OFFICE OF FAIR TRADING

Completed acquisition by Tesco Stores Limited of Brian Ford's Discount Store Limited

ME/3827/08

The OFT's decision on reference under section 22(1) given on 22 December 2008. Full text of decision published 19 January 2009.

Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Tesco Stores Limited (Tesco)** is a subsidiary of Tesco plc, a large grocery retailer with a portfolio of stores across the UK. In addition to its UK grocery retailing business (both food and non-food), Tesco has various other operations in the UK, which include petrol retailing, internet shopping and the provision of financial services. Tesco's turnover was approximately £46.6 billion in the year ending 24 February 2007, of which approximately £35.6 billion was generated in the UK.

2. **Brian Ford's Discount Store Limited (Brian Ford)** is a private limited company whose main assets include a single grocery store operated under the Brian Ford fascia in Barnstaple, North Devon. Its UK turnover in 2006 was approximately £18 million.

TRANSACTION

3. The transaction concerns the completed acquisition by Tesco of Brian Ford. The acquisition completed on 7 October 2003. It took place through a nominee company, which held the Brian Ford shares in trust on behalf of

Tesco until the shares were transferred to Tesco on 4 April 2007. However, the transaction was only 'made public' for the purposes of section 24 of the Enterprise Act 2002 (the Act) on 22 June 2008, when the Daily Telegraph published an article about the acquisition.

4. Tesco argued that an assertion of jurisdiction over the transaction by the OFT would undermine legal certainty, given that there was no obligation on Tesco to announce the transaction in 2003. Whilst the OFT fully accepts Tesco's point that it was under no obligation to publicise the transaction, the Act is clear that – in choosing not to publicise a merger – acquirers may effectively be 'delaying' the termination of merger control risk until four months after the time at which the transaction is subsequently made public. The OFT has no discretion under the Act not to refer a transaction to the Competition Commission simply on the basis that considerable time has passed since the merging parties originally ceased to be distinct.

5. The four month time-limit under section 24 of the Act therefore started on 22 June 2008, the day in which the acquisition was made public through the article published in the Daily Telegraph, and therefore the original statutory deadline for a decision on reference was 22 October 2008. However, the statutory deadline for this case has been extended by a period equivalent to 65 working days under section 25(2) of the Act, and therefore the new statutory deadline is 23 January 2009. The 40 working-day administrative deadline is 29 December 2008.

JURISDICTION

6. As a result of this transaction, Tesco and Brian Ford have ceased to be distinct. In accordance with section 23(9) of the Act, the question whether a relevant merger situation has been created is determined immediately before the time of the decision on reference (that is, not when the parties originally ceased to be distinct in 2003)[1]. The parties overlap in the retail supply of groceries. Tesco's share of supply of grocery retailing in the UK is above 25 per cent and, as a consequence, the share of supply test in section 23 of the Act is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

[1] The question of whether or not the OFT would have had jurisdiction under the Act at the time the transaction completed in 2003 is therefore irrelevant.

METHODOLOGY

7. Tesco argued that it was not appropriate for the OFT to review this acquisition because it was completed more than five years ago when Brian Ford would not have been considered an effective competitor to Tesco under the prevailing methodology at the time of the acquisition (known as the 'Safeway criteria)'[2]. In addition, Tesco submits that, even if the OFT were to decide to review the acquisition, it should apply the analytical framework prevailing in 2003.

8. The OFT does not consider it appropriate to apply the 'Safeway criteria' to this case. First, the OFT makes a decision on whether or not to refer the merger on the basis of the information available at the time of its decision. This applies not only to factual issues, but also to any developments in the OFT's analysis and thinking. UK competition authorities' analysis of and policy towards the grocery retail sector has evolved significantly since 2003, and it would not be reasonable for the OFT to apply a less developed analytical framework when the current tools available are, we believe, more satisfactory.[3]

9. Second, as well as being academic, it is also far from obvious what the OFT's approach to this case would have been had it been notified at the time of completion. In particular, the 'Safeway criteria' were designed to deal with mergers involving a large number of overlapping stores rather than the acquisition of a single store.

