account for this bias. As set out above, this is an important bias and must be taken into account;
- the CMA makes no adjustment for the bias that will have occurred due to non-supermarket PFS being more likely to open in areas where demand and prices are rising (and exit where demand and prices are falling). As a result, the PCA further understates the competitive strength of non-supermarkets;
- the CMA makes no adjustment for the bias due to measurement error in the counts and competitive strength of non-supermarkets, further understating the competitive strength of non-supermarkets; and

433 PFs, paragraph K15. The PFs do not explain how they determined the size of the adjustment, and in response to a request from CRA, the CMA indicated that this was set based on the Panel's judgement rather than any particular piece of evidence, but given the magnitude of the apparent bias in the survey, an adjustment of 1.5% is likely to be insufficient – see following footnote.

434 PFs, paragraph K14. We discuss the calculation of the out-of-market adjustment in Schedule 7.3. Calculating the out-of-market from the Parties' survey, which is less biased towards diversion within 10 minutes than the CMA's survey, indicates an out-of-market adjustment of 9% rather than the 6% implied by the CMA survey.

435 In principle, smaller catchments for non-supermarket PFS could be compensated for by the choice of an appropriate out-of-market adjustment. However, as we explain in Schedule 7.3, the adjustment implemented by the CMA is clearly insufficient.

436 See the Parties' response to Questions 83 and 84 of the CMA's RFI dated 24 September 2018.

437 Response to Fuel WP, Annex 1.

438 Response to Fuel WP, paragraph 93.

439 PFs, paragraph K30.

- rather than incorporating the evidence from the Volume Concentration Analysis ("**VCA**") in the Fuel WP into a WSS that takes all the available evidence in the round, the CMA dismisses it, on the grounds that the findings are "not sufficiently robust" to be used for the calculation of the WSS.[440] However, the results of the VCA indicated that the entry of non-supermarkets was associated with a statistically and economically significant competitive constraint on the Parties[441] – this information ought to be reflected in the CMA's WSS to at least some degree.[442] All the more so given that much of the evidence incorporated into the WSS of the PFs is itself decidedly non-robust.

The factors combined lead the CMA's PCA to significantly understate the competitive strength of non-supermarkets. As a result, any WSS based on this analysis will materially over-predict diversion between the Parties unless appropriately adjusted.

(764) Compared to the corrected analysis in the Fuel WP, the CMA has made further changes to its PCA that make the results less reliable and lead to results that place a lower weight on non-supermarkets:

(a) **Change in specification.** The analysis of the Fuel WP focused on a specification that estimated four key coefficients: the effect of (i) supermarket and (ii) non-supermarket entry and exit within (iii) the precedent catchment and (iv) up-to 25 minutes. The analysis of the PFs, however, estimates 10 coefficients. Because there are relatively few instances of entry and exit, estimating a large number of coefficients will cause each one to be quite imprecise as it will be estimated by averaging across a relatively small number of changes in local competition. This imprecision makes the CMA's WSS unreliable.[443]

(b) **Use of data from "Q1 2016".** The CMA has added data from "Q1 2016" to its analysis and has confirmed that this was done intentionally and not in error.[444] However, it calculates the average price for the entire quarter based only on incomplete data for 30 to 31 March 2016. Two incomplete days at the end of the quarter clearly cannot provide a reliable estimate of quarterly prices (as the CMA effectively acknowledges in a note in its code that explains that data from Q3 2018 is excluded because there is only a month of prices).[445] The use of this data makes the CMA's overall results less reliable.

(c) **"Own-brand" PFS are now excluded from counts, and an error has been made in how own-brand is defined.** In the Fuel WP, the CMA counted the total number of PFS of each type (supermarket or non-supermarket) within a given distance. In the PFs, the CMA has attempted to count only competitor PFS. Because the Parties (and from what the Parties understand, other supermarket and non-supermarket competitors) tend to price primarily with reference to a subset of competitors rather than the local average [✄], it is not correct that excluding own-brand competitors improves the measurement of local competition. If competitor PFS respond to the

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440 PFs, paragraph K43.

441 Response to Fuel WP, Table 31, specification S2a. As noted in the response to the Fuel WP, specification S2a appeared to be the CMA's preferred specification as it was most often discussed the Fuel WP.

442 The Parties note that the CMA's interpretation of the VCA at paragraph K42 of the PFs contains an error. The VCA found a statistically significant impact for non-supermarkets, but not for supermarkets, whereas the PFs state the reverse.

443 For example, the CMA's analysis suggests that the competitive impact of supermarkets located 20 to 25 minutes' drive away is stronger than that of supermarkets from 15 to 20 minutes away. Similarly, non-supermarkets located 10 to 15 minutes away are found to have a stronger impact than non-supermarkets located five to 10 minutes away (PFs, Table K4, Specification 2).

444 E-mail from Emma Budge to Diana Jackson on 25 February 2019.

445 A note in the CMA's code explaining why data from 2018 Q3 is dropped acknowledges that (much) more data is needed "*drop 2018q3 (not enough observations)*" ("*2 FuelPrices.do*", line 18). There is a complete months' worth of observations for 2018 Q3 rather than two incomplete days for 2016 Q1.

entry of an own-brand PFS, prices at the centroid PFS would still fall. This change therefore likely worsens the analysis.

(d) In addition to this, an apparent error has been made in the construction of the counts, where PFS are only considered "own-brand" if both the owner and the brand are the same. The counterintuitive implication of this is that, for example, an MFG Shell PFS competes with MFG Esso PFS, but not other MFG Shell PFS. Even more counterintuitively, if the MFG Esso PFS were to rebrand to an MFG Shell PFS, local competition would be found to decline (from the perspective of a nearby MFG Shell). Such rebranding is relatively common.[446] Although the Parties do not have full insight into how groups such as MFG price, they understand that pricing is generally done centrally,[447] and it would not seem rational for their pricing approach to allow price competition between owned PFS simply on the basis that they operate under a different brand. The profit maximising approach would be to optimise pricing over all commonly owned PFS.

(765) The effect of these changes and errors is two-fold. As explained above, these changes make the analysis less reliable and so add uncertainty to the CMA's WSS. This uncertainty must be taken into consideration when setting an appropriate GUPPI threshold. In addition, the practical effect of these changes is to reduce the estimated competitive strength of non-supermarkets even further (particularly non-supermarkets located more than 10 minutes away and in specifications where the effect on the pricing on all PFS is estimated). As the CMA acknowledges, both the "supermarket-only" and "all-PFS" samples provide information about local competition, so it would be appropriate to use the results of both (corrected) specifications to inform the CMA's WSS weights (making allowances for the biases above).[448] Once corrected, the CMA's PCA implies a higher weight on non-supermarkets (although this will still be biased downwards, due to the focus of the sample on small and failing PFS exit), and that both supermarkets and non-supermarkets provide effective competition over a wide catchment of 15 to 20 minutes or more.

