



Tesco plc and the Co-operative Group (CWS) Limited

A report on the acquisition of the Co-operative Group
(CWS) Limited's store at Uxbridge Road, Slough, by
Tesco plc

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The Competition Commission has excluded from this published version of the report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by ✂.

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Glossary

Summary

1. On 19 April 2007 the Office of Fair Trading (OFT) referred the completed acquisition of the Co-operative Group (CWS) Limited's (CGL's) store at Uxbridge Road in Slough by Tesco plc (Tesco) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). Our terms of reference are set out in Appendix A. We are required to publish our final report by 28 November 2007.
2. This is an unusual reference for the CC. The three and a half year period between the completion of the acquisition and its reference to the CC is substantially longer than would normally be the case. Also, our inquiry into Tesco's acquisition of the CGL store is taking place at the same time as a CC market investigation into the supply of groceries by retailers in the UK, and there is some overlap in the issues, in particular the definition of the relevant market.
3. The CGL store, the acquisition of which is the subject of this inquiry, was located on the corner of Uxbridge Road and Wellington Street in Slough, approximately 350 metres to the east of the town centre. The store had a net sales area of 4,300 sq metres (46,000 sq feet), sold grocery and non-grocery products, including petrol, and had approximately 450 car-parking spaces.
4. CGL told us that the store was performing poorly. Tesco told us that the store was run down in appearance and the range available at the store was not particularly appropriate. Tesco also told us that the site had poor, left-turn-only car access for shoppers from Wellington Street, which was inadequate for a large grocery retailer, and that the layout often resulted in traffic gridlock on the site.
5. Tesco's supermarket in Slough is located approximately 800 metres west of the CGL store on the corner of Brunel Way and Wellington Street and to the north of Slough's pedestrianized high street shopping centre. At the time of Tesco's acquisition of the CGL store, the store on this site had a net sales area of approximately 5,600 sq metres (60,000 sq feet), a petrol station and 511 parking spaces.
6. In contrast with the poor performance of the CGL store, the original Tesco Brunel Way store prior to the merger was suffering capacity problems, with research commissioned by Tesco indicating that the store was trading over its benchmark turnover and that congestion both inside the store and in the car park was a major problem.
7. Other large supermarkets in Slough in 2003 included stores operated by Asda, Safeway and Sainsbury's. In addition, mid-sized supermarkets present in Slough in 2003 included a Somerfield store, a local independent retailer, Chalvey Supermarket, a Budgens store and stores operated by Lidl and Iceland. Marks & Spencer (M&S) also had a food offering in its Slough department store. Other grocery stores in Slough at the time of the merger included a range of symbol group and non-affiliated convenience stores and specialist grocery stores.
8. CGL's sale of its store was motivated by its strategy to exit progressively from the larger store format, the objective of financing convenience store acquisitions, and the poor performance of the Slough store. Tesco told us that it acquired the CGL store so as to obtain temporary trading premises while its original Brunel Way store was closed for the purpose of being enlarged. We consider that concerns about the financial impact of a competitor acquiring the CGL store also influenced Tesco's decision as to how much to bid for, and ultimately its acquisition of, the CGL store.

9. CGL commenced marketing its Slough store in March 2003. A sale to Tesco was announced publicly on 17 July 2003 and completed in October 2003. Tesco refurbished the CGL store and reopened it as a Tesco-branded store on 26 January 2004, with Tesco operating the Brunel Way store and the CGL store simultaneously. Tesco closed the Brunel Way store for redevelopment on 23 January 2005, and traded exclusively from the CGL store for approximately six months. Tesco opened the developed Brunel Way store on 1 August 2005, having closed the CGL store permanently the previous day.
10. While Tesco traded from the CGL store between January 2004 and July 2005, it was also progressing plans for the development of a four- (initially five-) unit retail park on the CGL site. It proposed, pursuant to discussions with the OFT relating to undertakings in lieu of a reference to the CC, that one of these units would be used for grocery retailing. Tesco applied for planning permission for this development on 28 May 2004, and Slough Borough Council granted consent on 9 December 2004.
11. On 28 February 2005, following the Council's approval of Tesco's planning application, the planning application was 'called in' by the Government Office for the South-East, which discharged planning functions on behalf of the then Office of the Deputy Prime Minister. After a year-long public inquiry, consent for Tesco's proposed development was granted by the Secretary of State on 23 March 2006. Tesco commenced demolition of the CGL store on 27 November 2006 and started construction of the new development in March 2007.
12. The OFT started an investigation into Tesco's acquisition of the CGL store shortly after the transaction was completed in October 2003. In its decision of 2 February 2004 the OFT considered that there was a significant prospect that the merger would substantially lessen competition at the local level, but decided to suspend its duty to refer the merger to the CC given Tesco's offer of undertakings in lieu of a reference.
13. Following Tesco's final closure of the CGL store in July 2005, the OFT became increasingly concerned that Tesco should make progress in finding a suitable occupant for the proposed grocery retail unit on the site. At a meeting on 29 January 2007, the OFT told Tesco that, for its duty to refer the merger to the CC to remain suspended, Tesco must identify within two months a suitable buyer of either the undeveloped CGL site or the grocery retail unit in the Tesco redevelopment. Tesco did not provide to the OFT a proposal for a suitable buyer of either the site or the proposed retail unit. The OFT therefore decided that its duty to refer was no longer suspended, and Tesco's acquisition of the CGL store was referred to the CC on 17 April 2007.
14. We consider that the relevant market in which Tesco Brunel Way and the CGL store competed at the time of the merger also included Asda Telford Drive, Sainsbury's Taplow and Safeway (now Sainsbury's) Farnham Road. We do not, however, consider that each of these latter three stores exercised an equivalent competitive constraint. We conclude that under the counterfactual the CGL store would have been acquired and operated by Sainsbury's.
15. In considering the competitive effects of the merger, we are concerned to assess whether Tesco gained the ability to unilaterally increase prices or otherwise worsen its retail offer to customers. We are also concerned whether the merger may have reduced the competitive pressure faced by all the stores in the relevant market, thereby allowing each of the stores to weaken profitably their retail offer. Tesco's acquisition of the CGL store resulted in a significant increase both in Tesco's market share and overall market concentration compared with the counterfactual of a Sainsbury's acquisition of the CGL store.

