

Anticipated acquisition by Tesco Stores Limited of former BP/Safeway petrol forecourts and stores from Wm Morrison Supermarkets plc

The OFT's decision on reference under section 33 (1) given on 24 October 2005. Full text of decision published 16 November 2005.

Please note square brackets indicate information excised or replaced by a range at the request of the merging parties or third parties for reasons of commercial confidentiality

PARTIES

1. **Tesco plc** (Tesco) is the UK's largest grocery retailer. Tesco operates a variety of store formats, each of which is active, to some extent at least, in convenience retailing.
2. **Wm Morrison Supermarkets plc** (Morrisons) is the fourth largest grocery retailer in the UK, following its acquisition of Safeway in 2004. Safeway and BP previously jointly operated a number of properties on which both petrol filling stations and forecourt grocery stores were located. On the dissolution of this partnership, 30 sites were transferred to Safeway and BP retained 31 sites.

TRANSACTION

3. On 31 August 2005, Tesco made an offer to acquire up to 30 former BP/Safeway petrol stations from Morrisons. On 23 September 2005, BP chose to exercise its pre-emptive rights in respect of nine of these sites. Therefore, the total number of sites being acquired by Tesco (the Acquired Sites) was reduced to 21. The annual turnover for the Acquired Sites was approximately £[] million for the 2004/05 financial year.
4. The extended statutory deadline is 24 October 2005.

JURISDICTION

5. As a result of this transaction Tesco and the Acquired Sites will cease to be distinct. The UK turnover of the Acquired Sites 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 a relevant merger situation will be created.

RELEVANT MARKET

6. The parties overlap in grocery retailing, principally in the convenience grocery sector, and fuel retailing.

Grocery retailing

PRODUCT MARKET

7. In recent years the grocery retailing sector has been examined on a number of occasions by both the Competition Commission (CC) and the OFT.¹ No new evidence emerged in the course of this investigation that was sufficiently material to justify departing from the approach developed in previous cases.
8. Grocery retailers cater for a complex range of grocery shopping needs. The range of types of grocery shopping acknowledged in previous cases includes:
 - convenience shopping, where a few emergency or impulse items are purchased, usually for consumption within two hours of purchase²
 - secondary or top-up shopping, where a top-up of regular purchases is made, and
 - one-stop shopping, which can include a major replenishment of supplies.

To analyse the competitive constraints on an individual grocery store, one must therefore identify the types of shopping undertaken in that store.

9. Small stores (ie, those generally below 3,000 square feet) can only carry a limited range of products. Because of this, they predominantly meet customers' needs for

¹ For example, see the CC's Supermarket Report (2000, Cmnd 4842), the CC's report on the proposed acquisition of 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 (the Safeway Report) (2003, Cmnd 5950), the Deputy Director-General of Fair Trading's advice on 9 December 2002 on the proposed acquisition by Tesco plc of T&S Stores Limited (Tesco/T&S), the OFT's decision of 5 March 2004 on the anticipated acquisition by Tesco plc of 45 stores from Adminstore (Tesco/Adminstore) and the OFT's decision of 26 October 2004 on the completed acquisition by J Sainsburys plc of Jackson Stores Ltd (Sainsburys/Jacksons).

convenience shopping. However, convenience shopping is undertaken by customers in a wide range of retail outlets including mid-range³ and large stores.⁴ Evidence from the CC's Safeway Report and our own investigations indicates that mid-range and large stores represent a competitive constraint on small stores for convenience shopping.

10. Many of the responses received from third parties in this case have commented on the impact of the acquisition on the supply of all groceries, and not just convenience shopping done in any kind of outlet. However, the OFT continue to consider that an asymmetry exists between the ability of a large store to compete with a smaller store and the ability of these smaller stores to compete with a large store, an observation that was also made by the CC in its investigation into the Somerfield/Morrison inquiry.⁵ This asymmetry arises in part because whilst large stores can change their lines to compete more aggressively with smaller stores, this is not the case in reverse. It is worth noting that, the substantive analysis in this case would not differ even if the focus of our store analysis were to be the supply of all groceries.
11. All of the petrol forecourts stores being acquired in this instance are below 3,000 square feet. Therefore, as in previous cases, the appropriate product frame of reference for considering the competitive constraints in this case is convenience shopping, including secondary shopping undertaken in mid-range and large stores, but excluding smaller specialist shops that do not meet the Mintel/IGD criteria.

