(REDACTED VERSION)

Completed Acquisition by Somerfield Plc of Safeway compact store portfolio from WM Morrison Supermarkets Plc – Issues' Statement Response

Relevant Market(s)

1. Although the fluidity of the retail grocery market is considerable, and customer shopping behaviours are both complex and fickle, we believe it is possible to sustain a general proposition that:-

   1.1 in the main, only stores in excess of a certain size are capable of satisfying one-stop/main trip needs – we believe that size to be 11,000 square feet;

   1.2 in the main, stores below a certain size are predominantly associated with "convenience" (impulse, distress and light "basket") shopping - we believe that size to be no greater than 5,000 square feet;

   1.3 in consequence, there remains a category, residually defined and typically badged "mid-range", operating between, in the main, 5,000 and 11,000 square feet.

2. We accept that the largely homogenous nature of stores above 11,000 square feet (when measured against their capacity to meet one-stop/main trip needs for "groceries" as defined in the Supermarkets' Enquiry in 2000 and adopted again in the Safeway Enquiry three years later) is not replicated in the mid-range and convenience segments. However, acknowledging the desirability of market analysis which delivers certainty, we are of the view that segementalisation of the market by store size remains the most satisfactory manner of proceeding. The Issues' Statement, at paragraph 6 (a), itemises a very considerable number of factors which, it can readily be conceded, will not consistently (and virtually without exception) be exhibited by stores of one particular size whilst not being exhibited by stores of another particular size. So, it would be incorrect to assert that dedicated car parking can only be found in stores in excess of 11,000 square feet; but it would be correct to assert that dedicated parking is found much more frequently at those stores as opposed to smaller stores and, in particular, stores below 5,000 square feet.

3. This being so, the Commission should consider whether or not segmenting the market by store size (assuming the Commission endorses this and irrespective of the pinch-points it selects) should be an absolute rule or, as paragraph 6(c) of the Issues' Statement suggests, should be no more than a presumption rebuttable on the particular facts of any particular store. On balance, and subject to one limited exception (see paragraph 4 below), we favour the absolute rule (not least because a "presumption" basis only will more likely than not result in the regulator being troubled by endless attempts to rebut the presumption) and, consistent with this, we would advocate the abandonment of the so-called "75% rule", when determining which stores, as a matter of size, are capable of competing with those at or above the acknowledged one-stop/main trip threshold size, so long as that threshold becomes 11,000 square feet. If the threshold is to remain 15,000 square feet then, aligned with our judgement as to the capacity of 11,000 square feet stores to meet one-stop/main trip needs, we would expect the "75% rule" to be preserved.

4. Our only reservation arises from our considerable experience (which may exceed that of both the reference parties and any other interested party) of operating sub-11,000 and sub-5,000 square feet stores in relatively remote, population-widespread parts of the country such as the highlands and islands of Scotland and certain of the most rural areas of Wales and the West Country. In these locations, stores may "punch above" their apparent "weight" based on store size in the sense that a sub-5,000 square feet store may well be meeting needs which would more typically be associated with mid-range (and, occasionally, one-stop) elsewhere, and a store between 5,000 and 11,000 square feet may be meeting needs more typically associated with one-stop/main trip. Accordingly, the store-size thresholds may, in these areas, be misleadingly overstated (and, as a direct consequence, the relative isochrones may be unduly contracted) and, therefore, we would invite the Commission to accept very limited exceptions to both store size and isochrone "rules" (of otherwise general application) on a postcode basis to reflect the high degree of rurality of particular parts of the country.

5. We also accept, in broad terms, the asymmetry of the market in competitive terms i.e. that stores within any particular size segment compete (subject to considerations of competitor set discussed below) with stores in their size band and with stores featuring in any and all smaller size bands, without the converse being true. Our experience in the most rural areas of the country (see paragraph 4 above) qualifies this judgement modestly but not to an extent sufficient to undermine the proposition of asymmetry in general terms.

Relevant Geographical Markets

6. The geographic catchment of any store should correspond to that area within which it derives the overwhelming majority of its custom. So far as we are aware (and subject to what we have said in paragraph 4 above), the isochrone modelling adopted by the regulator hitherto (one-stop – 10 minute (urban), 15 minute (rural); mid-range – 5 minute (urban) and 10 minute (rural); convenience – one radial mile) represents a legitimate outcome of such an approach and we would not expect the approach to be invalidated were the Commission to share our view that (i) one-stop/main trip needs are satisfied by stores in excess of 11,000 square feet (so that the 10 minute (urban) and 15 minute (rural) isochrone would apply to them) and (ii) all stores below 5,000 square feet can broadly be characterised as "convenience" (so that the one radial mile isochrone would apply to them).