16. We conclude that Tesco's acquisition of the CGL store resulted in a significant increase in concentration in the relevant market compared with the counterfactual of a Sainsbury's acquisition of this store. We consider that the CGL store was the closest competitor for the customers of Tesco Brunel Way, and this situation would have been further emphasized had the CGL store been operated by Sainsbury's. As a result, Tesco's acquisition of the CGL store removed a substantial competitive constraint that would otherwise have been faced by Tesco Brunel Way. The constraint provided by other large grocery stores on Tesco Brunel Way was, in our view, significantly less than that provided by the CGL store prior to the merger, and even more so had the store come under Sainsbury's ownership.
17. Although there have been developments in grocery retailing since the merger, these are not, in our view, sufficient to offset the reduction in competition resulting from the merger.
18. Looking forward, we do not expect further entry or expansion to address the loss of the competitive constraint that would have been provided by the CGL store under Sainsbury's ownership. On the basis of the evidence from Slough Borough Council, we do not expect any sites in Slough that are suitable for the construction of larger grocery stores to become available in the medium term. In addition, we do not believe that any expansion of Farnham Road is likely to take place in the next two to three years given the undeveloped nature of the expansion plans for this site. Moreover, for the reasons explained above, we do not expect that the retail park being developed by Tesco on the CGL site would include a grocery store that would create a competitive constraint sufficient to remedy the substantial lessening of competition (SLC).
19. We conclude that the acquisition of the CGL store by Tesco constitutes a relevant merger situation. We also conclude that the acquisition of the CGL store by Tesco has resulted, and may be expected to result, in an SLC in the relevant market. We also find that Tesco's acquisition of the CGL store has given rise to reduced store choice for Slough residents, particularly those located to the east of the CGL store in the Langley area.
20. Consistent with our remedies notice, published on 21 September 2007, we consider that there are two broad options for a divestiture remedy, namely:
 - (a) the sale of the entire site for the development of a large grocery store; and
 - (b) a sale or lease of one or more units within Tesco's planned development scheme. This might involve, for example, unit 3, a combined units 1 and 2, or a combined units 3 and 4.
21. In assessing whether a divestiture remedy would be effective in addressing the SLC, we have considered the following three risks:
 - (a) whether the scope of the divestiture package is sufficient to address the SLC (taking into account any possible requirements for further planning permission), while also providing an attractive and viable platform for a purchaser (composition risk);
 - (b) whether suitable purchasers are present (purchaser risk); and
 - (c) whether the competitive potential of the assets to be divested might be eroded (asset risks).

22. We consider that there is a significant risk that a grocery store occupying one or more units in the Tesco development will not provide scope for a grocery retailer to compete effectively with other large grocery stores in Slough, and in particular with Tesco Brunel Way. We consider that a new large store on the entire CGL site would be the most effective remedy to the SLC that we have identified.
23. We consider that there is a relatively small pool of potential purchasers who would wish to acquire the entire site in order to construct a large grocery store. However, we are confident that a number of retailers would bid for this site on this basis and that a number of those bidders would be suitable, according to our criteria of independence, capability and freedom from competitive concerns. We note that there is a larger pool of retailers apparently interested in acquiring the lease for a unit or units within the Tesco development. However, we are less confident that these retailers would be suitable purchasers, in particular having regard to whether they would be capable of operating a store from the Tesco development that would compete effectively in Slough and in particular with Tesco Brunel Way.
24. Overall, our assessment of risk leads us to conclude that the sale of the entire CGL site as a whole for development as a large grocery store is significantly more likely to be an effective remedy than the operation of a grocery store from a unit or units within the Tesco development.
25. We have decided that a divestiture remedy should be implemented in this case. We have decided that this remedy should involve the simultaneous marketing of:
 - (a) the CGL site to a suitable purchaser with commitments from the purchaser to apply for planning permission for a single large grocery store on the site, and a commitment that should it fail to obtain planning permission within 12 months it would complete the Tesco development itself within a further 12-month period and either operate itself the largest possible grocery store within that development or find a tenant that the CC agrees is suitable to operate the grocery store; and
 - (b) a lease of a unit or units in the Tesco development to a suitable tenant on the understanding that Tesco would sell the freehold of the development to a suitable purchaser, such as the tenant or a property investor, within a specified period.
26. Taking into account the cost to Tesco, but bearing in mind the importance of the sale process to the effective implementation of our chosen remedy, we have decided that Tesco should appoint and remunerate a divestiture trustee to control the sale process. The way in which the sale process will be conducted will be subject to the agreement of the CC. The CC will evaluate the bids received for the different options and will not require Tesco to accept a bid that the CC considers wholly unreasonable.

