
Anticipated acquisition by Musgrave Investments plc of J & J Haslett Holdings Limited

The OFT's decision on reference under section 33(1) given on 4 September 2007. Full text of decision published 12 September 2007.

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

PARTIES

1. **Musgrave Investments plc** (Musgrave Investments) is a wholly owned subsidiary of Musgrave Group plc (Musgrave), a wholesale food and grocery distributor in the United Kingdom, the Republic of Ireland and Spain. Musgrave supplies independent grocery retailers in Northern Ireland (members of its SuperValu, Centra and DayToday symbol groups and non-affiliated retailers) and in Great Britain (including members of its Londis and Budgens symbol groups).
2. **J & J Haslett Holdings Limited** (Haslett) is a wholesale food and grocery distributor in Northern Ireland. It supplies independent grocery retailers (members of its Mace, XL Stop & Shop and NearBuy symbol groups and non-affiliated retailers). Haslett's UK turnover for the year ended 31 December 2006 was approximately £191.7 million.

TRANSACTION

3. Musgrave Investments has agreed to purchase the entire issued share capital of Haslett, subject, among other things, to clearance by the relevant competition authorities. The agreed consideration is £[].

4. The parties filed a satisfactory submission on 11 July 2007. The administrative deadline is therefore 6 September 2007.

JURISDICTION

5. As a result of this transaction Musgrave Investments and Haslett will cease to be distinct. The UK turnover of Haslett exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

6. The parties overlap in the wholesale supply of groceries in Northern Ireland, mainly to grocery retailers but also to foodservice customers, such as the catering sector, the on-trade, schools, hospitals and prisons. They do not overlap at the grocery retail level, as neither owns nor operates grocery retail stores in Northern Ireland (except for a small number of stores on a temporary basis). However, as the demand for the parties' wholesale supplies is derived from their customers' sales at the retail level, the OFT considered possible effects of the merger at this level. The OFT also considered the parties' overlap in the purchase of groceries from suppliers.

Product market

Wholesale supply of groceries in the foodservice sector

7. Musgrave operates a delivered wholesale service of groceries to foodservice customers. It also sells to foodservice customers from its cash and carry outlets. Haslett has only a small presence in the foodservice sector, as in 2004 it sold its delivered catering business to Henderson, another grocery wholesaler in Northern Ireland. Haslett's wholesale supply to foodservice customers is now limited to sales from its cash & carry outlets and some delivered sales to foodservice customers.
8. It is not necessary for the OFT to determine the relevant product frame of reference in relation to wholesale sales of groceries to foodservice

customers, because, as set out below, the merger does not raise competition concerns regarding these sales.

Wholesale supply of groceries to grocery retailers

9. Both parties sell groceries to grocery retailers through delivered and cash & carry wholesale. They also both offer symbol group arrangements to grocery retailers, including promotional support, training and stock control. Retailers that are symbol group members trade under the same store name, such as Centra (Musgrave) or Mace (Haslett), but remain independent.
10. The parties submitted that they face competitive pressure not only from other grocery wholesalers, but also from the retail sale of groceries by vertically integrated retailers such as Tesco, Asda and Sainsbury's, which are all active in Northern Ireland. According to the parties, competition at the retail level between the parties' customers and these retail multiples constrains the level of wholesale prices the parties can set, and therefore the supplies of groceries by these retail multiples to their own retail stores should be included in the relevant product market.
11. The OFT considered whether those retailers supplied by the parties could, in the presence of a five to 10 per cent price increase, switch to vertically integrated retail multiples as their suppliers. However, those retail multiples that responded to the OFT confirmed that they did not supply groceries on a wholesale basis to retailers. Also, vertically integrated retail multiples were not considered as potential suppliers by the customers of grocery wholesalers that responded to the OFT. Therefore, the OFT does not consider that the intra-group supply of groceries by these retail multiples forms part of the product frame of reference. The competitive constraint posed by the retail multiples is considered in the analysis of horizontal issues below (paragraphs 30 to 32).
12. The parties submitted that the product market should be the wholesale supply of groceries to grocery retailers and should not be segmented between delivered wholesale and cash and carry wholesale. In a previous decision, the OFT did not draw a distinction between delivered and cash and carry wholesale, noting a limited price differential, high price-sensitivity

of customers and likely customer switching in the event of a price rise.¹ The parties argued that these factors also apply in this case and that the service provided to retailers by delivered and cash and carry wholesalers is essentially the same. For example, delivered wholesalers generally offer same day or next day deliveries, making them suitable for urgent requirements as well as regular drops, and an estimated 15 to 20 per cent of customers in Haslett's cash and carry outlets request delivery. Also, both delivered wholesalers and cash and carry wholesalers offer symbol group arrangements (for example, the XL Stop & Shop brand of Haslett and the Premier brand of Booker, a cash and carry wholesaler in Great Britain).