7. Having defined the catchment of any particular store by identifying, in terms of geography, the source of the overwhelming majority of its custom, we are firmly convinced that prospective competitors to that store, in terms of being considered by the customer as realistic alternatives to the target store on travel time considerations alone, can only be identified by isochrones centred on the customer. Conceding that household centred isochrones are impractical, we would support the notion of isochrones centred on credible concentrations of domestic population and principal workplaces.

8. On balance, we would favour adopting an "edge of isochrone" rule designed to deliver, in respect of convenience and mid-range stores, an effect equivalent to that constructed for one-stop stores at paragraph 5.312 of the Safeway Report.

The Effect on Competition.

9. We refer to our remarks relative to the asymmetry of the competitive dynamics at work in paragraph 5 above.

10. We would not expect any horizontal anti-competitive effects to result from the transaction other than where, at a local level, Somerfield is not effectively constrained by competition.

The Effect on Local Competition

11. **Competitor sets:** We have grave doubts as to whether the competitor set relative to one-stop/ main trip and mid-range is identical (save the participation of Iceland in the latter) as found in the Supermarket Enquiry and confirmed in Safeway.

12. So far as one-stop/main trip is concerned, we believe that our own further participation in the competitor set may be misplaced. **[CONFIDENTIAL]** Our progressive exit from the one-stop/main trip segment has of course been well publicised. Examining a number of criteria in detail underlines this:-

    12.1 **basket size in excess of £30:** tested against Asda and Morrison whose estates are all but exclusively in excess of 15,000 square feet, **[CONFIDENTIAL]** versus 73.3% (Asda) and 69.3% (Morrison). We note that even the Somerfield figure is 34% (see Asda's initial submission in this Enquiry at paragraph 8.1);

    12.2 **percentage of portfolio (by number of stores) in excess of 15,000 square feet:** from IGD sources, we score both Asda and Morrison in excess of 95%, Sainsburys 60-65%, Tesco at approximately 30% and ourselves at 3.1%;

    12.3 **percentage of portfolio square footage comprised by stores in excess of 15,0000 square feet:** from IGD sources, we score Asda and Morrison in excess of 95%, Sainsburys just short of this figure, Tesco at approximately 85% and ourselves at 17.7%;

    12.4 **average store size in square feet:** from IGD sources, we score Asda at 45,090 (excluding George and Asda Living outlets), Morrison at 26, 796, Sainsburys at 22,442, Tesco at 13,598 and ourselves at just under 3,000 square feet – we note that Somerfield would score in excess of 8,000 square feet and Waitrose in excess of 18, 000 square feet;

    12.5 **sales per square foot:** the IGD and Verdict data, to which we have access, provides blended figures for the entire portfolio of each principal retailer. Accordingly, we have measured our own performance in our stores in excess of 15,000 square feet against those IGD/Verdict figures for Asda and Morrison (given the near exclusive 15,000 square feet and above character of their respective portfolios). This approach scores Asda and Morrison at approximately £20 per square foot and **[CONFIDENTIAL]**;

12.6 **average transaction size:** again, for consistency purposes (see paragraph 12.5 above), tested only against Asda and Morrison, we score Asda at £27.95, Morrison at £25.08 (see Asda's initial submission in this Enquiry at paragraph 7.6(v)) and **[CONFIDENTIAL]**.

13. We regard these data as revealing and strongly indicative of the fact that our ability to constrain the major four one-stop/main-trip retailers is, in relative terms, limited – we would not expect to come to a materially different conclusion were 11,000 square feet to be adopted as the one-stop/main-trip threshold. We imagine that data available from Budgens might tell a similar story, whilst that available from Booths, Somerfield and Waitrose we would expect to confirm the view the Commission took both in 2000 and 2003 as to their proper membership of the one-stop competitor set. We are also conscious of the fact that, in the 2000 Enquiry, Tesco (at least) adduced evidence demonstrating that of the order of 60% of customer activity at limited range discount stores was consistent with one-stop shopping and, therefore, we would expect the Commission to revisit the question of whether or not the hard discounters have a place in the one-stop competitor set.