Findings

1. The reference

- 1.1 This report sets out the CC's findings on the completed acquisition by Tesco of a supermarket formerly operated by CGL in Uxbridge Road, Slough, Berkshire (the 'CGL store'). The acquisition was completed by Tesco in October 2003, and was referred to the CC for investigation and report by the OFT on 19 April 2007 under section 22 of the Act. Our terms of reference are set out in Appendix A.
- 1.2 Initially, the CC was required to report on this reference by 3 October 2007. However, on 17 July, the CC extended the period for considering the reference by eight weeks until 28 November 2007. The Inquiry Group in taking this decision noted the desirability of ensuring consistency, where appropriate, with the ongoing market investigation into the supply of groceries by retailers in the UK (see paragraphs 1.5 and 1.6).
- 1.3 This report, together with its appendices, constitutes our findings in respect of this reference. Further information, including non-sensitive versions of written submissions and summaries of third-party arguments and views, can be found on our website.¹ We refer to these documents as appropriate.
- 1.4 This is an unusual reference for the CC. The three-and-a-half-year period between the completion of the acquisition and its reference to the CC is substantially longer than would normally be the case (the reasons for this extended period are set out in paragraphs 3.34 to 3.43). The passage of time and the closure of the CGL store subsequent to its acquisition have limited our ability to collect and analyse certain information that might otherwise have been used, such as consumer survey evidence. However, we have also been able to observe the market for a significant period of time since the transaction.
- 1.5 Our inquiry into Tesco's acquisition of the CGL store is taking place at the same time as a CC market investigation into the supply of groceries by retailers in the UK (the groceries market investigation). As part of that investigation, the CC is required to determine whether any feature or combination of features of a relevant market² prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK.³
- 1.6 While the timelines and ambit of the groceries market investigation and this merger inquiry are different, there is some overlap in the issues. In particular, the CC's consideration of the relevant product and geographic markets for grocery retailing in the market investigation provides a framework for our consideration of the relevant market in this merger inquiry.⁴ These findings address the three statutory questions that the CC must answer under section 35 of the Act in relation to this merger.⁵ While

¹www.competition-commission.org.uk.

²For market investigations, the term 'relevant market' is defined in section 134(3) of the Act as a market in the UK for goods or services of a description specified in the OFT's market investigation reference.

³The deadline for the final report in the CC's market investigation is 8 May 2008.

⁴The CC's provisional findings in the groceries market investigation were published on 31 October 2007 and are available on the CC's website. In addition, there are a number of documents on the groceries market investigation homepage (such as CC working papers and non-confidential versions of submissions by main and third parties) which may provide useful background material in relation to those issues which are common to the inquiries—see:

www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm.

⁵Namely, whether a relevant merger situation has been created, whether the creation of that situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK for goods or services, and whether remedial action should be taken (and, if so, what action should be taken and what is to be remedied, mitigated or prevented).

the findings in this case are linked to, they are separate from, the provisional findings of the groceries market investigation.

1.7 The remainder of this report is set out as follows:

- Section 2 provides an overview of grocery retailing in Slough, and in particular, the operations of CGL and Tesco in Slough at the time of the merger;
- Section 3 reviews the merger transaction and subsequent developments including Tesco's post-merger trading in Slough and its redevelopment of both its original store in Slough and the site of the former CGL store (the CGL site);⁶
- Section 4 examines the CC's jurisdiction over this merger;
- Section 5 considers the relevant product and geographic markets;
- Section 6 sets out the counterfactual for this inquiry;
- Section 7 contains our analysis of the merger and our conclusions on whether the merger has resulted in an SLC; and
- Section 8 sets out our reasoning and analysis in relation to remedying the SLC that we have identified.

2. Grocery retailing in Slough

2.1 The first part of this section provides an overview of grocery retailing in Slough at the time of the merger in 2003. The subsequent two parts of this section provide additional detail on the parties to this merger, namely CGL and Tesco, and their grocery retailing operations in Slough at the time of the merger. Post-merger developments are discussed in Section 3.

Overview

2.2 Slough is a town in Berkshire in England, some 22 miles (35 km) west of London.⁷ It has a population of approximately 120,000 and is one of the most ethnically diverse towns in the UK. Slough has approximately 3,000 businesses employing 75,000 people. It is an important regional centre of employment with 35,000 to 40,000 commuters travelling into Slough each day to work. Significant-sized businesses in Slough include SEGRO plc (formerly Slough Trading Estates), which operates the largest privately-owned trading estate in Europe with more than 400 businesses, and a confectionery production site for Mars UK.

2.3 Slough is located on, or near, several main roads. The A4 (which is known as Wellington Street as it runs through central Slough) runs east–west through Slough and intersects with Farnham Road, A355, to the west of the town centre and with Uxbridge Road, A412, to the east of the town centre. The M4 motorway runs immediately to the south of Slough, while the M25 lies approximately 3 miles to the east of Slough. The Slough urban area includes a number of distinct localities, in some cases formerly separate villages, such as Langley to the east, Chalvey to the

⁶We use the term 'CGL site' to refer to the site, as distinct from the CGL store on that site.

⁷The urban area of Slough does not fall exclusively within the Borough of Slough. References to Slough in this report are to the Slough urban area unless otherwise indicated.

south, and Cippenham to the south-west. Slough's closest neighbours include Windsor (to the south), Maidenhead (to the west) and Uxbridge (to the north-east).