13. Third party comments indicate that many customers of delivered wholesalers in Northern Ireland do not generally consider delivered and cash and carry wholesale to be close substitutes, mainly due to the more limited range of products available from cash and carry wholesalers. Customers rather use cash and carry outlets as a complementary source of supply over and above those received through their delivered wholesaler. However, some customers said they would probably switch to a cash and carry wholesaler if their delivered wholesaler increased its prices by five to 10 per cent.
14. The parties also submitted that there is significant supply-side substitutability between delivered wholesaling and cash and carry wholesaling. Wholesalers of one type could use their existing warehouse to start wholesale operations of the other type with relatively few changes. The parties referred to the fact that Holmes Wholesale, a Haslett division, operates both its cash & carry and delivered wholesale operations from the same sites.
15. In view of the factors above, the OFT considers that delivered wholesale and cash and carry wholesale combined form the appropriate product frame of reference in this case.

¹ OFT merger decision on the completed acquisition by Bestway (Holdings) Limited of Batleys Limited, 19 May 2005, paragraph 10.

Purchasing and retail supply of groceries

16. As the merger does not raise competition concerns in relation to the purchasing and retail supply of groceries, as discussed below, it is not necessary further to consider the relevant product frame of reference.

Geographic market

Wholesale supply of groceries in the foodservice sector

17. It is not necessary for the OFT to determine the relevant geographic frame of reference in relation to wholesale sales of groceries to foodservice customers, because, as set out below, the merger does not raise competition concerns in Northern Ireland, the narrowest possible frame of reference.

Wholesale supply of groceries to grocery retailers

18. The parties submitted that the wholesale supply of groceries to grocery retailers should be considered on a national (UK) level. They argued that there is considerable similarity of competitive conditions between Northern Ireland and the rest of the UK, including the presence of major UK supermarkets throughout Northern Ireland and the similarity in convenience store brands. They also referred to the fact that they obtain large quantities of products from Great Britain (over 50 per cent in the case of Musgrave) and the fact that Nisa and Costcutter (whose warehousing, distribution and logistics are outsourced to Nisa) import the vast majority of their supplies from Great Britain. Nisa does not have a warehouse in Northern Ireland.
19. The views of third parties on the relevant geographic scope were mixed. Some customers saw Nisa and other wholesalers from Great Britain as viable alternative wholesalers, but other customers were more cautious about the scope to operate effectively with a wholesale supplier from outside Northern Ireland. In addition, in view of Northern Ireland's geographic separation from Great Britain there is some potential for regional variation in wholesale supply conditions. There is, for example, a significant difference in the identities of the leading grocery wholesalers between Northern Ireland and Great Britain.

20. In view of these factors, the OFT adopted a cautious approach and carried out the competition assessment with respect to both Northern Ireland and the UK. Given the lack of competition concerns on both geographic frames of reference, it is not necessary to conclude on the relevant geographic frame of reference in relation to the wholesale supply of groceries to grocery retailers.

Purchasing and retail supply of groceries

21. It is not necessary for the OFT to determine the relevant geographic frame of reference in relation to the retail supply of groceries and purchasing of groceries, because, as set out below, the merger does not raise competition concerns on any possible geographic frame of reference.

HORIZONTAL ISSUES

Market shares

Wholesale supply of groceries in the foodservice sector

22. Musgrave's sales to the foodservice sector in Northern Ireland were around £[]. Haslett's sales were around £[] (excluding sale of tobacco and alcohol). The parties estimated that Haslett's sales represent less than three per cent of total sales to the foodservice sector in Northern Ireland. The parties indicated that there are a number of competitors to the parties that are around the same size, such as Lynas Frozen Foods (around £[] sales to foodservice customers in Northern Ireland), Henderson (also around £[] sales), O'Kanes (around £[] sales), as well as other delivered and cash & carry wholesalers. In view of the presence of significant competing suppliers and the small increment to Musgrave's sales post-merger, the merger does not raise competition concerns in relation to the wholesale supply of groceries in the foodservice sector.