Table 20 Relative weights implied by the CMA's PCA analysis and corrected versions of that analysis

	PFs	Parties' corrections			
		+ Exclude 2016 Q1	+ Correct Rival Counts	+ Count all PFS (Fuel WP)	+ Correct Supermarket Definition
Supermarket PFS only sample					
Relative Weight NS 0-10 minutes	18.7%	18.1%	18.2%	20.7%	19.8%
Relative Weight NS 10-25 minutes	13.9%	15.7%	21.0%	18.1%	18.6%
Super 0-10/Super 10-25	28.3%	27.3%	28.1%	27.9%	28.7%
Non-supermarket 0-10 statistically significant	TRUE	TRUE	TRUE	TRUE	TRUE
Non-supermarket 10-25 statistically significant	FALSE	FALSE	TRUE	TRUE	TRUE
All PFS sample					

[446] For example, an MRH PFS in Newcastle Under Lyme, ST5 2TL, rebranded from a Jet to a Texaco in the first half of 2017; a EuroGarages in Lancaster, LA1 2LL, rebranded from BP to Esso in the first half of 2018; an MFG in Norwich, NR2 4HX, also rebranded from BP to Esso in the first half of 2018. There are hundreds of other examples of rebranding where the owner does not change, as reported in Catalist.

[447] For example, the following job advert, for a Pricing Analyst in St Albans (where MFG is based), requests a pricing analyst to "*thoroughly review, approve and communicate daily retail fuel prices to the Retail Operations team.*", available at: https://www.indeed.co.uk/cmp/Pink-Recruitment-Solutions-Limited/jobs/Fuel-Pricing-Analyst-d6a980a43dc613b1?vjs=3.

See also, for example MFG/MRH, paragraphs 50 and 53 where the CMA states that both MFG and MRH set prices centrally, and MFL/Murco, paragraph 14 which states that "*MFG Sites are run under a 'commission operator' model whereby MFG appoints a commission operator to have day-to-day responsibility for operating the pumps and running the shop, including hiring the staff and buying and selling the groceries while MFG sets the fuel price*" (attached as **Annex_005_067**).

[448] PFs, paragraph K28.

Relative Weight NS 0-10 minutes	10.1%	12.9%	11.9%	23.7%	23.6%
Relative Weight NS 10-25 minutes	12.1%	14.8%	0.0%	34.2%	34.2%
Super 0-10/Super 10-25	18.5%	14.5%	13.0%	18.4%	18.3%
Non-supermarket 0-10 statistically significant	FALSE	TRUE	FALSE	TRUE	TRUE
Non-supermarket 10-25 statistically significant	FALSE	FALSE	FALSE	TRUE	TRUE

Notes: Column PFs reproduces the weights implied by the PFs PCA. The second column excludes data from Q1 2016, the third corrects the CMA's counts of rivals, the fourth counts all the PFS in the area (this is closely analogous to the corrected analysis of the Fuel WP), the final column includes Waitrose and Costco in the counts of supermarket competitors. The results are based on regression coefficients estimating the effect of a change in the number of PFS of a given type between 0 and 10 minutes and 10 and 25 minutes. A full set of regression results are provided in Schedule 7.4.

(766) The Parties' note that the revised PCA for all PFS appears to be the only additional piece of evidence in the PFs (as compared to the Fuel WP) that could support a reduction in catchment size to 20 minutes for supermarkets (compared to 25-minutes in the Fuel WP). As the CMA focuses on the supermarket-only specification for weights – which supports a 25-minute catchment – the justification for this change in catchment appears weak. If the "supermarket-only" specification is viewed as more reliable for determining weights, why is the "all PFS" specification used to determine catchments? The PFs are silent on this apparent contradiction.

E. The "PI" methodology does not predict merger effects and is in any case flawed

(767) The CMA has accepted the correction to a serious error in its code identified in paragraphs 68 to 73 of the response to the Fuel WP. No further substantive changes were made to the PI analysis.

(768) However, as noted by the CMA[449] and laid out in more detail in paragraphs 74 to 84 of the Parties' response to the Fuel WP, the Parties have fundamental reservations over the use of the PI approach to predict merger effects. While the Parties' current approaches to pricing provide broadly appropriate prices in the current competitive environment ([✂][450]), there is no guarantee that the Parties' approaches would continue to be appropriate should competitive conditions change. The CMA dismisses these concerns on two grounds:

(a) First, the CMA states that "*apart from the internalisation of sales that are diverted to the other party, we are not aware of any major planned entry or exit*".[451] Given that the CMA identifies 129 SLCs, the CMA appears to view the internalisation of sales alone as a significant change in competitive conditions.

(b) Second, that in practice, the next closest match is usually a supermarket PFS (80% of the time for Sainsbury's and more than 90% of the time for Asda). [✂].[452] [✂].

(769) As some of the third party responses to the PFs recognise, supermarket fuel needs to be cheaper than non-supermarket fuel in order to compete in the face of quality differences: both in terms of the perceived quality of the fuel itself and the grades on offer.[453] One or more unnamed third parties flagged that as well as price, availability, ease of use of the PFS and convenience of location are also important competitive parameters.[454] Similarly, BP flagged that fuel price is one factor in choosing a PFS but the non-retail offering may also be a key part of a customer's decision-making.[455] In light of these differentiating factors

449 PFs, paragraph 14.141.
450 PFs, paragraph 14.45.
451 PFs, paragraph 14.142.
452 PFs, paragraph K86.
453 PFs paragraph 14.30.
454 PFs paragraph 14.26.
455 PFs paragraph 14.27.

between supermarket and non-supermarket PFS, it would clearly not be attractive for the merged firm to start pricing at a par with non-supermarket rivals with significant location/convenience and QRS advantages – as set out in detail in response to the Fuel WP.[456] Therefore, the Parties continue to believe that the PI is likely to overstate rather than understate the impact of the Proposed Merger on prices.

(770) Again, the benefits of an area-by-area approach can clearly be seen here. This would allow the CMA to interpret the PI with respect to particular details of which competitors were present locally and the relative level of their pricing. If the PI suggests a 1.2ppl price increase, but this significantly narrows the gap to local non-supermarket PFS with superior location or other services, this could be taken into account in an area by area approach. If this is not done, then any threshold applied needs to take account of how realistic it is to think that the merged firm would in reality want to raise prices in areas where a large number of rivals with convenient locations and an attractive broader offer will remain nearby.