10. Tesco further submitted that, in the context of the UK's voluntary merger notification regime, Tesco assessed at the time of the acquisition the risk involved in not notifying the transaction on the basis of the analytical framework prevailing then, making a decision not to notify based on that framework. However, the OFT notes that, whilst Tesco was fully entitled not to notify on this basis, it effectively took the risk of developments in

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[2] Based on the Competition Commission's Report: *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets plc, J Sainsbury plc, and Tesco plc: A report on the mergers in contemplation* (2003).

[3] For instance, the analysis conducted by the CC as part of its investigation into the acquisition by Somerfield of 115 stores from Wm Morrison. See Competition Commission *Somerfield plc / Wm Morrison Supermarkets plc: A report on the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc* 2 September 2005. See also, amongst others, Competition Commission *The supply of groceries in the UK market investigation* 30 April 2008 (the Groceries Report), and OFT decision Anticipated acquisition by Co-operative Group Limited of Somerfield Limited 20 October 2008 (Co-op/Somerfield).

the analytical framework applicable to this merger occurring between the time of the transaction completing and the time of it subsequently becoming public. Given the operation of section 23(9) of the Act, discussed above, this conclusion applies notwithstanding Tesco's argument that it believed at the time of completion that UK merger control did not apply to this acquisition and did not apply so as to raise competition issues.

MARKET DEFINITION

Product market

11. Brian Ford operates a single store of 2,900 square meters. By size, it is a 'larger grocery store' according to the CC's definition in the Groceries Report.[4]

12. Tesco argues that Brian Ford cannot be considered an effective competitor to the large grocery stores in Barnstaple (Sainsbury's, Tesco and Somerfield) and that as such Brian Ford is not part of the same relevant market. Its main arguments are that:

    a) Brian Ford is a single grocery store and not a national operator

    b) Brian Ford is in poor condition and requires extensive redevelopment, and

    c) Brian Ford is closer in its product / amenities offering to that of a limited assortment discounter (LAD)[5] or that of a retail cash and carry operator.

13. The OFT notes that Brian Ford offers a significantly higher number of individual product lines or 'stock keeping units' (SKUs) than the average LAD [10,000 -20,000] as opposed to 1,000 for the average LAD).

14. The CC considered that LAD stores should not be included in the same product market as stores belonging to large grocery retailers when the starting point for a SSNIP test is stores operated by large grocery retailers.

[4] Paragraph 4.135 of the Groceries Report.
[5] For example, Aldi, Lidl or Netto.

However, the CC also considered that there is a one-way or asymmetric constraint from large grocery retailers on LADs.[6]

15. The OFT accepts that some characteristics of Brian Ford might suggest that it does not pose an important competitive constraint on the Tesco store in Barnstaple. Indeed, this finding is supported by the survey evidence discussed below. However, whilst Brian Ford's store condition and offer may suggest that it is not a particularly strong competitor to the other national grocery chains in the local area, the store's condition and offer are not informative about the extent to which Brian Ford is constrained by other grocery stores in the local area. To identify and gauge the level of constraint posed by other grocery stores on Brian Ford, Tesco commissioned a customer survey, the results of which are discussed below.

16. As a consequence, the OFT does not consider it necessary to conclude on the boundaries of the relevant market in this case given that detailed evidence is available about the relative competitive constraints from various grocery retailers in this local area.

Geographic market

17. As discussed below, previous CC and OFT reports into supermarkets have found that there are both national and local aspects to competition.[7]

18. In its Groceries Report the CC found that the geographic market for large stores was 10- to 15-minutes drive-time around the store. The Groceries Report found that mid-size stores competed with other mid-size stores within 5- to 10-minutes drive-time around the store but also found that mid-size stores competed with large stores within a 10- to 15-minute drive-

[6] Paragraph 4.81 of the Groceries Report.