14. In contrast, we are of the view that the competitor set relative to mid-range stores is more extensive than previously supposed. Whilst accepting that shopping behaviour in these stores generally complements that in one-stop stores and, further, that the nature and extent of that complement can vary (as highlighted by Asda at paragraph 7.2 of their initial submission to this Enquiry), we do not subscribe to the proposition that this segment is so heterogeneous that those participating within it do not constrain the competitive activity of one another and, indeed, of "convenience" stores – by way of example we have attached, when responding to a handful of items left open at our meeting with the Commission on 6 May 2005, a table **[CONFIDENTIAL]**

15. Accordingly, we would be confident that the mid-range competitor set can be appropriately enlarged by the inclusion of Aldi, Lidl and Netto (their offer is, after all, analogous to that of Kwik-Save which has consistently been included) and Marks & Spencer (whose offer is not dissimilar to that of Waitrose which has consistently been included). However, we would go further than this to the point where, at a local level, we would expect any store (on our analysis between 5,000 square feet and 11,000 square feet) to be included in the competitor set irrespective of its fascia – if a store of that size has survived the increasing competition and consolidation in grocery retailing of the last decade and, presumably, carries a core range of products broadly similar to that in any one of the established mid-range fascias, (e.g. our own, Booths, Tesco, Morrisons etc), we can see no reason for doubting that it is competing with those fascias and probably competing effectively. This would, most obviously, include the larger format Spar, Costcutter and other symbol group stores as well as genuine independents.

16. **Fascia counting**: at the 6 May 2005 hearing, we explained that, although all methodologies had their imperfections, we believed that a sales-based market share test of lessening competition occasioned by store acquisitions would, by and large, serve competitive dynamics better than the strict fascia counting test adopted thus far – primarily because most factors at play in a customer's shopping decision-taking process convert to sales. We have

given further thought to this since the hearing and would supplement our remarks then as follows:-

(i) we accept that, even with a sales-based market share test, there may still be a need for a minimum number of fascias "floor" whether one-stop, mid-range or convenience consolidations are being considered. If there is to be such a floor, we believe it should sit at three different fascias;

(ii) some method needs to be devised to reflect the impact of relative travel times separating the population centre from the respective stores under consideration. For example, assume (i) a 40,000 square feet one-stop store and a 6,000 square feet mid-range/2,500 square feet convenience store are equidistant from a given population centre but each within the relevant isochrone; separately assume (ii) that the 40,000 square feet one-stop store is four times more distant (but still within the relevant isochrone) from the population centre than the mid-range/convenience store; finally, assume (iii) that the respective sales of the stores are unaltered in (i) and (ii). In the circumstance of the one-stop store acquiring the mid-range/convenience store, we would expect prospective mid-range/convenience shoppers, within the population centre, to regard competition as having been more significantly reduced, relative to mid-range/convenience shopping, in the case of (ii) than (i). In other words, the competitive constraint presented by the mid-range/convenience store to the one-stop store (and, in broad terms, we would expect a similar but less pronounced, effect in examining the competitive constraints offered by a convenience store to a mid-range store relative to convenience shopping) is a function of travel time to a degree which cannot be reliably regarded as being reflected in the sales' performance of the stores.

17. If this analysis is correct, it would suggest that the sales' performance of the competitor stores within a relevant population-centred isochrone should be weighted relative to travel time from the isochrone centre. Unfortunately, we have not had sufficient time to develop, on a justified basis, a weighting mechanism for consideration.

18. **Definition of sales for market share analysis**: we would expect the relevant sales to be of a range of categories/items which it was felt defined the (i) convenience, (ii) mid-range and (iii) one-stop offers and that all sales of those items would be relevant to the analysis irrespective of the basket size in which they were found. The Commission would also have to determine whether or not internet/home-delivery sales would be included in the count. In principle, it would appear they should be.

19. If accumulation of these data was likely to prove problematic, then retail sales' (excluding non-food) area might be an acceptable proxy in all respects save internet/home delivery impacts.

20. **Market-share Threshold:** defining this threshold would involve the Commission in both (i) pin-pointing it in absolute terms and, perhaps, (ii) putting some boundaries around the weight of sales (see paragraph 17 above) in percentage terms, relative to the local market as a whole, which

would have to be consolidated with the acquiring party's sales for a test of substantial lessening of competition to be made out (i.e. a de minimis type rule). As has been the case with strict fascia counting, we would expect the threshold to raise a presumption of "problem" stores which might then be overridden by the patent existence of very low barriers to entry (or, less likely perhaps, countervailing benefits sufficient to outweigh the competition diminution). Furthermore, the threshold in absolute terms might operate at differing levels as between one-stop, mid-range and convenience.

21. The novelty of the issue prevents our pinpointing the threshold. **[CONFIDENTIAL]**.

Barriers to Entry

22. We have nothing to add to the material already presented in our initial submission of 27 April 2005, at the in person hearing of 6 May 2005 and as part of our response to the Competitor Questions at 18 May 2005.

The Effect of the Acquisition on Competition and Other Possible Adverse Effects

23. We have nothing to add to the material already presented in our initial submission of 27 April 2005, at the in person hearing of 6 May 2005 and as part of our response to the Competitor Questions at 18 May 2005.

Possible Remedies

24. As we explained at the 6 May 2005 hearing, we would expect divestment of problem stores to be the only satisfactory remedy in this case.