Geographic market

12. There are both national and local elements to competition among grocery retailers. Tesco and other major grocery retailers undertake much of their procurement and set many of their competitive strategies (eg core product ranges, some or all prices, branding and advertising) at national level. At a local level, however, stores appear to tailor their offerings in response to demographic and other factors in a number of ways, including local variations in opening hours, ranges, or promotional offers. The scope of local competition in types of grocery retailing depends, to some extent, on the distance consumers are able or willing to travel to shop for groceries, which depends to a degree on the type of shopping trip to be undertaken (which in part is related to the size of store in question).

² See Safeway Report, para 2.44.

³ Generally defined as stores between 3,000 square feet (280 square metres) and 15,000 square feet (1,400 square metres), although the CC recognised that stores closer to 15,000 square feet were likely to compete with large stores, and stores closer to 3,000 with convenience stores – see para 5.344 of the Safeway Report.

⁴ Defined as stores above 15,000 square feet (1,400 metres) in size.

⁵ Para 6.35-6.36.

13. The evidence in previous cases indicates that, in general, the catchment area for a small store is up to one mile from the store.⁶ The OFT has received no evidence during its investigation to justify departing from this approach.

Petrol retailing

Product market

14. The majority of fuel retailers sell two types of fuel: unleaded petrol and diesel. On the demand side, these two products are not substitutes as cars designed to run on diesel cannot take petrol and vice versa. On the supply side, however, retailers are able to switch easily between selling diesel and petrol since the equipment required for retailing each product is the same. This is consistent with the OFT's 1998 report on petrol retailing which concluded that the unleaded, leaded and diesel should be considered to be in the same market.⁷ Third parties contacted during the investigation also supported this conclusion, but noted that leaded fuel now only makes up a very small proportion of fuel sales.
15. In light of the above, the relevant product frame of reference for assessing this merger is considered to be the retail supply of fuel.

Geographic market

16. In its report on the supply of petrol in the UK, the OFT commented that individual retailers operate in local markets, with most sites monitoring competitor prices within a fairly limited radius. It was also put forward that a chain of substitution may exist between these small local overlaps to form larger regional markets, or possibly a UK wide market. However, the possibility of a UK wide market was considered unlikely given the considerable price variations between local areas, suggesting that the chain of substitution was imperfect. Therefore, at its widest the supply of fuel retailing may be regional.⁸
17. At the regional level, it is unclear the extent to which local markets overlap without breaks to form regional markets. It is clear, however, that an important competitive dynamic exists between petrol retailers at the local level, for example:
- a. Tesco monitors the prices of other petrol retailers [] of its own filling stations⁹

⁶ However, as observed in the Tesco/Adminstore case, a half mile radius may be more appropriate in densely populated areas.

⁷ *Competition in the supply of petrol in the UK*, May 1998 (OFT230)

⁸ Nonetheless, national shares of supply may still be considered important when examining upstream buyer power.

⁹ Within the M25 Tesco monitors sites [] of its sites, however, no sites acquired in this acquisition lie within the M25.

- b. petrol retailers contacted during the investigation all indicated that they look at the price of other retailers within the local vicinity when setting their own prices, typically on a one to two mile radius in urban areas, but as wide as 20 to 30 miles in rural areas
 - c. in 1995, Esso launched a local price monitoring and marketing initiative which sought to ensure that prices charged at its petrol stations matched the lowest being offered by supermarkets within three miles of its site, and by roadside sites within one mile, and
 - d. the CC commented in its Safeway Report that fuel prices are not as competitive in areas where only a few petrol retailers exist.¹⁰
18. Therefore, for the purposes of this case, the impact on fuel retailing will be considered at the local level, focusing on areas where a Tesco fuel retail site is within a three mile radius of one of the Acquired Sites.