[7] For example, OFT Decision *Anticipated merger between Co-operative Group (CWS) Limited and United Co-operatives Limited* 23 July 2007 paragraphs 103 and 104, OFT Decision *Anticipated acquisition by Tesco plc of 45 outlets from Adminstore Ltd* 5 March 2004 paragraph 11, CC Report: Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc), Wm Morrison Supermarkets plc, J Sainsbury plc, and Tesco plc: A report on the mergers in contemplation (2003) paragraph 2.65.

time of the mid-size store.[8] Lastly, the Groceries Report found that convenience stores competed with other convenience stores within both a 5-minute drive-time and half a mile radius around the store but also competed with mid-size stores within 5- to 10-minutes drive-time around the convenience store, and with large stores within 10- to 15-minutes drive-time of the convenience store.[9] That is, in its Groceries Report, the CC concluded that geographic markets for grocery retailing are asymmetric with larger stores further away constraining smaller stores but not vice versa.

19. In this case, the OFT took account of the alternative grocery stores available within a 15-minute drive time from Brian Ford, as well as stores located just outside that cut-off point. However, because more direct empirical evidence was available regarding customer behaviour in that locality (that is, the results of the customer survey), the OFT placed proportionally more weight on this evidence rather than basing its decision on a simple 'fascia counting' exercise on the basis of strictly defined isochrones.

SUBSTANTIVE ASSESSMENT

Introduction

20. In previous investigations in the grocery retail sector the OFT and the CC have concluded that the ambit of grocery retailing is local because consumers are prepared to travel only a limited distance for their grocery shopping, although that distance may vary according to the type of shopping trip required.

21. The OFT accepts that, at the same time, on the supply-side, national dimensions of competition, such as national advertising, promotional activity and purchasing arrangements, also exist. Key decisions affecting the operation of stores and other aspects of their business (such as supplier relationships and general promotional activity) are taken centrally, often on a national basis.

[8] Paragraph 4.145 of the Groceries Report. Paragraphs 3.51–3.54 of the Groceries Report suggest that the drive time ranges the CC gave in its geographic market definitions reflect differences between urban and rural locations.
[9] Paragraphs 15(c) and 4.145(c) of the Groceries Report.

22. However, the CC has indicated that weak competition in local markets allows a grocery retailer to worsen the store-specific retail offer at its stores in markets facing weak competition in order to earn higher profit margins at those stores. In addition, the CC found that 'a grocery retailer with a number of stores in local markets where competition is weak is able to weaken that part of its retail offer, such as pricing, that it applies uniformly, or near uniformly, across its stores nationally and thereby earn higher profits across all of its stores.'[10]

23. Tesco argued strongly that it competes at the national level only, and that its price, quality, range and service (PQRS) offering and margins at the local store level, in this case in relation to its Barnstaple store, are not affected by local competition. In support of this argument, Tesco referred to the CC's margin concentration analysis in the Groceries Report which, according to Tesco, when applied to Tesco data, did not show any statistically significant results.

24. Ultimately, the OFT has not been required in this case to determine whether it shares Tesco's interpretation of this aspect of the CC Groceries Report. This is because, even if one were hypothetically to accept – for the sake of argument – that local competition does not have any influence on aspects of Tesco's PQRS retail offer or store margins, Brian Ford, as a single store, was undoubtedly influenced by local competition when setting its prices. As a consequence, the local constraint on Brian Ford's behaviour is lost with the merger. Therefore, the OFT does not believe that it should deviate in this case from the CC's generic approach to the relevance of competition in local markets as described in paragraph 22 above.

National level

25. According to Tesco, on the basis of recent TNS data its current national share of grocery sales is 27.3 per cent. The increment caused by the merger will be minimal (significantly less than one per cent). Hence, the merger does not give rise to any substantive competition issues on a national basis.

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[10] Groceries Report, paragraph 6.75.

Local level

Local competition landscape

26. There are three larger stores[11] in Barnstaple within a 10-minute drive-time of Brian Ford: Sainsbury's, Tesco and Somerfield. Within a five minute drive-time of Brian Ford there is a mid-sized Lidl and a mid-sized Iceland (which are not considered by the CC as part of the 'effective competitor set') as well as a mid-sized Marks and Spencer.

27. In addition, there are three larger stores (Asda, Co-op and Morrisons) in the neighbouring town of Bideford. Of these, Morrisons sits on the edge of the 15-minute drive-time isochrone centred on Brian Ford, and Asda and Co-op are just outside the isochrone.