Wholesale supply of groceries to grocery retailers

23. On a UK-wide frame of reference, the parties estimated that their combined share of the wholesale supply of groceries to grocery retailers amounts to at most [5-10] per cent, with an increment due to the merger of [0-5] per cent. Given this share and the presence of several large competing wholesalers, such as Palmer & Harvey McLane, Booker and Bestway, the merger does not raise competition concerns at a national level.
24. In Northern Ireland, after the merger the parties will become the largest grocery wholesaler. The parties estimated that their combined share of supply in Northern Ireland is [35-40] per cent (Musgrave with [20-25] per cent and Haslett with [10-15] per cent). The parties' largest wholesale competitor is Henderson, whose share was estimated at [20-30] per cent. The parties estimated the shares of the two other main wholesalers, Nisa and Costcutter (which are linked, as noted in paragraph 18), to be [5-15] per cent and [5-15] per cent respectively. Makro, a cash and carry wholesaler, was estimated to have a [0-10] per cent share. The other wholesalers were all estimated to have shares below [0-10] per cent.
25. The parties argued that they are not each other's closest competitors. In support, they provided evidence that recent switching by customers between wholesalers was rarely between the parties. The evidence from retailers that the OFT spoke to was mixed in this respect. While some saw Musgrave and Haslett as close competitors, others commented that Musgrave's closest competitor was Henderson.
26. Grocery wholesalers do not compete only on price, but also on their symbol group arrangements. Membership of a symbol group entails a significant degree of support from the wholesaler, including promotional support, training and stock control. For example, one grocery retailer that the OFT spoke to, switched wholesalers due to the superior support offered by another wholesaler. In Northern Ireland, all the main wholesalers, including the parties' competitors, offer symbol group membership, under the following brands:
 - Musgrave: SuperValu, Centra and DayToday
 - Haslett: Mace, XL Stop & Shop and Nearbuy
 - Henderson: Spar, VG and Vivo

- Costcutter: Costcutter, and
- Nisa: Nisa.

27. The evidence on retailers' ability to switch wholesalers is mixed. The parties submitted that their SuperValu/Centra and Mace symbol group retailers sign [] contracts with a duration []. The contracts often include obligations or incentives for retailers to purchase most or all of their supplies from their main wholesaler. Some retailers with a contract with Haslett can terminate their contract []. In some cases, Musgrave or Haslett provide financial support to retailers as part of their symbol group membership. When a retailer terminates its contract, it must normally repay this support, although such repayment obligations may be met by the retailer's new wholesaler. Also, in some of Musgrave's contracts []. Some of these contractual arrangements create barriers to switching between wholesalers.
28. Musgrave and Haslett normally have no formal contracts with their DayToday and XL Stop & Shop retailers. This also applies to unaffiliated retailers who buy from Musgrave and Haslett's cash and carry operations. Hence, for these retailers there are fewer barriers to switching. They are also not obliged or incentivised to purchase supplies from Musgrave and Haslett and can hence easily reduce the proportion of supplies sourced from these wholesalers.
29. Responses from retailers show that many retailers do not see switching as difficult. Although a few retailers expressed concerns about the reduction in the number of grocery wholesalers in Northern Ireland as a result of the merger, most retailers felt that sufficient alternative wholesalers would still be available. Retailers also said that other wholesalers are actively targeting retailers to encourage them to switch and join their symbol groups. The parties argued that in practice switching does occur. For example, in 2006 three Centra stores (owned by one individual) switched from Musgrave to Henderson and three Mace stores switched from Haslett to Nisa and Henderson. Similarly, some stores switched from other wholesalers to Musgrave and Haslett.
30. The parties have placed great significance on the constraint on their conduct from vertically integrated multiple retailers such as Tesco,

Sainsbury's and Asda. Most retailers contacted by the OFT also felt that the biggest competitive threat to them came from these multiples.

31. The parties have provided evidence of the influence of the multiples' retail pricing on their wholesale prices. For example, Musgrave sets recommended retail prices (RRPs) for its SuperValu and Centra retailers [].² Musgrave regularly monitors the retail prices of these multiple retailers and revises its own RRP's to reflect any price initiatives by these retailers. Musgrave's RRP's are one of the factors that determine Musgrave's wholesale prices, as Musgrave wants to ensure a satisfactory retail margin and hence the economic viability of its retail customers. Accordingly, Musgrave generally varies its wholesale prices in accordance with changes in its RRP's. Similarly, Haslett adjusts its wholesale prices in response to retail price changes by the multiple retailers, albeit on what appears to be a more short-term basis.

32. The OFT considers that it is plausible that the competitive constraint from the multiple retailers restricts wholesalers' ability to increase their prices.³ A wholesale price increase would result in the wholesaler's retail customers either increasing their retail prices, with the risk of losing sales due to an increased price differential with the multiple retailers, or reducing their margins. In both cases there is a risk that the wholesaler's retail customer goes out of business, which is not in the wholesaler's interest. This also applies to wholesalers' ability to reduce the quality of their service.

² [].

³ This was also noted by the Competition Commission in the course of its groceries inquiry (Emerging Thinking report, 23 January 2007, paragraph 114).