(771) The PFs also suggest that the resulting estimates are "*probably biased downwards*".[457] However, the only reasoning given is feedback between the Parties' price adjustments. This is the same type of "feedback" already discussed in relation to the GUPPI thresholds and, as shown in that response, can only be material where the GUPPI is large, which is clearly not the case in relation to fuel.[458] The PFs do not engage with this point or explain why, notwithstanding this point, feedback effects in fuel should be material (either in relation to the PI or the GUPPI measure). Combined with the potential for the PI to in fact *overstate* merger effects, there cannot be any legitimate presumption that the estimates are biased downwards.

(772) Taking consideration of the two previous points together, therefore, in the Parties' view, the PI analysis (to the extent it can be relied on at all) is more likely to overstate rather than understate merger effects on price. More generally, the Parties would propose that this measure can be better interpreted as a summary measure of the extent to which the Parties will continue to face nearby competitors who price at similar levels to supermarkets. This can provide useful insights when considered in the round alongside other evidence, but cannot be interpreted as an accurate forecast of post-merger price increases.

(773) As a practical matter, and despite the CMA's assertions to the contrary,[459] the corrected pricing rules do not capture the Parties' pricing behaviour with a sufficient degree of accuracy for the analysis to be informative of the Parties' actual pricing behaviour. The prices predicted by the model are within 0.75ppl of actual prices (where 0.75ppl is the threshold for identifying a lessening of competition as "substantial") less than half the time. Prediction errors for other thresholds are also reported in Table 22.

Table 21 Predictive accuracy of CMA pricing model

	Asda		Sainsbury's	
	Petrol	**Diesel**	**Petrol**	**Diesel**
Prediction Error = 0ppl	23.8%	32.2%	41.3%	51.9%
Prediction Error ≤0.75ppl	**40.8%**	**49.9%**	**48.3%**	**58.5%**
Prediction Error ≤1ppl	73.4%	83.0%	78.9%	86.4%

Note: Measures share of days which the CMA's pricing model correctly predicts the price set by the Parties within a given tolerance between 1 April 2016 and 31 July 2018 (the simulated period).

[456] Response to Fuel WP, paragraphs 76-78.

[457] PFs, paragraph 14.143.

[458] See Response to GUPPI WP, section III.VIII.

[459] PFs, paragraph 14.135.

(774) As submitted at paragraph 66 of the response to the Fuel WP, the CMA's pricing model is significantly worse at predicting prices on a given day than simply rolling forward the previous day's prices, and performs only similarly well to charging the same price as a week previously. The CMA dismisses the comparison on the basis that predicting the price will be the same as the day or week before would be incapable of predicting any changes in pricing behaviour.[460] However, this entirely misses the point. The comparison with a rule that was clearly not how the Parties price, and clearly cannot predict a price increase was intentional. The point is precisely that this is *not* how the Parties set prices – yet the method for assessing reliability in the PFs cannot distinguish this clearly incorrect pricing approach from the very crude approximation to the Parties' pricing approaches actually used. That is, the CMA's PI is outperformed by a rule that clearly does not describe how the Parties price. As submitted in the response to the Fuel WP, the pricing model employed by the CMA also clearly does not describe Asda's pricing and, [✂].[461]

F. Adoption of 0.75ppl PI threshold is highly inappropriate given inaccuracy of this measure

(775) Significantly, the CMA acknowledges that:

(a) the results of the PCA underpinning the PI "*cannot be interpreted as accurate predictions of post-Merger prices*";[462] and

(b) the PI measure is at best "*an indicator, rather than a precise estimate, of the likely local merger effects*".[463]

(776) These admissions alone show that the PI measure is inherently unsuitable for use in a determinative Decision Rule that automatically generates SLC findings without the opportunity to take into account other evidence. To not only disregard this, but set the threshold for the PI measure under the provisional Decision Rule at a level as low as 0.75ppl, is patently incompatible with the legal standards required of a Phase II investigation.

(777) Indeed, the CMA has actually <u>decreased</u> the threshold at which it raises concerns since the Fuel WP, from 1ppl to 0.75ppl. When considering a potential threshold for the PCA, the Fuel WP appeared to suggest that a 1ppl threshold may be of sufficient accuracy to obtain meaningful results, given that the prediction is able "*to capture c.75-80% of the Parties' pricing behaviour to within +/- 1ppl*".[464] In the PFs, the accuracy of the CMA's model is essentially unchanged, but the threshold has been decreased to 0.75ppl. As a result, the PI's accuracy in predicting the actual outcomes of the Parties' pricing policies falls from an already low 75-80% using a 1ppl threshold, to less than 50% using the 0.75ppl threshold.[465] The PFs do not offer any explanation for this shift in the CMA's thinking.

(778) The Parties cannot see any reasonable basis for the switch from the CMA being comfortable with a 75-80% standard of accuracy in the Fuel WP, to effectively accepting 50% standard of accuracy in the PFs.[466] The Parties note that this shift in the CMA's approach coincided with the CMA correcting an error in its code – which dramatically reduced the number of sites where a price increase of more than 1ppl was indicated by its model. Using such a low standard for accuracy means that the analysis simply cannot

[460] PFs, footnote 827.

[461] Response to the Fuel WP, Section III.

[462] PFs, paragraph 14.143.

[463] PFs, paragraph 14.134.

[464] Fuel WP, paragraph 123.

[465] Fuel WP, paragraph 123: "*Overall, the pricing rules appear to capture c. 75-80% of the Parties' pricing behaviour to within +/- 1ppl. We view this as a sufficient degree of accuracy to place weight on this analysis as being informative of the Parties' actual pricing behaviour*."

[466] The Parties also note that the CMA makes no allowance for the site level accuracy, despite previously indicating that it would be taken into account (see Fuel WP, paragraph 124).