Local unilateral effects concerns premised on the loss of an asymmetric competitive constraint

28. As a preliminary point, in previous cases in which the OFT has explored unilateral effects theories of harm in a merger of suppliers of differentiated products (such as grocery retailing), the OFT has not taken the view that, for it to find that there is a realistic prospect of a substantial lessening of competition, the OFT must necessarily envisage the prospect of a loss of a competitive constraint on the acquirer's products or retail proposition.[12] Competitive constraints imposed by merging parties on each other may be symmetric (two-way, that is each party constrains the other) or asymmetric (one-way, one party constrains the other but not vice versa), and the loss through merger of an asymmetric constraint may in some circumstances be sufficiently concerning to the OFT for its reference test to be met. This includes mergers in which the constraint lost is on the target business alone.

[11] Above 1,000 square meters.
[12] See OFT Decision *Completed acquisition by Home Retail Group plc of 27 leasehold properties from Focus (DIY) Ltd* 15 April 2008 (Homebase/Focus), paragraphs 49ff.

Summary of results of the customer survey

29. The survey evidence provided by Tesco indicates that the diversion ratios between Tesco and Brian Ford (and between the merging parties and other stores) are as follows:[13]

	Diversion ratios from Tesco Barnstaple (per cent)		Diversion ratios from Brian Ford (per cent)	
	Revenue	Customers	Revenue	Customers
Brian Ford	[5-15]	[5-15]	X	X
Tesco Barnstaple	X	X	[25-35]	[25-35]
Morrisons	[0-10]	[0-10]	[10-20]	[10-20]
Sainsbury's	[more than 40]	[more than 40]	[15-25]	[15-25]
Somerfield	[10-20]	[5-15]	[0-10]	[0-10]
Tesco (other)[14]	[5-15]	[5-15]	N/A	N/A
Lidl	[0-10]	[0-10]	[15-25]	[15-25]

30. The survey results above indicate that the diversion ratio from Tesco to Brian Ford is relatively low, so that Tesco's customers do not consider Brian Ford as their next best choice. Conversely, for almost [25-35] per cent of Brian Ford's customers that stated to whom they would switch, Tesco is their next favourite option.[15]

31. These results support the view that Tesco exerts a stronger constraint on Brian Ford than Brian Ford exerts on Tesco, and that Tesco is the strongest constraint on Brian Ford in comparison with other local grocery stores. The question to be answered therefore is whether the constraint from Tesco on

[13] All survey results have been adjusted to exclude the responses 'do not know' and 'would not have shopped' as these would unduly underestimate the diversion ratio between the parties. This approach is consistent with the approach taken by the OFT in recent cases including Co-op/Somerfield.

[14] Some [5-15] per cent of survey respondents, accounting for [5-15] per cent of revenue, said that they would divert from Tesco Barnstaple to another Tesco. Given that Tesco's survey was intended to capture the next-best choices of shoppers who are marginal to the Tesco and Brian Ford fascias, the OFT considers it arguable that the responses of these shoppers – who evidently are infra-marginal to the Tesco fascia – should be excluded from the diversion ratios. Doing this increases the customer diversion ratio from Tesco to Brian Ford to [5-15] per cent and the revenue diversion ratio to [5-15] per cent.

[15] Although Tesco has owned Brian Ford since 2003, Tesco informed the OFT that the Brian Ford store has continued to be operated independently by the existing management. This was confirmed separately by the management themselves. As such, the OFT does not consider that the diversion ratios should be affected by the fact that Tesco has owned the Brian Ford store for a considerable period of time.

Brian Ford is significant enough for there to be a realistic prospect of a substantial lessening of competition arising from the merger.