- 2.4 The CGL store, the acquisition of which is the subject of this inquiry, was located on the corner of Uxbridge Road and Wellington Street, approximately 350 metres to the east of the Slough town centre. The store first opened in 1988 and CGL added a petrol filling station to the site in 1990. At the time of its sale to Tesco, the store had a net sales area of 4,300 sq metres (46,000 sq feet). In addition to selling both grocery and non-grocery products,⁸ including petrol, the store also offered dry-cleaning services, photo processing, ATMs and customer toilets. Approximately 450 car-parking spaces were available for customers on the site.
- 2.5 The CGL store was described, after its closure, as 'a poor design in terms of modern retail operations, unrenovated since its construction'.⁹ Tesco told us that the store was run down in appearance and the range available at the store was not particularly appropriate. Tesco also told us that the site had poor, left-turn-only car access for shoppers from Wellington Street, which was inadequate for a large grocery retailer, and that the layout often resulted in traffic gridlock on the site.
- 2.6 Other major national grocery retailers operating large supermarkets in Slough in 2003 included Asda, Safeway, Sainsbury's and Tesco (see Figure 1). Of these, the Tesco supermarket¹⁰ was closest to the CGL store, lying approximately 800 metres to its west on Wellington Street. The Tesco store is to the north of Slough's pedestrianized high street shopping centre (on the opposite side of the A4), and next to Slough's bus station and the main Slough railway station on Brunel Way. At the time of Tesco's acquisition of the CGL store, the original Tesco Brunel Way store had a net sales area of approximately 5,700 sq metres (61,000 sq feet), a petrol station, and also offered a fish counter, a meat counter, scratch bakery, hot deli, and a curry bar. The store was open 24 hours a day (excluding Sundays where trading hours are restricted by law) and had 511 parking spaces.
- 2.7 The Safeway store on Farnham Road, Slough (owned and operated by Sainsbury's since August 2005), was 5 to 10 minutes' drive-time from the CGL store. It is located to the north of the Slough town centre, and just north of the Great Western Railway line to Bristol that runs through Slough. At the time of the merger, the store had a net sales area of approximately 1,400 sq metres.
- 2.8 The Asda store, in Telford Drive, Slough, was located approximately 10 minutes' drive-time from the CGL store to the south-west of the Slough town centre, in the area of Cippenham. The store is somewhat unusual in being located on the far edge of a housing estate with access through the estate. At the time of the merger, the Asda store had a net sales area of approximately 5,500 sq metres.
- 2.9 The Sainsbury's store in the west of Slough (hereafter Sainsbury's Taplow)¹¹ was 10 to 15 minutes' drive-time from the CGL store. At the time of the merger, the store had a net sales area of nearly 3,000 sq metres, larger than the Safeway store, but somewhat smaller than the supermarkets operated by Asda, CGL and Tesco.

⁸While we do not have precise figures for the relative floor space devoted to grocery and non-grocery products at the CGL store, Tesco has told us that approximately 70 per cent of the store was devoted to food and 30 per cent to non-food.

⁹Hoile C J, Inspector appointed by the First Secretary of State, *Application by Spen Hill Developments Limited, 78 Uxbridge Road, Slough, Report to the First Secretary of State*, 5 October 2005.

¹⁰Since the acquisition the original Tesco store has been replaced by a larger store on the same site (see paragraph 3.19). We hereafter refer to both the original Tesco store and its larger replacement store as Tesco Brunel Way so as to distinguish the store on this site from other Tesco stores in Slough. Where necessary, we specifically distinguish between the original Tesco store on this site and the later replacement store.

¹¹Taplow is in the Slough urban area, but is outside the Borough of Slough.

2.10 In addition to these large supermarkets, mid-sized supermarkets¹² present in Slough in 2003 included: a Somerfield store of approximately 500 sq metres located on the A4 to the west of Tesco Brunel Way; a local independent retailer, Chalvey Supermarket located in Chalvey to the south of the Slough town centre; a Budgens store located in Langley to the east of Slough town centre; and stores operated by Lidl and Iceland. M&S also had a food offering in its Slough department store. For details of store sizes, see paragraphs 5.21 and 5.22 and Table 5.

FIGURE 1

Large supermarkets in Slough, October 2003



Source: CC.

2.11 Other grocery stores in Slough at the time of the merger included a range of convenience stores, including stores owned by both Tesco (see paragraph 2.20) and CGL (see paragraph 2.16), as well as other symbol group and non-affiliated convenience stores,¹³ and specialist grocery retailers, such as butchers, bakers and greengrocers.¹⁴ Approximately 70 per cent of UK grocery sales take place in supermarkets, 20 per cent in convenience stores and the remaining 10 per cent in other grocery stores.¹⁵ Based on this, we estimate that the value of total sales at grocery retailers in Slough in 2003 was in the region of £300–£350 million.¹⁶

¹²Consistent with the provisional findings in the groceries market investigation, we use the term 'large' to refer to supermarkets with a net sales area larger than 1,400 sq metres and 'mid-sized' to refer to supermarkets with a net sales area of between 280 and 1,400 sq metres. We consider the importance of the distinction between supermarkets of different sizes in our discussion of the relevant product market in Section 5.

¹³We define a convenience store as a grocery store with a floor space of less than 280 sq metres.

¹⁴Consistent with the approach in our current market investigation into the supply of groceries in the UK, we define groceries as food (other than that sold for consumption in the store), pet food, drinks (alcoholic and non-alcoholic), cleaning products, toiletries and household goods, but excluding petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers and magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products.

¹⁵*IGD Grocery Retailing 2006* estimates these proportions for 2006 as 71 per cent for supermarkets, 21 per cent for convenience stores and 8 per cent for specialist retailers. The proportion of grocery sales at supermarkets has generally increased in recent years. However, we consider that these figures are a reasonable approximation of the situation at the time of the merger in late 2003.