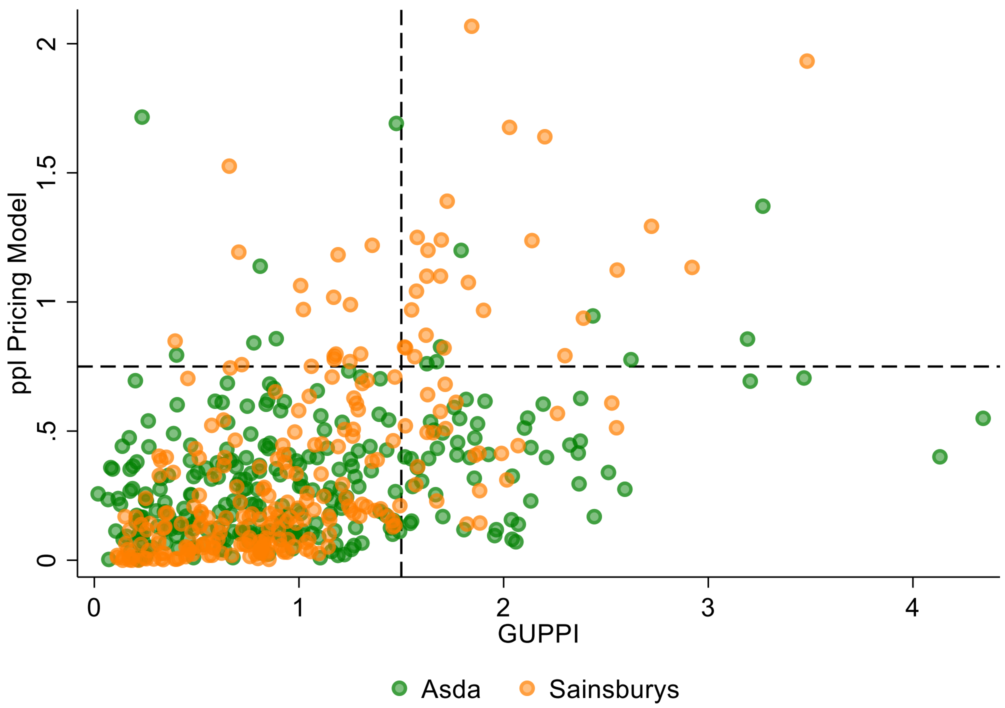
discriminate between competing hypotheses. As such, it is completely inappropriate to apply such a low threshold for identifying concerns.

V. Adoption of an "either/or" standard for identifying SLCs is illogical and substantially overstates concerns

(779) Even leaving aside the individual flaws in the measures used by the CMA as set out in the previous section, by then *combining* those metrics on an "either/or" basis in the provisional Decision Rule, the CMA compounds the unreasonableness of its approach. It is patently irrational to conclude that two measures – which often predict significantly different or wholly contradictory outcomes – can each be separately used as the sole basis for an SLC finding in a local area on the balance of probabilities. No reasonable decision-maker could disregard conflicting evidence of this kind.

(780) The divergence of predictions can be readily seen by plotting the GUPPI and PI measures for each site against one another, as shown in Figure 23 below. There is very little correlation between the two measures: the PI explains just 23% of the variation in GUPPI (and vice versa). In particular, there are many areas that constitute an SLC (on the CMA's assessment) according to the GUPPI but not the PI and vice versa.

Figure 23 The PI and the GUPPI provide vastly different suggestions about the nature of competition in local areas



(781) The logic that the correct response to the weaknesses of these measures is to take an "either/or" approach does not hold. As Table 23 below summarises, each measure has strengths and weaknesses (in the table below we focus primarily on those summarised by the PFs – although as set out above we have detailed concerns about the implementation of both measures and the interpretation of the PI). Even if the CMA were correct that errors in each measure were symmetric around zero or even biased against

finding an SLC,[467] it would still not be correct to say that using an "either/or" test will give a good estimate of which areas in reality generate an SLC (although note that the Parties strongly dispute that there is evidence that either measure is biased against finding an SLC).

Table 22 Advantages and disadvantages of GUPPI and PI measures

Measure	Advantages	Disadvantages
GUPPI	• Averages information across two sources (PCA and survey) [468] • Standard approach to assessing unilateral effects in local mergers.[469]	• Not a purely local view.[470] • Survey and PCA both down-weight non-supermarkets unduly strongly (weights < 20%).[471]
PI	• "may capture variations in the local conditions of competition across different local areas that cannot be reflected in the GUPPI".[472]	• "Not an accurate prediction of post-merger prices"[473] • Very poor explanatory power of pre-merger prices.[474]

(782) The CMA recognises that both measures are imperfect, and it is clear from Figure 23 above that the measures often predict inconsistent or contradictory outcomes. When the measures disagree, it must be the case either that one of the measures is wrong – or (more likely) that both of the measures contain some information but also do not accurately reflect all the relevant information for each area – and hence each will understate or overstate the lessening of competition. The CMA's either/or Decision Rule effectively *always* gives precedence to the measure that indicates a greater lessening of competition – and *never places any* weight on the countervailing evidence from the other measure if its threshold is not exceeded. What this means is:

- if the PI is above 0.75 ppl, it is relied on entirely to determine an SLC (regardless of the level of the GUPPI or of other evidence) – but if it is below 0.75 ppl, it is ignored entirely – i.e. given zero weight in the CMA's assessment; and
- if the GUPPI is above 1.5%, it is relied on entirely to determine an SLC (regardless of the level of the PI or of other evidence) – but if it is below 1.5%, it is ignored entirely – i.e. given zero weight in the CMA's assessment.

467 At paragraph 14.142, the PFs suggest that the PI is likely to be biased downwards. However, the only support provided for that view is that there may be feedback effects post-merger. See discussion at paragraphs (772) *et. seq*. above.

468 PFs, paragraph 14.146(a).

469 PFs, paragraph 1.149: "*the GUPPI is a direct estimate of the incentive to raise prices due to the ability to recapture sales at a nearby PFS, which is at the heart of unilateral effects theory*.".

470 PFs, paragraph 14.149.

471 We note that in the CMA's view this is only true of the PCA although, as we set out above, given the weights on non-supermarkets in both measures are similar, if the CMA accepts that the PCA's weight on non-supermarkets is biased downwards it should accept that the same is true of the survey.

472 PFs, paragraph 14.149.

473 PFs, paragraph 14.146(c).

474 We note that the CMA does not appear to agree with this assessment, but also that the accuracy of the model is even weaker if held against a standard of 0.75ppl rather than 1ppl as set out in the Fuel WP.

(783) This cannot be a valid approach to assessment on a balance of probabilities standard. If, as the CMA suggests, both measures contain useful information, then the best estimate of the lessening of competition lies between that indicated by the two measures.

(784) In the case where both measures are believed to carry equal information, a decision rule that is consistent with the thresholds defined by the CMA would find an SLC whenever the *combined* value of those thresholds is above a specified value. As the CMA has set the threshold for the PI to 0.75ppl and the GUPPI to 1.5%, it is reasonable to assume the two measures "agree" when they are both equal to that value.