Rebuttable presumption of adverse merger effects arising from a loss of competition evidenced by high margins and high diversion ratios between the parties

32. In order to assess the probability that there will be a loss of local competitive rivalry between retailers, the OFT will, when available, examine two sources of evidence in seeking to arrive at an illustrative quantitative measure of the closeness of competition between merging firms, and thereby the change in incentives that the internalization of this close rivalry would bring post-merger:

- Gross margins – if firms are able to mark-up prices to a substantial degree over the cost of sales, this suggests that the collective competitive pressure from rivals is relatively low (suggesting a narrower market) because otherwise price-sensitive marginal customers of the firm would switch to these rivals and oblige the firm to lower its margins (lower prices or increase spend on its non-price offer), as such, gross margins are a proxy for the degree of rivalry in absolute terms between all market participants *ex ante*, and

- Diversion ratios between the merging parties – the diversion ratio is the proportion of switching customers in response to a worsened offer that would divert from one merging party to the other, when this ratio is significant, this suggests relatively close competition between the parties that the merger would remove, and suggests that the merged firm, having internalized this rivalry, would have an incentive from the merger to raise price or worsen its non-price retail offer.

33. Accordingly, the combination of gross margin data and diversion ratios is a valuable measure of the change of incentives brought about by a merger. Due to the general probative value of this combination of evidence, the OFT applies a rebuttable presumption that a horizontal merger between firms with (i) high margins and (ii) significant diversion ratios between the

merging firms raises a realistic prospect of a substantial lessening of competition through unilateral effects.[16]

34. This presumption is stronger the greater the illustrative changes in incentives brought about by the merger. All else equal, the higher the parties' gross margins and the higher the diversion ratio between them, the greater the presumed incentive of the merged firm to worsen its offer to customers, whether in respect of the acquiring firm's products or target products.[17] Equally, the lower the gross margin and diversion ration, the weaker the presumption regarding the merged firm's incentive to worsen PQRS. The presumption will also be weaker if the reliability or probative value of the margin or diversion ratio evidence is in doubt.

35. More generally, this presumption may be rebutted, by the OFT itself or by the parties, on the basis of evidence suggesting a contrary interpretation: for example, that the parties are not, in fact, close competitors pre-merger despite this evidence, or that other rivals are close third and fourth choices for diverting customers, or that countervailing constraints from supply-side responses (entry, expansion or repositioning) or buyer power would discipline away any such incentive to worsen the merged firm's offer post-merger.

Calculation of illustrative price increases on basis of appropriate margins

36. In Co-op/Somerfield the OFT combined diversion ratios with data on gross margins to compute 'illustrative price rises' (IPRs) to identify local areas in which the merger causes competition concerns — these areas first having been identified on the basis of isochrone- and fascia-count-based filtering.[18] In that case, in applying its rebuttable presumption in terms of unilateral effects, the OFT applied thresholds in either direction (ie from either the acquiring Co-op or the target Somerfield) of 14.3 per cent for diversion ratios and five per cent for IPRs. All shops that failed this test in the second stage of the analysis were required to be divested.

[16] See Homebase/Focus, paragraphs 61ff.
[17] See Homebase/Focus, paragraph 63.
[18] See Co-op/Somerfield, Annex A.

37. In this case, Tesco made extensive submissions on how best to calculate margins for the purposes of calculating the IPR, and the OFT considered these points carefully. By way of general principle, the OFT accepted that it was reasonable when calculating the margin for these purposes to remove certain variable costs (given that any increase in a firm's price resulting in a reduction in sales would also enable the firm to reduce those particular variable costs).

38. The OFT considered carefully the relevant time period over which margins should be calculated. This matters because more costs are variable over a year than are variable over (say) a month, hence annual margins will generally be lower than monthly margins.

39. Tesco argued that the appropriate Brian Ford profit margin should be calculated annually on the basis that adverse effects from the substantial lessening of competition will normally last more than one year.[19] However, the OFT considered that the relevant time period over which margins should be measured for these purposes should correspond to the time period over which the firm in question makes decisions about how much to sell or at what price, not on the duration of the substantial lessening of competition.

40. The OFT therefore considered that margins calculated on a monthly basis were more appropriate in this case given that grocery retailing is characterised by fast-changing retail offers and marketing initiatives.[20] As a result, some costs that would be classified as variable over a longer term are fixed in the shorter term. For example, while staffing policies can undoubtedly constitute a part of the retail offer and be flexed according to the local competitive constraints, not all staff costs can be avoided, it is

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[19] Tesco noted that the CC used annual margins in some analysis in its Groceries Report. However, footnote 12 in Appendix 4.4 of the Groceries Report states that the CC used annual data because 'it was not possible to collect information on our instrumental variables prior to 2005, and this data was available only on an annual basis.' The OFT notes also that the use of annual margins would not have affected the CC's analysis (see paragraphs 30ff of Appendix 4.4 of the Groceries Report). However, the choice of time period over which margins are measured does affect the OFT's IPR calculations.