¹⁶This figure may be an overestimate as it includes reported grocery and non-grocery sales from each of the large supermarkets in Slough, in addition to estimated sales at other grocery stores, including convenience stores and specialist grocery retailers.

- 2.12 Supermarkets larger than 1,400 sq metres in towns close to Slough at the time of the merger included Waitrose and Tesco stores in Windsor, Sainsbury's and Waitrose stores in Maidenhead, and Tesco and Sainsbury's stores in Uxbridge.

CGL

- 2.13 CGL is a consumer cooperative society which today operates more than 4,000 trading outlets throughout the UK, including food stores, pharmacies, travel agents and funeral homes. The largest component of CGL's business is grocery retailing and its annual revenue from grocery retailing at the time of the merger was around £3 billion.
- 2.14 The CGL store that was the subject of the acquisition by Tesco in October 2003 is described in paragraphs 2.4 and 2.5. At the time of its sale to Tesco, 135 staff were employed at the store, it had annual revenues of approximately £[redacted] million and was generally performing poorly (see paragraph 3.6 for a more detailed discussion of the store's financial performance).
- 2.15 Part of the rationale for CGL's sale of its Slough store was its progressive exit from the larger store format to focus on smaller stores. CGL's motivation for selling its Slough store is discussed in further detail in paragraphs 3.3 to 3.6.
- 2.16 In addition to the store sold to Tesco, CGL also operated four convenience stores in Slough at the time of the merger, located at Trelawney Avenue, Wentworth Avenue, Burnham Lane and Scaffell Road, as well as other convenience stores in the neighbouring towns of Maidenhead, Windsor and Iver Heath. A number of these stores had been acquired relatively recently by CGL, in particular as part of CGL's acquisition of Alldays, a convenience store chain, in 2002. The location of these stores is shown on the map at Appendix B.¹⁷

Tesco

- 2.17 Tesco is the largest grocery retailer in the UK currently operating more than 1,800 grocery stores, and at the time of the merger, its annual UK turnover was around £23 billion. Tesco operates four different store formats broadly linked to store size: Express up to 280 sq metres (3,000 sq feet); Metro, approximately 300 to 1,400 sq metres (7,000 to 15,000 sq feet); Superstores, approximately 1,800 to 4,700 sq metres (20,000 to 50,000 sq feet); and Extra, approximately 5,600 sq metres (60,000 sq feet) and above. Tesco has also operated the One Stop fascia of convenience stores since its acquisition of T&S Stores in January 2003. In addition to its UK operations, Tesco operates grocery stores in Europe and Asia, and has recently commenced operations in the USA.
- 2.18 Details of the original Tesco store at Brunel Way in Slough are set out in paragraph 2.6. More than 500 staff were employed at the store at the time of the merger, and it had annual revenues of approximately £[redacted] million, nearly four times those of the CGL store, even though its floorspace was only 25 per cent larger.
- 2.19 In contrast with the poor performance of the CGL store, the original Tesco Brunel Way store was suffering capacity problems prior to the merger. Research by external consultants Development Planning Partnership (DPP)¹⁸ for Tesco indicated that the

¹⁷Any references to the CGL store in Slough in the remainder of this report are specifically to the CGL store on Uxbridge Road that was sold to Tesco rather than any of CGL's convenience stores in Slough.

¹⁸Development Planning Partnership, *Retail and Planning Assessment*, January 2004.

store was trading by [X] per cent over its benchmark turnover with congestion being a major problem. Research by Tesco showed that customers at the original Brunel Way store were concerned with congestion around the checkouts, fresh produce areas and the store entrance.¹⁹ Tesco's research also indicated that there were congestion issues in the store car park, and that customers were looking for an expanded product range, particularly Halal meat, an improved non-food offer and improved facilities, such as the toilets and the cafe.²⁰

2.20 Other Tesco stores in Slough at the time of the merger included Tesco Express, London Road; One Stop, Grassmere Parade; One Stop, Elmshott Lane, Cippenham; and One Stop, Parlant Road, Langley. The location of these stores is shown on the map at Appendix B.²¹

3. Tesco's acquisition of the CGL store and subsequent developments

3.1 This section discusses CGL's rationale for selling its Slough store (paragraphs 3.3 to 3.6) and Tesco's rationale for the acquisition (paragraphs 3.7 to 3.11). We then describe the sales process for the store, including bids submitted by other grocery and non-grocery retailers and developers (paragraphs 3.12 to 3.16).

3.2 As we note in paragraph 1.4, three and a half years elapsed between the completion of Tesco's acquisition of the CGL store in October 2003 and the OFT reference to the CC in April 2007. As a result, the final part of this section reviews developments subsequent to Tesco's acquisition of the CGL store. These include:

- Tesco's use of the CGL store as a temporary store, its replacement of its original Brunel Way store with a substantially larger store, and its efforts to redevelop the CGL site (paragraphs 3.19 to 3.33);
- the OFT's investigation of the transaction and its monitoring of Tesco's actions in Slough subsequent to Tesco's acquisition of the CGL store (paragraphs 3.34 to 3.43); and
- interim measures taken by the CC during the course of this inquiry (paragraphs 3.44 to 3.49).

CGL's rationale for selling its Slough store

3.3 CGL's sale of its Slough store was motivated by at least three factors. These were, first, CGL's strategy to exit from the larger store format progressively; second, the objective of financing convenience store acquisitions; and finally, the poor performance of the CGL store. We discuss each of these factors below.