HORIZONTAL ISSUES

Grocery retailing

National competition

19. Tesco estimated that, post-merger, it would have a combined UK share of supply of [0-10] per cent (increment [less than 1] per cent) by sales of secondary shopping (including convenience shopping)¹¹ (see note 1).
20. At the national level, concerns have been raised by third parties regarding Tesco's increasingly substantial position and estimated that Tesco currently accounted for [25-30] per cent¹² of national grocery retailing (see note 2). However, the increment arising from this merger in respect of grocery retailing is extremely small. Concerns were also raised with respect to Tesco's significant land bank, i.e. the number of undeveloped, but potential grocery retailing sites, currently owned by Tesco. It was submitted that these undeveloped sites should be taken into account when examining Tesco's market power. The OFT is of the view that, whilst it may be the case that this reduces entry barriers for Tesco in the areas where it holds undeveloped land, these sites are as yet not active in the grocery retail segment. It would therefore not be appropriate to attribute a share of supply to Tesco for these undeveloped sites, as suggested by third parties.
21. Overall, the increment from this transaction to Tesco's national share of supply (whether considering convenience shopping separately or grocery retailing as a

¹⁰ Para 2.50.

¹¹ []

¹² Based on TNS till roll data.

whole) is very low and, therefore, the merger does not give rise to concerns at a national level.

Local competition

22. In the Safeway Report the CC identified that potential competition concerns arise in local areas where, post-merger, there will be two or fewer fascia competing with the merged parties (i.e. a four to three or less). There are 11 local areas where an Acquired Site overlaps with a Tesco store (of any size) on a one mile radius. Local overlap analysis provided by the parties demonstrated that:
 - a. in two overlap areas there will be no reduction in fascia as a Morrisons store will remain post-merger
 - b. there are two overlap areas where there will be three competing fascia post-merger
 - c. there are four overlap areas where there will be a reduction in the number of competing fascia from five to four, and
 - d. for the final three overlap areas more than five competing fascia will remain post-merger.
23. On the basis that any potential competition concerns are most likely to arise in more concentrated areas with three or fewer competing fascia, the two overlap areas at (b) above (Chippenham and St Helens) could give rise to prima facie competition concerns.
24. It is important to note that when calculating the reduction in fascia, Tesco concentrated on fascia only with national, regional or sub-regional presence. Co-operatives, multiples, symbol groups, franchises and petrol filling stations were therefore included. To the extent that other small stores exist but do not fall under these criteria, it may be the case that the changes in fascia numbers above overestimate the impact of the merger in local areas.
25. One third party raised concerns regarding local overlaps in the Kings Lynn and Middlesborough (Marton) areas. In respect of Kings Lynn, it submitted that, on the basis of their own local analysis, the merger would result in a reduction in small store fascia from two to one (or three to two, if a local independent small store was included in the analysis). It further submitted that the Middlesborough (Marton) store was greater than 3,000 square feet and should be assessed as a mid-range store. On this basis, it argued that the merger would give rise to a reduction in fascia from two to one for mid-range stores.