[20] For example, Tesco told us that it can change prices [frequently]. We also noted that supermarkets' pricing offers (for example, buy-one-get-one-free or 3-for-the-price-of-2) tend to last for a few weeks, up to a month. The OFT recognises that a monthly basis is unlikely to be an exact proxy for these purposes but considers that it is more appropriate than a yearly basis.

41. unrealistic to expect that all staff costs can vary with sales and that staff costs could be reduced to zero if no sales were made.[21]

42. There is inevitably some degree of uncertainty about which costs should properly be regarded as avoidable in this context, the OFT therefore considered a number of possible measures of Brian Ford's margins based on varying assumptions about the nature of store-related costs.

43. When calculating IPRs on the basis of the diversion ratio from Brian Ford to Tesco, combined with the most plausible alternative assumptions about Brian Ford's margins as tested by the OFT, the resulting IPRs suggested that, to the extent there was an incentive to increase Brian Ford's prices or worsen PQRS as a result of the acquisition, such an incentive was likely to be limited. In particular, the five per cent threshold for IPRs used in Co-op/Somerfield was triggered only on a subset of all plausible margins.

44. Given that, in this case, there is genuine uncertainty as to whether or not the rebuttable presumption is in fact invoked, the OFT considers it appropriate to examine other evidence in order to determine whether its duty to refer is met. Placing undue significance on whether or not the presumption is just met or is not quite met would be inappropriate given that the OFT is examining in this case the acquisition of a single store and is therefore able to examine other evidence as to the impact of the merger on competition in the local market.

45. The OFT notes that, as discussed above, the presumption is stronger the greater the IPR brought about by the merger. In this case given that any incentive to increase prices or worsen PQRS would be relatively limited, the presumption (assuming it were invoked, which is by no means certain) is a weak one and would therefore be more readily rebutted than if the IPR were significantly above the five per cent threshold used in Co-op/Somerfield.

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[21] Tesco previously made this point to the CC. According to paragraph 6 in Appendix 4.4 of the CC's Groceries Report: 'Tesco said that the margin that we [the CC] computed contains elements of fixed costs. In particular, Tesco has submitted that portions of staff costs are fixed, and that because we include staff cost in the computation of profit margin, parts of our measure of variable costs is fixed.'

Consideration of local conditions of competition

46. Although local conditions of competition should in principle be taken account of by the diversion ratio and the margin (which together form the basis of the IPR) the fact that the OFT is examining the acquisition of a single grocery store in this case has allowed it directly to examine local conditions of competition.

47. In this respect, the OFT notes first that the survey results (as set out above) indicate that whilst Tesco is the first preferred alternative to Brian Ford, the diversion ratios to Lidl, Sainsbury's and Morrisons are also significant and, in the case of Sainsbury's, are not significantly below that to Tesco. This suggests that all these stores are important sources of competitive constraint on Brian Ford.

48. The reasonable diversion ratio from Brian Ford to Morrisons is particularly significant because it is located in another town (Bideford), 15 minutes away from Brian Ford, suggesting that shoppers in Barnstable would be prepared to travel reasonable distances to an alternative store. These results are consistent with other findings of the customer survey, namely that [50-60] per cent of Brian Ford customers travel for more than 15 minutes to get to the store (the average travel time to Brian Ford is [around 15-20 minutes] and that the vast majority of customers [85-95 per cent] use a car to travel to the store. This should be compared with the findings of the CC's Groceries Report that the majority of customers (more than 80 per cent) shop in larger grocery stores within 15-minute drive-time from their leaving location.[22] This suggests that the distances that Brian Ford customers travel on average are longer than the notional national average travel-time in the CC's Groceries Report, and that therefore Brian Ford might be constrained by stores located further than would normally be the case for larger stores.[23] It is also relevant to note in this context that the most significant reason in the customer survey given by Brian Ford

[22] Groceries Report, paragraph 4.103. The Groceries Report refers to drive times, whereas the customer survey refers to time taken to travel to the store. However, given that the vast majority of customers surveyed travelled to the store by car, the OFT considers that the comparison is appropriate.