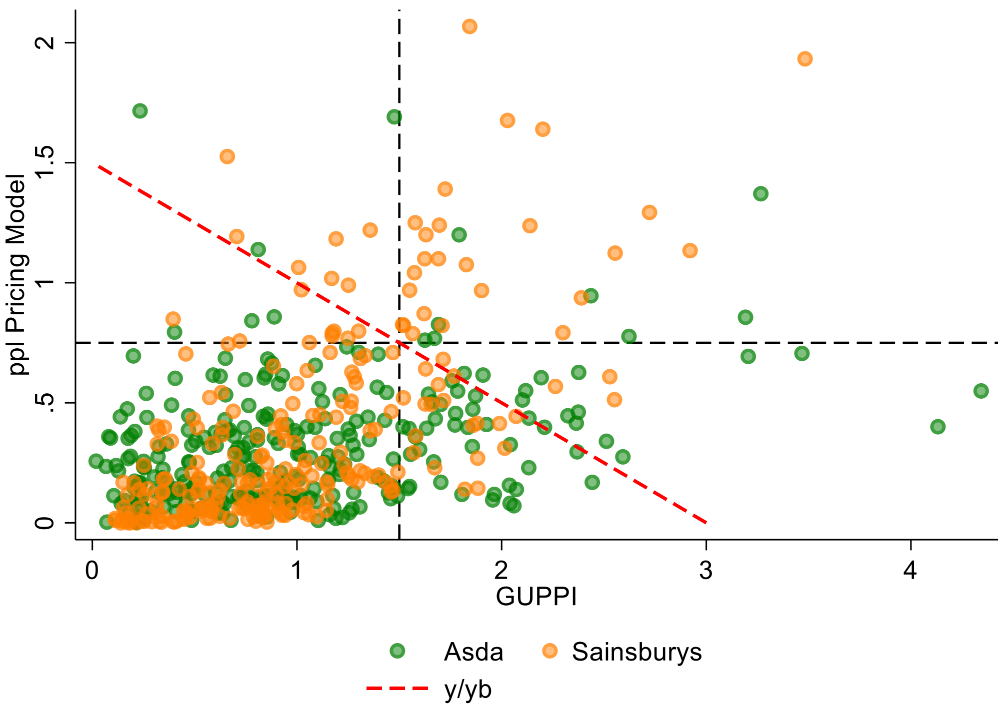
(785) Assuming that a given ppl PI value is equivalent to twice the percentage value of the GUPPI, then a combined measure would identify an SLC when the following inequality was satisfied:

$$\text{GUPPI} + (2 \text{ x PI}) > 3$$

this is effectively a "best estimate" of the true GUPPI, given imperfect information.

(786) Such a decision rule would identify an SLC whenever the PI and GUPPI were such that the PFS fell above and right of the dashed red line in Figure 24 below. In this case, using the CMA's either/or approach would have incorrectly identified 63 PFS as SLCs. This would leave only 66 of the original provisional SLCs in place, even without changing the CMA's thresholds. As set out in Section III, these thresholds should also be increased, and were reasonable thresholds to also be applied, the number of SLCs would be lower still.

Figure 24 Illustration of a decision rule that accounts for the flaws in each approach



(787) If the CMA does not believe that both measures carry equal weight, <u>either the CMA should discard the measure which it considers less robust, significantly increase the threshold at which that measure is used to generate SLC findings, or upweight the more reliable measure in coming to its conclusions.</u>

(788) In any event, unless the CMA on reflection considers that one measure should carry *zero* weight, the evidence from one measure should be weighed against the evidence from the other in a manner similar to that described in paragraph (784) above, so that an SLC finding is genuinely established on the balance

of the evidence. The most straightforward way to do this would be to consider both measures as part of an area-by-area analysis which, as set out in section III.B, is entirely possible and appropriate in this case. A more balanced consideration of the evidence would also offer greater consistency with Phase I decisional practice as set out above.

VI. Many of the SLC findings are contradicted by local evidence

(789) The scope for the CMA's provisional Decision Rule to unreasonably generate "false positive" SLC findings is made very clear when looking at evidence for individual local areas in greater detail. This can be seen from the examples set out below (and in greater detail in Schedule 7.5).

(790) For each area discussed, we provide a range of available evidence, including:

- a map of the local area and short description;
- basic information about the Parties' PFS (including drive times to each other and margins);
- local concentration measures (fascia counts, WSS);
- the indicators used by the CMA to indicate an SLC (PI, GUPPI); and
- a chart showing the pricing of key local competitors over time.

(791) Findings for each area can be summarised as follows:

(792) In **Ladbroke Grove**, both Asda and Sainsbury's are provisionally identified as SLCs even though neither would be caught by the CMA's initial filters and they are 12 minutes' drive from one another.

- The price increases indicated by the PI are only [✂] ppl (i.e. in line with the variable cost synergies expected by the Parties).
- Both sites have a GUPPI below [✂], even on the CMA's measure and excluding own-brand diversion.
- Much of this is grocery-driven: the fuel GUPPIs are only [✂] for Sainsbury's and [✂] for Asda.
- The Parties compete not only with a wide range of non-supermarket PFS within 10 minutes (on a 10-minute catchment, the fascia count reduction for both is an 8:7), and also with Tesco (eight minutes from Asda and 14 minutes from Sainsbury's).

(793) In **Cramlington**, only Sainsbury's is identified as an SLC even though neither Sainsbury's nor Asda would be caught by the CMA's initial filters and they are nine minutes' drive from one another.

- The price increase indicated by the PI is only [✂] ppl, less than the variable synergies expected to arise from the Proposed Merger,
- Sainsbury's has a maximum multi-product GUPPI of [✂] and a fuel GUPPI of [✂], even on the CMA's analysis.
- On a 10-minute catchment, the fascia count reduction due to the merger is 11:10. Within these 10 Sainsbury's will continue to compete with Co-op, Morrisons and Jet (which competes at prices closer to supermarket than non-supermarket PFS in this area), among others.

(794) In **Fulwood/Preston**, only Asda is identified as an SLC – and also would have been caught by the CMA's initial filter as Sainsbury's is its closest PFS competitor (four minutes away). Note that a detailed discussion of the Preston/Fulwood area was also included in Schedule 18 to the Merger Notice.

- The price increase indicated by the PI is just [✂] ppl, less than the variable cost synergies expected by the Parties.

- The highest GUPPI (multi-product excluding own brand) is just [✂], and the highest fuel GUPPI is just [✂], even on the CMA's analysis.
- Even on a 10-minute catchment, the fascia count reduction is 7:6. Asda will continue to face competition from Morrisons (six minutes away) as well as Tesco (16 minutes), among others.

(795) In **Shrewsbury**, only Sainsbury's is identified as a provisional SLC, and neither site would have been caught by the CMA's initial filters. Sainsbury's and Asda are around five minutes' drive time apart.

- The price increase indicated by the PI is just [✂] ppl, lower than the variable cost synergies expected to arise from the Proposed Merger.
- Sainsbury's has a maximum GUPPI of [✂], and a fuel GUPPI of only [✂], even on the CMA's methodology.
- On a 10-minute catchment, the fascia count reduction due to the merger is 10:9. Sainsbury's will continue to face competition from Morrisons and Tesco PFS within 10 minutes, as well as a BP that frequently discounts to similar levels to the supermarket PFS prices.