3.4 In terms of CGL's strategy of moving to smaller format stores, primarily in the 500 to 1,500 sq metre range, this was noted by the CC in its 2000 Supermarkets investigation,²² and again in its 2003 inquiry into the acquisition of Safeway.²³ In its

¹⁹Tesco Customer Question Time, Slough Extra 3194, Replacement Store CQT, 2 November 2004.

²⁰Ibid.

²¹Any references to the Tesco store in Slough in the remainder of this report are specifically to the Tesco store on Brunel Way (either the original store or the new, larger store that was subsequently built by Tesco) rather than any of Tesco's convenience stores in Slough.

²²*Supermarkets: a report on the supply of groceries from multiple stores in the UK*, October 2000. It was noted that in June 2000, Co-op put '16 of its larger supermarkets up for sale to secure funds needed to roll out its new market town fascia and expand its convenience store portfolio' (paragraph 5.168).

2006 submission to the current groceries market investigation, CGL also told us that it had pursued a policy of gradual exit from the larger store format in recent years, noting that this strategy had been triggered by an inability to compete on equal terms with large stores operated by the four major grocery retailers.²⁴ More specifically, the paper considered by CGL's South East regional board in relation to the proposed disposal of the CGL store noted that the store 'is not compatible with the Retail strategy which focuses on the development of a convenience store and market town portfolio'.²⁵

- 3.5 In terms of CGL's objective of financing convenience store acquisitions, the same board paper stated that 'recycling of superstore assets is an integral part of the financing of recent and future acquisitions ... as well as the society's working capital'.²⁶ As noted in paragraph 2.16, CGL had in 2002 acquired the Alldays chain of convenience stores, which included three stores in the Slough area. However, CGL told us that the sale of the Slough store was not specifically linked to this transaction.
- 3.6 In terms of the performance of the CGL store, the CGL board paper referred to above [redacted].²⁷ The contribution of the CGL store, including all overheads, for the period June 2001 to July 2003 is shown in Figure 2. This shows that during this period, the store was only intermittently making a positive contribution, after imputed rent charges. If internal rent had been excluded, however, the store was making a positive, although declining, cash contribution.

FIGURE 2

Revenue and contribution, CGL, Uxbridge Road, Slough



Source: CGL.

Tesco's rationale for acquiring the CGL store

- 3.7 Tesco told us that it acquired the CGL store to obtain temporary trading premises while the original Tesco Brunel Way store was replaced with a substantially larger store, thereby minimizing the disruption for its customers.
- 3.8 The desirability, from Tesco's perspective, of building a new larger store on the Brunel Way site is borne out in internal Tesco documents both before and after its acquisition of the CGL store. In September 2002, prior to the acquisition, Tesco at a board level examined the possibility of expanding the Brunel Way store, and the relevant board committee was informed that a larger store could be supported, and was appropriate, due to:
- (a) population levels, good access to the store, and high existing sales densities;
 - (b) demand for an increased non-food range; and

²³In 2003, CGL told the CC that it was following a strategy of disposing of large stores while increasingly focusing on medium and smaller stores (*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*, September 2003, paragraph 8.95.)

²⁴Summary of CGL hearing with the CC, 24 October 2006, paragraphs 3 and 4 (see www.competition-commission.org.uk/inquiries/ref2006/grocery/hearing_summaries.htm).

²⁵CGL, Proposed Store Disposal paper for its South East regional board, 17 June 2003.

²⁶Ibid.

²⁷CGL, Proposed Superstore Disposal paper prepared for South East Regional Board, 17 June 2003.

(c) demand for increased provision of ethnic products.

- 3.9 A report produced for Tesco by planning consultants DPP in January 2004 to support Tesco's planning application for the new store stated that the then existing store was trading at [redacted] per cent over the store's benchmark turnover.²⁸ As set out in paragraph 2.19, consumer research by Tesco revealed that customers at Tesco Brunel Way were keen to see congestion problems in the store entry, checkout and food service areas addressed, and that there were congestion problems in the store's car park. Tesco told us that the expansion of Tesco Brunel Way was also in line with its high-level strategy to extend many of its larger stores to increase the non-food offering at these stores.
- 3.10 Tesco told us that it would have been possible to expand the original Tesco Brunel Way store without acquiring the CGL store. It said that it could have expanded the store from its then size of approximately 5,700 metres net sales area (61,000 sq feet) to an F80 or F90 format (ie 80,000 sq feet or 90,000 sq feet) without acquiring an alternative site to trade from during the redevelopment. Tesco's preferred option was to expand the store to an F100 format (ie 100,000 sq feet), but in order to develop an F100 store it required an alternative site to trade from during the redevelopment. Without this, it would have had to cease trading in Slough for the period of the redevelopment (other than from the various convenience stores listed in paragraph 2.20). As a result, a key part of Tesco's rationale for the acquisition of the CGL store was the ability that this gave it to expand its Brunel Way store to its preferred size, while continuing to trade in Slough through a large supermarket.²⁹
- 3.11 An internal appraisal by Tesco clearly shows that Tesco considered the impact on Tesco Brunel Way of a competitor acquiring the CGL store in deciding whether, and how much, to bid for the CGL store. In particular, a [redacted] Report considered by the relevant Tesco board committee ([redacted])³⁰ in June 2003 (ie following the launch of the sales process for the CGL store in March 2003) states that 'the proximity of two stores means that there would be high impacts in the event of a competitor acquiring the Co-op'.³¹ In considering alternative scenarios for the stores on the two sites, the appraisal estimated that if Morrisons were to acquire the CGL store it would reduce sales at Tesco Brunel Way by approximately [redacted] per cent.³² We therefore conclude that concerns about the financial impact of a competitor acquiring the CGL store also influenced Tesco's decision as to how much to bid for, and ultimately its acquisition of, the CGL store. We discuss Tesco's internal appraisals in more detail in paragraphs 7.28 to 7.30.