26. In relation to Kings Lynn, evidence submitted to the OFT by Tesco and a third party competitor indicated that there will be at least 3-4 competing fascia post-merger, in addition to the parties, located within the one mile radius. Given this, the reduction in fascia for Kings Lynn does not give rise to prima facie competition concerns. With respect to Middlesborough, evidence supplied by Tesco confirms that the store is below 3,000 square feet. It therefore meets the definition of a convenience store as identified by IGD and should be assessed as a small store rather than a mid-range store. Examining the overlap in the context of convenience shopping, the merger does not give rise to prima facie competition concerns as it results in a reduction in fascia from five to four.
27. One third party suggested that there were six (unspecified) sites where the provisional fascia count would suggest a diversion ratio in excess of the required 14.3 per cent used by the CC to support a substantial lessening of competition finding.¹³ However, no consumer survey evidence or documentation was received in support of this concern and hence it was not possible to assess why the complainant viewed the six stores as being problematic on this approach.
28. Another third party submitted that analysis by number of competing fascia is an imperfect way of measuring loss of competition and supplied rough shares of supply based on retail sales space within a one mile radius. In a few local areas the shares are surprisingly high, although the increments are low. We have serious reservations about the basis on which these shares have been calculated. First, these figures include all types of grocery retailing including one-stop shopping.¹⁴ As some of the sales from this retail floor space will be related to neither convenience retailing nor populations within a mile radius of an Acquired Site, these figures overstate Tesco's share of convenience retailing to a significant degree. Further, the accuracy of this share data is highly questionable as it is based on certain arbitrary assumptions about the sizes of the stores for which the third party had no data (which was the vast majority of stores in some areas). For these reasons, and the lack of evidence that this approach is more appropriate than the OFT's previous approach to convenience shopping cases, we are not persuaded that the floor space figures provided to us are an accurate measure of the competitive effect of this merger in local areas.

¹³ This would appear to be a reference to the CC stage 2 analysis in the Somerfield/Morrisons inquiry which is currently on appeal to the CAT. In that case, having identified potential competition concerns in local areas on the basis of fascia reduction the CC sought to measure the degree to which Somerfield and Morrisons had been rivals prior to the merger on the basis of diversion ratios.

¹⁴ It may also include non-grocery sales from some stores.

Barriers to entry and expansion

29. Previous investigations by the OFT have concluded that, while there might be differences between different geographic locations, in general, barriers to entry for small stores are not substantial at present.
30. We invited third parties to comment specifically on any entry experience that they have had within the two areas in which prima facie competition concerns could arise (Chippenham and St Helens) and also within the areas which give rise to a five to four reduction in fascia. No third parties have been able to supply any evidence on this.
31. Some third parties have submitted that the convenience sector is becoming increasingly difficult to enter for individual independent retailers, mainly due to the disparity of buying terms between grocery retailers and high rental costs (which some have asserted are a result of the multiples' willingness to pay well above the normal rate). However, third parties were unable to provide specific examples of where this had occurred or other persuasive evidence to support their assertions. Indeed a report submitted by one third party which examined the impact of supermarket expansion into the convenience sector concluded that there was no evidence to suggest that any of the supermarkets are pursuing a deliberate strategy of raising site prices to the exclusion of small players. In particular, it notes that the trend in higher prices reflects other factors including the sharp rise in property prices in general.¹⁵
32. The CC's recent report on Somerfield/Morrisons did, however, conclude that the barriers to entry into the convenience retailing sector in one specific area (Filey) were not sufficiently low that it could be confident that the prospect of potential new entry would be enough to address any competition concerns. In particular, there was limited retail space available in the local area for conversion to a new small store within a reasonable time frame. For the reasons given below, similar concerns regarding barriers to entry do not arise in this case.
33. Tesco has submitted that within both Chippenham and St Helens there are vacant retail properties to let which would be capable of conversion. The OFT has no evidence to suggest that this is not true.
34. In addition there appears to be a high churn rate on premises in the relevant areas. Churn data provided by Tesco for the nearest town centre locations in Chippenham¹⁶ and St Helens¹⁷ indicate a 'churn' of 16 per cent and 10 per cent

¹⁵ Europe Economics, *Impact of Supermarket Expansion in the Convenience Retailing Sector*, May 2005.

¹⁶ Between June 2002 and May 2005.

¹⁷ Between July 2002 and July 2004.

on all properties respectively, and a 'churn' of 27.8 per cent and 12.5 per cent on food-only stores respectively.