(796) In **Straiton**, only Asda is identified as a provisional SLC, and neither Asda nor Sainsbury's would have been caught by the CMA's initial filter. Although the parties are only two minutes' drive apart, in each case their closest competitor is Costco, which is located between the two. Note that Straiton was also discussed in detail in Schedule 21 to the Merger Notice.

- The price increase indicated by the PI is [✂] ppl. However, this takes no account of Costco pricing which – despite not being tracked in Catalist – does appear to have an impact in the area, resulting in Straiton benefiting from very low prices.
- As a result of these very low prices, Asda has a GUPPI, even on the CMA's most conservative basis, of [✂] (and only [✂] based on fuel).
- Even within just 10 minutes' drive, Asda will continue to compete with a Tesco, a Morrisons and Costco among others – with a fascia count reduction within 10 minutes from 10:9.

(797) In **Wakefield**, only Asda is identified as a provisional SLC, and neither Asda nor Sainsbury's would have been caught by the CMA's initial filter. The Parties' PFS are around seven minutes apart.

- The price increase indicated by the PI is only [✂] ppl, barely above the variable cost synergies expected by the Parties.
- The highest GUPPI for Asda is [✂], which is mainly driven by grocery – the fuel GUPPI is [✂].
- Even within 10 minutes' drive, Asda will continue to face competition from Morrisons (eight minutes – i.e. only one minute further away than Sainsbury's) and Jet, as well as Texaco and BP, which in this area price below Co-op and often not far above the supermarkets.

(798) It is clear from these examples that the decision rule used in the PFs is not fit for purpose as a method of identifying areas where a fuel SLC can be expected to arise. It is far-fetched to expect that significant price increases could be expected in any of these areas.

VII. The evidence on merger-specific fuel efficiencies is erroneously dismissed

(799) Although the variable cost efficiencies that the Parties expect to achieve in fuel are small relative to the fuel price, they are material relative to any plausible prediction of merger effects. Therefore, they need to be considered seriously and not dismissed out of hand. We note that in their report attached as **Annex_001V.2_001**, [a third party] has now checked these synergy estimates (among others), and still, even after applying a "sensitisation" to allow the synergies to meet the standards required if the synergies

were to be covered by Rule 28 of the Takeover Code, estimates [✂] of synergies in relation to fuel (or around [✂]).[475]

(800) The [third party] report does not imply that the full synergies could not be achieved, but rather that only [✂] of the total could meet the standards required under the Takeover Code. The [third party] report also points to potential upsides in relation to fuel: specifically that [✂] [476]

(801) The Efficiencies section of the PFs drops all but one of the concerns previously raised in the WPs (and addressed in the Parties' response to the WPs).[477] Specifically, [✂] [478] [✂][479]

(802) On both bases, this is simply unsubstantiated assertion. The Parties, of course, do not contest that there are considerations other than price per litre when selecting a procurement model. [✂].

(803) [✂]

(804) In reality, two firms using different procurement strategies can indeed be expected to obtain variable cost savings when combining their operations. To see why this is the case, consider the following example. Two equally sized firms both procure 10 million litres of fuel per annum – one undertaking the procurement activity in-house and the other outsourcing it to a third party.

- **In house:** Firm A undertakes its own procurement and employs a team of staff to manage this process, using multiple suppliers to ensure that its business priorities (e.g. low costs, security of supply) are met. As a result, it manages to procure fuel at a cost of 98ppl, or £9.8m per annum. However, it spends £220,000 in overhead, on its fuel procurement function – bringing the total cost of fuel procurement to £10.02 million.

- **Outsourced:** Firm B other uses a third-party contractor to undertake its fuel procurement – which in turn uses multiple suppliers to ensure that its client's business priorities (e.g. low costs, security of supply) are met. As a result, it manages to procure fuel at a cost of 98ppl, or £9.8 million per annum, but also charges a management fee of 2ppl, or £200,000, meaning that Firm B pays its supplier 100ppl or £10 million for fuel. Because it outsources this function, Firm B has very limited procurement costs in house, however, at £20,000. Therefore, the total cost of fuel procurement is also £10.02 million.

(805) Pre-merger, there is no reason for either firm to switch to the other's business model. Each obtains very similar benefits (including the same risk exposure – managed through using a range of suppliers, either directly in the case of Firm B, or via a third party in the case of Firm A) at a very similar cost: albeit Firm A has slightly lower variable costs and higher overheads, while Firm B has lower overheads but higher variable costs. The total cost incurred is the same. This example is entirely consistent with both Firm A and Firm B placing value on non-price factors (such as security of supply), and achieving the same benefits in relation to these non-price factors.

(806) Now imagine that the two firms merge. The logic of the CMA's critique says that it cannot possibly believe that lower variable costs can be obtained by Firm A in this situation by putting its volumes through firm B's procurement function, because it would lose some other non-price benefit by doing so. However, it can be seen in the example that this is simply not the case. Pre-merger, both firms achieve the same non-price benefits and both firms pay the same price overall for fuel. Post-merger, Firm A can put its fuel

475 [third party] "*Project Solar: Draft Synergy Review Report*" 5th March 2019, slide 4 (attached as **Annex_004_129**).

476 [third party], op cit, slide 13.

477 Response to Fuel Efficiencies WP, 11 January 2019.

478 PFs, Appendix M, paragraph 71. Other factors mentioned at paragraph 68 such as fuel quality, temperature, location, etc. are explicitly taken into account in [the consultant]'s analysis.

479 PFs, Appendix M, paragraph 69.

volumes through Firm B’s procurement team and save 2ppl on its procurement costs. There is no reason why it should forego this saving unless putting its fuel through Firm B’s procurement team generates significant additional overheads for the merged firm: but there is no reason to believe this would be the case. In the response to the Fuel Efficiencies WP Asda confirmed [✂].[480] Similarly, Sainsbury’s confirmed [✂].[481]

(807) If the CMA does not believe these statements from the Parties, it should indicate the basis for its belief that they are untrue so that the Parties have the opportunity to respond, rather than simply disregarding that the Parties have made any submissions on this topic.

(808) In the Efficiencies Appendix, the CMA makes one further argument in relation to the fuel efficiencies, specifically that the efficiencies reflect “cherry picking” parts of a larger contract.[482] The CMA clarifies that its concern is not that [✂], but rather that if [✂].

(809) This is not in fact correct. It is notable that Sainsbury’s [✂]

Figure 25 [✂]

[✂]

(810) Even if the “cherry-picking” concern were upheld, the appropriate response would be to adjust the calculated efficiencies to adjust or remove the assumption of cost savings in relation to [✂], and not to reject the entirety of the fuel synergies. However, as set out above, there is in any case no reason to believe that these savings could not be achieved.