Sales process

- 3.12 CGL commenced marketing its Slough store in March 2003, inviting binding offers from [redacted] grocery retailers and non-binding offers from around 50 non-grocery retailers. Initial offers were received from four grocery retailers—Asda, [redacted], Sainsbury's and Tesco.³³ Offers were also received from three non-grocery retailers, [redacted], as well as from three property developers, [redacted].

²⁸Development Planning Partnership, *Retail and Planning Assessment*, January 2004.

²⁹In subsequent submissions, Tesco suggested that an expansion of Tesco Brunel Way to an F100 format might actually have been possible in the absence of its acquisition of the CGL store but this was never considered.

³⁰[redacted]

³¹Tesco, [redacted] report to [redacted] [the relevant Tesco board committee], 9 June 2003.

³²Tesco told us that Morrisons was used in its appraisal as an example of the effect of a rival operator buying the CGL store. We consider that there would be little difference between the impact of an acquisition by any of Sainsbury's, Asda or Morrisons.

³³Offers were not received from the [redacted] that CGL approached as potential purchasers of the store, namely [redacted].

- 3.13 Following these initial offers, improved offers were invited from Asda, Sainsbury's and Tesco. In inviting improved offers from Asda, Sainsbury's and Tesco, CGL sought the inclusion of additional value items in the form of extended and/or new leases in various other locations for other CGL businesses. Sainsbury's revised offer included the transfer of leases on four Sainsbury's convenience stores to CGL as well as [redacted]. Tesco's revised offer [redacted]. Asda, in discussing a revised offer with CGL, stated that it was considering increasing its initial cash offer of £[redacted] million to £[redacted] million. However, on being told by CGL that this was insufficient, Asda did not formally submit a revised offer.
- 3.14 CGL did not further pursue the offer from [redacted] as it had offered significantly less for the store than the other three grocery retailers. CGL also rejected the offers from [redacted].³⁴ The rejection of these offers was due to [redacted].
- 3.15 Details of the six offers ultimately considered by the CGL board at its meeting in July 2003 are set out in Table 1. These comprised the improved offers from Sainsbury's and Tesco, the original cash offer from Asda (as its improved cash offer was not formally submitted), and the offers from three non-grocery retailers, [redacted].³⁵

TABLE 1 Offers for the CGL store reviewed by the CGL board

	Initial offer	Revised offer		Total offer	Offer type
	£m	Cash offer £m	Additional value items* £m	£m	
Grocery retailers					
Sainsbury's					
Tesco					
Asda					
Non-food retailers					
[redacted]					

Source: CGL Property Disposal request paper.

*[redacted]

- 3.16 The gap between the final offers from the three grocery retailers was less than £3 million, while the gap between the first and second ranked offers was less than £0.5 million. The highest offer submitted by a non-grocery retailer was more than £2 million below the lowest initial offer submitted by the three grocery retailers invited to submit improved offers. While Sainsbury's submitted the highest cash offer, CGL valued the non-cash component/additional value items of the Tesco offer more highly, leading the CGL board to approve a sale of the store to Tesco. The sale was announced publicly on 17 July 2003 and completed in October 2003.

Events subsequent to Tesco's acquisition of the CGL store

- 3.17 More than four years have elapsed since Tesco completed its acquisition of the CGL store. The long interval between completion of the transaction and its consideration by the CC is due, in part, to the OFT's willingness to allow Tesco to seek to re-develop the CGL site, rather than insisting that Tesco sell the site undeveloped (see paragraphs 3.34 to 3.43). The following paragraphs set out the events subsequent to

³⁴[redacted]

³⁵In the case of the bids from the grocery retailers, we note that these were binding offers and were not subject to, for example, planning consent.

Tesco's acquisition of the CGL store, which are of relevance to our analysis of the merger in Section 7.

- 3.18 We set out, first, details of Tesco's post-merger trading in Slough (at both the CGL store and the original Tesco Brunel Way store), then Tesco's efforts to develop the CGL site, and finally, Tesco's interactions with the OFT in the period following the completion of the transaction in October 2003 until the reference to the CC in April 2007.

Tesco post-merger trading in Slough

- 3.19 CGL ceased trading at its Slough store on 30 September 2003 and completed the sale of the store to Tesco on 10 October 2003. Tesco then refurbished the CGL store and reopened it as a Tesco-branded store on 26 January 2004 with Tesco operating the original Tesco Brunel Way store and the CGL store simultaneously during the year that followed. In February 2004, Tesco applied to Slough Borough Council for planning permission to develop a new, larger store at the Brunel Way site and this was granted in December 2004. Tesco closed the original Tesco Brunel Way store for redevelopment on 23 January 2005, and traded exclusively from the CGL store for approximately six months. Tesco opened the new Tesco Brunel Way store on 1 August 2005, having permanently closed the former CGL store from which it was temporarily trading the previous day.