[23] The CC in the Groceries Report considered that larger grocery stores will, in general, be constrained by other larger grocery stores within a 10- to 15-minute drive-time.

shoppers for choosing to shop at that store was 'good prices / value for money' rather than 'easy to get to / convenient location' (which is normally given as the main reason for choice of store).

49. As discussed above, post-merger there are four large store fascias within a 15-minute drive-time from Brian Ford, and two other just outside the 15-minute isochrone. In addition, there are three mid-sized stores in Barnstaple, one of which (Lidl) is the second preferred alternative to a significant proportion of Brian Ford customers.

Other considerations on the impact of the merger on competition in the local market

50. In addition to considering directly local conditions of competition, the OFT has also considered what additional information is available to it – beyond that already taken account of by the diversion ratio and margin data (which, to the extent that they collectively give rise to a rebuttable presumption, do so at most to a weak one) – such as to determine whether, overall, the OFT believes that the merger gives rise to a realistic prospect of a substantial lessening of competition.

51. In this case, the OFT considers that it is relevant to take account of three additional pieces of evidence as to the extent of the impact of the merger on competition in Barnstable.

52. First, the OFT notes that the fact that any loss of competition in this case is asymmetric reduces the impact of the competitive harm that could result from the merger. The loss of the competitive constraint is felt solely with respect to the Brian Ford store, and not on the Tesco store (given that Brian Ford did not act as a significant competitive constraint on Tesco pre-merger). Further, the reasons why Brian Ford did not act as a constraint on Tesco, taking into account the factual points discussed in paragraph 12 above, are likely to apply also in relation to the constraint Brian Ford imposed on other effective competitors in Barnstable. For this reason, the loss of the competitive constraint from the removal of Brian Ford as an independent competitor will not be experienced more generally in the market (in contrast to the position – even in cases involving the loss of an asymmetric constraint – in other grocery mergers).

53. Second, the OFT has seen no evidence in Tesco's internal documentation relating to the acquisition to suggest that Tesco anticipated any increase in market power from the merger. Although the loss of constraint arising from the merger would be experienced by the Brian Ford store (rather than by Tesco's existing store) Tesco would still have benefited from diversion of Brian Ford customers to it were it to increase Brian Ford's prices, or lower PQRS, following the merger. However, there is no evidence that Tesco contemplated such an effect.

54. Third, as discussed in further detail below, no customer complaints were received about the merger despite the prominence of its coverage in the national and local press.

55. While the OFT accepts that, taken individually, none of these reasons is particularly strong, the OFT believes that they have sufficient weight collectively to rebut any weak presumption of adverse merger effects arising from the diversion ratio and the gross margins in this particular case.

CHANGE OF FASCIA – BENEFITS TO CUSTOMERS

56. Tesco informed the OFT that, once planning permission for conversion of the Brian Ford site is obtained, the subsequent conversion of the Brian Ford store to the Tesco fascia will bring real and tangible improvements for each element of the current PQRS offer at the Brian Ford store thereby bringing significant benefits to consumers. They argued that the current offering by Brian Ford would be significantly enhanced by its replacement as a Tesco.

57. The OFT notes that, even on the basis of Tesco's own argument, shoppers in Barnstable already had the option of a Tesco store prior to the merger. It is therefore unclear what additional benefit is created by the addition of a second Tesco fascia (in particular given the average drive time of customers using the Brian Ford store, as discussed above).

58. However, the OFT has not had to consider Tesco's arguments on this point further because the OFT considers that, to the extent it can rule out a realistic prospect of a substantial lessening of competition on the assumption that the Brian Ford fascia remains (albeit controlled post-merger by Tesco), there can be no possibility of the duty to refer being met on the

basis that there is intended to be a conversion of the target fascia post-merger (on the basis that a change of fascia cannot increase any potential lessening of competition brought about by the merger).[24]

59. Accordingly, the fact that Tesco intends to convert the Brian Ford store into a Tesco does not affect the OFT's conclusions on the duty to refer.