35. Furthermore competing small store fascia would not necessarily need to be large to compete with these stores: the average basket sizes for St Helens and Chippenham are £[] and £[]. This compares to a Tesco Express basket average of £[] and Tesco one-stop basket average of £[].
36. The population levels of St Helens and Chippenham are considerably higher than the population of Filey and both stores are located on major A roads. This may suggest that the local population or catchment area is large enough to support further entry.
37. It therefore appears that barriers to entry into convenience retailing are not substantial in Chippenham and St Helens and are sufficiently low to offset any prima facie competition concerns.

Conclusion on local competition concerns in grocery retailing

38. Although the OFT identified two overlap areas that may give rise to prima facie competition concerns, there are a number of reasons why these concerns are not sustainable on closer analysis. In both cases there will remain at least three competing fascia in the overlap areas. There may in fact be more competing fascia in the overlap areas as only stores with a national, regional or sub-regional presence were taken into account. Furthermore, irrespective of the actual number of competing fascia in the overlap areas, barriers to entry in the overlap areas are sufficiently low, such that competition concerns in regard of the two overlap areas do not arise.

Upstream buyer power

39. The issue of upstream buyer power, particularly negotiating strength, was considered at some length in the Safeway Report. A number of third party respondents to this case have raised concerns about this issue, although only one of these is a grocery supplier. Given the extremely low national increment this acquisition is unlikely to have any material impact on Tesco's negotiating strength and we have no evidence to suggest that it will lead to any rationalisation of suppliers.
40. One third party alluded to the possibility of 'waterbed' effects arising from this merger, i.e. as suppliers would expect lower prices from the merged entity, they would attempt to obtain higher prices from other grocery retailers. We have however received no evidence to support the assertion that suppliers could increase prices to other retailers. In any event, the size of the increment to

Tesco's purchasing volumes is so small that vertical competitive concerns as a result of the merger are not judged to be credible.

Petrol retailing

Market shares

41. Tesco supplied maps detailing the location of competing petrol retailers within a three mile radius of each Acquired Site. As a result, 15 areas were identified where a Tesco petrol forecourt overlapped with an Acquired Site. In all cases at a minimum eight alternative fascia will remain within the three mile radius post-merger and in most cases there exist an even larger number of alternative petrol retailers.¹⁸
42. Previous preliminary analysis by the OFT into petrol retailing suggested that the strongest competitors in fuel retailing are supermarkets and that these operators on average charge lower fuel prices than traditional forecourts. Therefore, the OFT has considered whether this merger could result in a reduction in the intensity of competition due to the removal of a supermarket petrol retailer in the local areas identified. In this case, three sites were identified where the merger would remove the only other supermarket petrol competition, namely Exmouth, Kings Lynn and Sale.
43. It is first worth noting, that until the dissolution of the BP/Safeway JV earlier this year, BP was responsible for setting petrol prices at all of the sites concerned. In the interim, Morrisons took control of price setting at each of the Acquired Sites, however, it has been submitted that the stations have continued to be BP branded and have not benefited from the use of Morrisons loyalty cards. In this respect, the additional constraint provided by a supermarket operated site preceding the merger may have been limited. Nevertheless, the OFT has examined the relationship between prices charged at the Acquired Sites and Tesco's sites in the overlapping areas and the number of supermarket competitors. This analysis appeared to suggest that the competitive interaction between Tesco and the Acquired Sites is not particularly strong. Furthermore, no third party raised specific concerns about the loss of supermarket competition in fuel supply in this case.
44. A concern was raised by one third party that the supermarkets were driving independents out of the market by selling petrol as a loss leader, particularly where money-off coupons are used. It was claimed that the exit of independent retailers would cause competition in fuel retailing to diminish over the longer term. Whilst smaller independents may find the competitive environment tough as they

¹⁸ For 11 of the 15 overlap sites more than 20 competing petrol retail fascia remain within the three mile radius.

are generally unable to match the economies of scale of the major retailers and supermarkets, a significant number of large national retailers will continue to exist post-merger. Furthermore, in all of the areas affected by this transaction at least one major fuel retailer or supermarket retailer will remain post-merger.