Retail supply of groceries

33. A wholesaler's sales volume depends on its customers' sales at the retail level. Therefore, in principle it is possible that the merger will affect Musgrave's and Haslett's competitive incentives if there are local areas where there are only limited alternatives to their retail customers. The OFT considered this in a previous decision regarding the purchase by Musgrave of Londis (Holdings) Ltd, a grocery wholesaler in Great Britain.⁴ In that case, it was relevant that Musgrave owned and operated the majority of the Budgens chain of retail grocery stores in Great Britain. For local areas with few alternatives to Budgens and Londis retailers, the OFT considered a strategy to increase retail prices in Budgens stores with the expectation that some of the profits lost through reduced retail volumes would be recouped from increased wholesale sales to Londis stores, and a strategy to increase wholesale prices to Londis stores with the expectation of displaced retail sales being won by Budgens stores. The OFT concluded in that case that the prospects of such a strategy being profitable were very low.
34. In the current case, the parties do not to any material extent own or operate retail grocery stores. Their customers, including their symbol group customers, are independently-owned and operated and the parties have no control over their retail prices. The parties also submitted that it is not Musgrave's practice to vary wholesale prices on a localised basis (except possibly where a customer is under local competitive pressure, when wholesale prices would remain unchanged but []). Taking also into account the competitive assessment at the wholesale level with respect to the availability of alternative wholesalers, switching and the competitive constraint from multiple grocery retailers, the OFT considers that there is very limited scope for the parties profitably to raise wholesale prices in local areas with limited retail competition.

⁴ OFT merger decision on the completed acquisition by Musgrave Investments plc of Londis (Holdings) Limited, 30 September 2004.

Purchasing of groceries

35. Using the share of grocery sales to retailers (including intra-group sales by vertically integrated multiple retailers) as a proxy for share of grocery purchasing, the parties have a combined share of [0-5] per cent in the UK and [15-20] per cent (with an increment of [5-10] per cent) in Northern Ireland. The OFT did not receive any comments from grocery suppliers during its investigation. Accordingly, the merger does not raise competition concerns in relation to the purchasing of groceries.

Barriers to entry and expansion

36. The parties submitted that there are barriers to entry at the wholesale level, such as the need to establish a delivery infrastructure and relationships with suppliers and customers, but that these are not insurmountable. Barriers to expansion for wholesalers already active in Northern Ireland are likely to be low given the nature of their business.
37. Barriers to entry to grocery wholesalers currently active in Great Britain are likely to be lower, as they already have knowledge of the business, relationships with suppliers and often also an established symbol group. To deliver groceries in Northern Ireland on a wholesale basis does not require a depot in Northern Ireland, as is shown by Nisa's lack of warehousing facilities. A number of retailers also confirmed to the OFT that they would consider buying from a wholesaler that is based in Great Britain.
38. The parties noted that new entry by wholesalers has been limited in the past five years, but attributed this to intense competition at the wholesale level and increasing competition from the vertically integrated multiple retailers. They submitted that if the current wholesale offer in Northern Ireland were to deteriorate, this would most likely attract new entrants. The parties point as an example to recent entry in Northern Ireland by Palmer & Harvey McLane, a major wholesaler in Great Britain, which has established its own symbol (Your Store) in Northern Ireland in the last two years.

Buyer power

39. As individual retailers do not generally account for a significant proportion of the parties' sales, it is unlikely that any of them has significant buyer power. However, most retailers will continue to have the ability to switch to a different wholesaler after the merger.

VERTICAL ISSUES

40. The merger does not create new vertical ownership links and hence raises no vertical issues.

THIRD PARTY VIEWS

41. The OFT contacted the parties' main competitors and a significant number of retailers in Northern Ireland, both customers of the parties and customers of other wholesalers. The views from the parties' competitors were mixed. Some retail customers of Haslett were concerned about the merger and the resulting uncertainty for them, but no other retailers were concerned. Third party views are discussed in more detail above.

ASSESSMENT

42. The main overlap in the parties' activities is in the wholesale supply of groceries to grocery retailers. On a national level, the parties' position does not give rise to competition concerns given the parties' small share of supply and the presence of several large competing wholesalers. In Northern Ireland, the parties will be the largest grocery wholesaler. However, they will still face significant competitive constraints. A number of alternative wholesalers will remain in Northern Ireland, the largest of which, Henderson, is not much smaller than the parties in share of supply. Although for some of the parties' customers switching to a different wholesaler is likely to be difficult in the short term, for other customers the barriers to switching are not insurmountable. This was confirmed by retailers' comments to the OFT. Also, the parties are constrained by competition at the retail level between their customers and vertically integrated multiple grocery retailers such as Tesco, Sainsbury's and Asda. There is potential for entry and expansion for grocery wholesalers in

Northern Ireland, including by wholesalers that are currently only active in Great Britain.

43. The OFT did not find that the merger raises significant competition concerns in relation to the parties' purchase of groceries and their supply of groceries to foodservice customers, nor in relation to grocery retailing.
44. Third parties expressed relatively few concerns about the merger.
45. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

46. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.