THIRD PARTY VIEWS

60. The OFT was originally alerted about this merger by a third party competitor.

61. The OFT received seven responses from grocery retailers to our questionnaire. In general, retailers believed that Brian Ford was a large grocery retail store with a large number of SKUs. However, one retailer told us that it did not consider Brian Ford to be a close competitor for its stores because it was an 'old-fashioned' discounter model operated from a hangar-style building.

62. Six of the seven responding retailers were concerned about the acquisition, whilst one believed that the acquisition would be pro-competitive. The concerns included arguments that the number of competitors in the large grocery stores market in the Barnstaple area would be reduced from three to two (Sainbury's being the only other retailer). However, this concern is not reflected in the survey results which indicate that Morrisons and Lidl are also competitive constraints on Brian Ford. Retailers also argued that the customer choice of fascia would be seriously reduced. Retailers further argued that the way in which Tesco acquired Brian Ford was 'underhand' and that Tesco wanted to increase its market power within the local market by expanding its presence. Many retailers feared that the transaction would have a negative impact on their trade.

63. The one retailer who believed that the transaction would have a pro-competitive effect argued that, despite the reduction in the fascia count, Tesco's trading from the Brian Ford site would improve local competition

[24] The OFT also notes that the conversion to a Tesco fascia remains (in practice) dependent on receipt of planning permission. It is not clear when such planning permission will be received, or whether it will in fact be granted at all.

by bringing an additional leading national brand to the area.

64. Finally, the OFT did not receive any complaints from consumers about the Tesco/Brian Ford transaction. This is particularly notable given the fact that the transaction was extensively publicised in national and local newspapers and contrasts with other grocery mergers, in which the OFT has received complaints from individual consumers.

ASSESSMENT

65. Tesco acquired Brian Ford Discount Store in October 2003 through a nominee company but the transaction was not made public for the purposes of the Act until June this year.

66. A customer survey commissioned by Tesco indicated a significant diversion ratio from Brian Ford to Tesco (approximately [25-35] per cent) and a relatively modest diversion ratio from Tesco to Brian Ford (approximately [5-15] per cent). This suggested an asymmetric constraint between Tesco and Brian Ford, with Tesco constraining Brian Ford but not vice-versa.

67. The OFT therefore assessed whether Tesco would have an incentive to increase Brian Ford's prices or worsen PQRS as a result of the acquisition. Based on the most plausible estimations of Brian Ford's monthly margins, an IPR analysis combining the diversion ratio and the margins showed that Tesco's incentives in this respect were limited but that the five per cent IPR threshold used in Co-op/Somerfield would be tripped on at least one plausible measure. The OFT therefore examined other evidence on competitive conditions, whilst bearing in mind that any rebuttable presumption of harm would be a weak one.

68. The OFT considers that additional evidence available on the impact of the merger in Barnstable is sufficient to rebut any such weak presumption of adverse merger effects. First, the OFT has taken account of the fact that, to the extent that there is any lessening of competition, this will be limited to a loss of competitive constraint on the Brian Ford store and will not affect the Tesco store or (for the same reasons that Brian Ford did not significantly constrain Tesco) on the other effective competitor stores nearby. Second, the documentary evidence received by the OFT does not suggest that Tesco anticipates obtaining increased market power through

the merger. Third, no customers complained about the merger to the OFT despite extensive coverage in the press.

69. While local conditions of competition should in principle be taken account of by the diversion ratio and the margin data, a consideration of the local conditions of competition (also arising out of the customer survey) support the conclusion that the loss of competitive constraint on Brian Ford arising from the merger is not substantial, and that a number of important competitive constraints will remain in the market place. In particular, the survey results indicate that Brian Ford might be constrained by stores located further than would normally be the case for larger stores given the distances that Brian Ford customers will travel. In this context, it is worth noting that price (rather than convenience of location) was cited at the most popular reason for choosing to shop at a particular store.

70. On balance, therefore, the OFT does not believe that it is or may be the case that the merger has resulted, or may be expected to result, in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

71. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.