Barriers to entry and expansion

45. The OFT's 1998 report into petrol retailing concluded that at that time entry into the retail supply of fuel was particularly unattractive given low margins on fuel sales, the costs of complying with environmental legislation and difficulties in obtaining planning permission for greenfield sites.
46. Third parties have commented in this case that, if anything, barriers to entry are higher today than in 1998. In particular, responses consistently commented on the historically low margins and the fact that the market is characterized by consolidation and exit rather than entry. There is no evidence of entry in recent years.
47. Although it does not appear necessary to conclude on the extent to which barriers to entry are high or not in this case, responses received from third parties suggest that entry into petrol retailing cannot be relied upon as a countervailing factor in this case.

Buyer power

48. Post acquisition Tesco will have a relatively small national share of supply in petrol retailing and given the very small increment in this case the acquisition is not expected to have any impact on negotiating strength. During this investigation the OFT contacted Tesco's largest fuel suppliers. None raised concerns about the impact of the acquisition on upstream buyer power.

THIRD PARTY VIEWS

49. A number of third parties expressed concerns about this merger. However, many of these concerns do not relate specifically to this merger, but more to Tesco's existing size. The main concerns raised by third parties are addressed above.

ASSESSMENT

Grocery retailing

50. The analysis in this case has focused on convenience retailing, both in convenience stores and supermarkets (of any size), although the impact on the total grocery industry has also been examined. On a national basis the merger creates combined shares of supply for (i) grocery retailing of [25-30] per cent for

Great Britain (with a very small increment) (see note 2); and (ii) [0-10] per cent (increment [less than 1] per cent) of secondary shopping by value in the UK. On any basis the increment arising from the merger is very small.

51. There are two local areas, Chippenham and St Helens where, as a result of the merger, there will be three competing fascia.¹⁹ There may in fact be more competing fascia in the overlap areas as only stores with a national, regional or sub-regional presence were taken into account. Furthermore, irrespective of the actual number of competing fascia in the overlap areas, barriers to entry in the overlap areas are sufficiently low, such that competition concerns in regard of the two overlap areas do not arise.
52. The acquisition will lead to only a very small increment to Tesco's upstream buyer power. Although third parties have expressed concerns about Tesco's existing purchasing power, this acquisition is not expected to change the current position.

Petrol retailing

53. In fuel retailing, the analysis has focussed on petrol and diesel retailing at the local level²⁰ on the basis of a three mile radius of the target. Post merger at least eight alternative petrol fascia will exist within each affected radius and in all cases, a major retailer or supermarket will remain.
54. Given the limited impact on fuel retail competition it has not been necessary to conclude on barriers to entry in this segment. The impact on upstream buyer power is minimal.

Conclusion

55. On the basis of the evidence set out above, 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

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

¹⁹ It is worth noting that additional fascia do exist in each area but these are not captured by the Tesco approach [] (see note 3).

²⁰ At the national level the increment is very small indeed.

NOTES

- 1 If shares of supply are limited to dedicated convenience retailing, Tesco estimated the parties combined share by number of stores is less than 5 per cent (increment less than 1 per cent) and by sales between 0 - 10 per cent (increment less than 1 per cent).
- 2 As noted earlier, this figure is based on TNS till roll data. Conflicting analysis of TNS data was submitted during the investigation and following the announcement of the decision. Therefore a range has been inserted in this instance. Furthermore, Tesco has submitted that TNS data tends to overstate its share of supply, because it is collected from a panel of members who scan their purchases at home. Tesco considers that purchases from supermarkets are easier to scan (as they are bought together, allowing a single scanning session) whilst many other purchases may not be picked up, resulting in an upward bias of the share of major multiples. Moreover, TNS does not include all retailers in its analysis, thereby overstating the share of those retailers that it does track.
- 3 Tesco believes that these additional fascia could, upon further examination, be identified as effective competitors.