VIII. The Decision Rule is incompatible with the Phase II “balance of probabilities” standard and SLC test

(811) As discussed above in section II, at Phase II the Inquiry Group is required to reach its findings on a “balance of probabilities” standard, which sets a higher bar for establishing an SLC than at Phase I. According to the CMA’s Merger Assessment Guidelines, “*[i]n answering the two questions the [CMA] will apply a ‘balance of probabilities’ threshold to its analysis, ie it addresses the question: is it more likely than not that an SLC will result? It must therefore form an expectation which has a higher level of probability than that required*” of the CMA at Phase I.[483] The preceding sections identify a number of compelling reasons why the CMA’s provisional Decision Rule does not provide adequate grounds to support the SLC findings it automatically generates.

(812) These shortcomings alone should be enough to dissuade the CMA from adopting the unmodified Decision Rule in a final report. However, there are also significant legal and policy reasons for either drastically altering the Decision Rule, or abandoning it in favour of a more robust approach. These reasons are explored in Chapter 2 above, in the context of explaining the Parties’ position on the use of GUPPI in the grocery sector, but apply equally here. In particular, see sections V and VI of Chapter 2.

IX. Constructing a reasonable approach to identifying local SLCs

(813) For all the reasons set out above, the Parties do not believe the CMA’s provisional Decision Rule can be seen as a reliable or robust assessment of which horizontal PFS overlaps generate an SLC to a balance of probabilities standard.

(814) It is clear that – notwithstanding the very intense competition seen across the market for the retail supply of road fuel in the UK – in some local areas, the Parties are particularly close competitors and face limited

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480 Response to Fuel Efficiencies WP, paragraph 7.

481 Response to Fuel Efficiencies WP, paragraph 7.

482 PFs Appendix M, paragraph 109-112.

483 Merger Assessment Guidelines, paragraph 2.12 (attached as **Annex_005_010)**.

local competition, meaning that an SLC can be expected (on the balance of probabilities) to arise. However, the weight of evidence shows that this is not the case in relation to all 129 PFS across 95 areas identified in the PFs.

(815) As noted above, there are several important adjustments that would need to be made in order to construct a reliable WSS, based on the available survey and PCA evidence. In particular, the CMA should:

- increase the relative weight on non-supermarket PFS to take account of the downward bias on non-supermarket weights in both the survey and the PCA analysis;
- include Shell PFS located at large Waitrose as well as Costco PFS (both of which price much more competitively than non-supermarkets and have similar locational characteristics) as supermarket PFS;
- increase the out of market adjustment to take proper account of the bias in the CMA survey; and
- increase the catchment for non-supermarket PFS to 20 minutes.

(816) However, unless the intervention thresholds are increased and the reliance on an "either/or" assessment of GUPPI and PI analysis is abandoned or heavily adjusted, an assessment based even on these updated WSS will remain an overstatement of the true level of SLCs.

(817) Given that the ability to do an area-by-area analysis of areas that fail the CMA's previously applied filters is rejected entirely on the basis of a misapprehension of the number of areas involved (in turn driven by a coding error), there is nothing in reality to prevent the CMA from undertaking such an exercise even at this stage. All the necessary evidence and maps exist for the 43 areas that fail the initial filter and are provided with the Response as Schedule 7.6. The CMA can then either review all these amber areas or apply filters to automatically identify some of the areas as clear SLCs (red) or clear non-SLCs (green) before engaging in an area-by-area review for a smaller number of areas. As set out above, this review would then allow the CMA to take a balanced view of all the evidence "in the round", which is critical given the clear contradictions in many areas between the two measures of competitive effects that the CMA favours (PI and GUPPI).

(818) If the CMA is not willing to engage in such an exercise, notwithstanding the reasoning above, rather than applying extremely low thresholds and an "either/or" standard, given the highly noisy and contradictory nature of the evidence on which the PFs rely, the Parties submit that a better determinative approach would be to take a well understood and accepted measure used in previous cases, such as the Established Filters, diversion ratios, or some combination of the two, as the basis for a decision rule.

(819) As shown by Table 24 below, a 40% diversion threshold when applied as a decision rule would generate 38 SLCs in approximately 32 areas (pairs).[484] This uses the actual survey diversions where available and the estimated diversions the CMA has calculated for its WSS methodology in all other instances (notwithstanding that the latter should, for the reasons set out above, overstate diversion between the Parties). This would be consistent with the diversion filter applied in *Shell/Rontec*, albeit far more conservative (and interventionist), given: (a) *Shell/Rontec* was a Phase I case subject to the more easily satisfied "may be the case" legal test; and (b) the diversion threshold in that case was only used as an additional filter to identify local areas that warranted closer scrutiny (many of which were ultimately not found to give rise to an SLC). In fact, SLCs were ultimately only identified in areas where the diversion ratio exceeded 50%.

[484] Note that an error in the CMA's code resulted diversions from the survey being mixed with estimated diversions from the PCA for some PFS (whereas we understand the CMA's intention is to use only survey-based diversions when available). Correcting this error does not impact the number of SLCs using the CMA's GUPPI and PI criteria, but does reduce the number of PFS with estimated diversions to the other merging Party in excess of 40%, from 40 to 38. Corrected code is provided in the accompanying data pack.

Table 23 Potential SLCs identified using a 40% diversion threshold from the WSS or survey

					Drive Times		Post-merger fascia counts		
Site	**Fail Initial Filters?**	**PI**	**GUPPI**	**WSS or survey**	**Other merging party**	**Rival super**	**All 10 mins**	**S/m 10 mins**	**S/m 20 mins**
Asda									
Coleraine NI	1	0.7	[✂]	81%	3	17	8	1	2
Sinfin	1	0.5	[✂]	70%	7	15	7	1	4
Tamworth Supercentre	1	0.9	[✂]	70%	1	4	9	3	4
Grantham	1	0.7	[✂]	68%	4	24	5	1	1
Bridge of Dee Supercentre	1	0.3	[✂]	65%	1	6	6	2	4
Pontypridd Rhonnda	1	0.4	[✂]	64%	3	6	5	2	3
Wolverhampton	1	0.5	[✂]	64%	3	5	9	2	4
Barons quay Northwich	1	0.5	[✂]	63%	1	3	6	2	3
Charlton	1	0.6	[✂]	62%	2	11	7	1	3
York	1	0.6	[✂]	60%	1	7	10	3	3
Frome	1	0.4	[✂]	60%	5	12	4	1	3
Arrowe Park	1	1.4	[✂]	56%	3	8	9	2	4
Chelmsford	1	0.6	[✂]	52%	4	6	8	3	4
South Woodham Ferrers	1	0.2	[✂]	49%	3	14	3	1	3
Chesser	0	0.4	[✂]	48%	3	6	4	2	4
Taunton	0	0.7	[✂]	44%	4	3	7	2	3
Liscard	0	0.9	[✂]	44%	11	8	5	2	4
Keighley	1	0.3	[✂]	43%	2	3	8	3	4
Lancaster	0	0.5	[✂]	42%	3	7	7	2	2
Sunderland Thompn Rd	0	0.1	[✂]	41%	4	5	9	2	3
Staines Chertsey Ln	1	0.7	[✂]	41%	3	10	5	2	3
Sainsbury's									
Grantham	1	1.9	[✂]	75%	3	23	6	1	1
Coleraine	1	1.1	[✂]	70%	3	15	8	1	2
Colne	1	1.2	[✂]	68%	3	4	8	2	4
Monks Cross	1	1.3	[✂]	56%	1	7	10	3	3
Garthdee Rd - Aberdeen	1	2.1	[✂]	52%	1	6	6	2	4
Rice Lane	0	0.9	[✂]	51%	4	7	10	3	4
Birkenhead	1	0.6	[✂]	50%	4	10	7	1	4
Telford	1	0.8	[✂]	49%	2	5	9	3	4
Dundee	1	0.3	[✂]	46%	5	7	6	3	4
Amblecote	0	0.5	[✂]	46%	4	7	9	2	3
Great Home Street	0	0.6	[✂]	44%	6	4	9	3	4
Thingwall Pensby Rd	1	0.8	[✂]	44%	4	11	6	1	4
Osmaston	1	1.3	[✂]	44%	7	8	9	2	5
Crystal Peaks	1	0.3	[✂]	43%	2	4	10	4	6

Upton	0	0.4	[✂]	43%	4	8	8	2	4
Ashton Moss	1	0.7	[✂]	43%	3	5	11	4	4
Melton Rd	1	1.2	[✂]	41%	2	5	7	2	4

(820) The Parties note that these areas often also have low GUPPIs and low PI values, or do not fail the CMA's Established Filters, and therefore are not obvious SLCs under any measure – but the combination of the Established Filter and diversion thresholds, with PI and GUPPI then used to inform an area-by-area analysis, presents a possible way forward to identifying a realistic list of areas that may be expected (on the balance of probabilities) to generate an SLC.

(821) The Parties continue to be of the view that the approach that should (and could) be taken in this case would be an initial filter, followed by a deep dive into areas failing the filter. As noted above, the Parties provide evidence packs as Schedule 7.6 of the type set out in Schedule 7.5 for all areas failing the CMA's initial filters with the Response.

(822) Furthermore, the Parties firmly believe (as set out in the NPR response) that any SLCs that are reasonably established on the balance of probabilities can be resolved through the divestment of PFS alone, and that it is unnecessary (as well as disproportionate) to require the entire grocery store to be divested to address a fuel SLC finding. With this in mind, and in light of the questions raised at the response and remedies hearings, the Parties note there are two key reasons why most supermarket-petrol stations generally price lower than most non-supermarket petrol stations:

- due to their generally less convenient locations (if convenience and location were not relevant factors to customers, oil major retailers would be out of business, and would not be able to charge a premium relative to the supermarkets); and
- due to the spill-over benefits (i.e. "halo") to the grocery store (with supermarkets generally seeing a small but noticeable uplift on average to grocery store sales when they add a PFS to a supermarket site).

(823) The first factor will remain true for any divestment purchaser of a PFS, as the location will remain the same.

(824) To address any concerns the CMA may have about the second factor, and ensure any divestment purchaser has the same or greater incentive to price "like a supermarket" rather than "like a non-supermarket", the Parties propose to support the divestment of each PFS (as required) with a contract that pays the new owner 2.5ppl for each litre of fuel sold. This has been calculated by reference to the Parties' internal documents on the size of the halo, econometric analysis of the impact of new PFS on grocery sales undertaken by CRA, and an analysis of survey findings – all of which triangulate to a very similar range of estimates of how large this halo incentive is for the parties today (at around 2-2.5ppl).[485] Moreover, all three methods calculate the size of halo for the presence of the PFS, and therefore are likely to overstate what the halo would be in relation to a small price change, rather than the presence/absence of the PFS.[486]

(825) This volume incentive payment will ensure that the new owner has the incentive to price as if it was a supermarket PFS. For example, if supermarket petrol stations were on average making 3.5ppl margin on fuel and benefitting from a 2.5ppl halo, then supermarket PFS prices would be set to optimise profits given this overall 6ppl margin. By paying the new buyer of the PFS the 2.5ppl "halo" payment in cash

[485] A new purchaser may well have its own "halo" to some extent (e.g. on any food-to-go or other value-added offers made at the site, that incentivise it to follow a low price high-volume business model).

[486] This is because, for some customers, the convenience of a co-located PFS alone will be a sufficient reason to shop at the grocery store, whether or not fuel is priced at the current price or a few ppl higher.

under this mechanism, the same set of incentives is achieved. Consequently, if the new owner raised its prices and therefore saw its volumes decrease, it would not only directly lose the margins on its fuel sales, but would also suffer the loss of the additional "halo" payment of 2.5ppl.

(826) Moreover, the remedy will effectively keep the purchaser "in the same shoes" as (e.g.) Sainsbury's would be absent the Proposed Merger, regardless of changes in cost or demand conditions in the future. For example, even if fuel volumes were to halve (e.g. due to rising fuel costs and/or electrification), the halo per litre would stay the same, and would ensure that the new owner of the PFS would maintain the same pricing incentives as (e.g.) Sainsbury's would have absent the Proposed Merger.

X. The scope for national level issues, whilst ultimately dismissed, is nonetheless overstated

(827) Although the PFs reject any national concerns in relation to fuel, the Parties remain concerned that the national elements of the fuel market are not accurately described. In particular:[487]

- while pricing policies are designed centrally, these do not take the form of "rules" (as set out in response to the Fuel WP),[488] and are subject to a significant degree of human judgement that mean that the rules themselves do not automatically translate to a certain degree of "*aggressiveness*";[489]
    - while there are announcements of national price cuts by all supermarket fuel operators, these generally track falling costs (rather than affecting the intensity of competition);
    - while Asda does also announce cuts to a national price cap, [✂];
    - while Asda [✂]; and [490]
    - finally, the national weighted average GUPPI, while low, is still overstated, for the same reasons set out in relation to the local GUPPIs above.

(828) The Parties, however, agree that there should be no scope for any SLC on a national basis in fuel – given low diversions between the Parties, low national market shares, and the fact that national pricing announcements effectively track costs, rather than having any material impact on margins.

[487] PFs, paragraph 14.17.

[488] Response to the Fuel WP, Annex 3.

[489] PFs, paragraph 14.43.

[490] Response to the Fuel WP, Annex 3, paragraph 241.