Tesco's redevelopment of the CGL site

- 3.20 While Tesco traded from the former CGL store between January 2004 and July 2005, it was also progressing plans for the development of a four- (initially five-) unit retail park on the CGL site.³⁶ It proposed, pursuant to discussions with the OFT in anticipation of undertakings in lieu of a reference to the CC (see paragraphs 3.34 to 3.43), that one of these units would be used for grocery retailing. Tesco applied for planning permission for this development on 28 May 2004, and Slough Borough Council granted consent on 9 December 2004.
- 3.21 Planning officers at Slough Borough Council told us that the Council's consideration of Tesco's planning application was affected by the existing A1 open planning consent for the CGL store. This planning consent meant that the store could be used for the retail sale of any goods, and the Council was concerned that it might be subdivided and used for discount retailing of clothes and other 'comparison' goods, which would have an adverse effect on retailing in the Slough town centre.³⁷ In contrast, the Council considered that Tesco's proposed retail park would attract retailers that would complement, rather than compete with, the retail offer already present in the town centre. As such, the Council hoped that the development proposed by Tesco would attract customers from surrounding areas, who were not at that time shopping in Slough.

³⁶The development work has been undertaken by Tesco's wholly-owned subsidiary, Spen Hill Developments Ltd, although for ease of reference we use the term 'Tesco' to refer to Tesco plc and all its subsidiaries.

³⁷The CGL store was considered to be 'out of centre' for the purpose of PPG6, Town Centres and Retail Developments (now superseded by PPS6). PPG6 set out government guidance on the interpretation of planning policy with regard to retail developments and their relationship to the town centre. It emphasizes the plan-led approach to promoting development in town centres and introduced a sequential approach to selecting sites which favoured developments in the town centre over edge-of-centre developments, and edge-of-centre developments over out-of-centre. Its aim is to retain important town-centre functions by adopting a coherent town-centre parking strategy and managing the town centre as a whole. There is clarification of key tests for assessing proposed developments for retail, leisure and other town centre uses, focusing on the need for such a development, whether there are more central sites after having been flexible, the likely impact on the vitality and viability in town centres, accessibility by a choice of transport modes and impact on overall travel and car use.

- 3.22 A condition of the planning consent granted by the Slough Borough Council (and subsequently adopted in the consent granted by the Secretary of State) was a restriction on the times during which deliveries could be made to the site. Under this condition, deliveries would only be permitted between 8am and 6pm Monday to Friday, and 8am and 1pm on Saturday, with no deliveries allowed on Sundays or bank holidays. This condition was imposed to address concerns regarding the impact on local residents of delivery lorries using the delivery access road running from Wellington Street along the boundary of the site in close proximity to neighbouring residential dwellings.
- 3.23 While Tesco was seeking planning permission for a retail park on the CGL site, it was also seeking tenants for the development, including the planned grocery retail unit. Waitrose was approached in April 2004 as a prospective tenant and heads of terms were agreed by the parties in July 2004 for a lease of a unit within the proposed retail park, based on [redacted] sq metres ([redacted] sq feet) of ground floor space plus [redacted] sq metres ([redacted] sq feet) of mezzanine floor space.³⁸
- 3.24 However, on 13 October 2004, Waitrose, following consideration of the matter by its board, advised Tesco's agent that it no longer wished to proceed with the letting, due to concerns about [redacted]. Waitrose formally confirmed its withdrawal in writing on 18 November 2004.
- 3.25 Following Waitrose's withdrawal, Tesco sought further interest in the grocery retail unit. Expressions of interest were received between November 2004 and January 2005 from [redacted] for a store with a net sales area of 1,300 sq metres (14,000 sq feet), [redacted] for a store of 2,300 sq metres gross internal area (25,000 sq feet) and [redacted] for a store of 650 sq metres gross internal area (7,000 sq feet). In addition, [redacted] confirmed its interest in the site, but stated that it required a store of at least 6,400 sq metres (68,000 sq feet) gross internal area, which was, in effect, the entire site. [redacted] advised Tesco, through their respective agents, on 18 April 2005 that if it was to make an offer for a store of this floorspace, the offer would be in the region of £[redacted] million.
- 3.26 On 28 February 2005, following Slough Borough Council's approval of Tesco's planning application for the CGL site in December 2004, the planning application was 'called in' for review by the Government Office for the South-East, which discharged planning functions on behalf of the then Office of the Deputy Prime Minister. The 'call-in' process involved a public inquiry into the planning application, conducted by an independent planning inspector, who then reported to the First Secretary of State. At the commencement of the inquiry, the planning inspector stated that the Secretary of State particularly wished to be informed about the following matters for his consideration of the application: (a) the extent to which the proposed development accorded with the development plans for the area; (b) the extent to which the proposed development accorded with government policy set out in PPG6;³⁹ (c) the extent to which the proposed development was consistent with national policy guidance in PPG13;⁴⁰ (d) whether there were any other material planning considerations that should be considered; and (e) whether the permission should be subject to any conditions.

³⁸[redacted]

³⁹The planning inspector highlighted three issues for consideration regarding the consistency of the proposal with PPG6, namely: (a) whether a sequential approach had been satisfactorily applied in selecting the location for the proposed development, and whether the applicants have demonstrated flexibility in terms of the format, design and scale of their proposal and the amount of car parking, to fit local circumstances; (b) whether quantitative need for the proposed store had been satisfactorily demonstrated; and (c) the degree to which the proposal would have an impact on the vitality and viability of any centres within the catchment.

⁴⁰PPG13 concerns transport policy. The planning inspector highlighted the need to assess how issues around access to the site had been considered.

- 3.27 The planning inspector also requested that Tesco and Slough Borough Council provide 'convincing evidence about the reality of Messrs. Waitrose actually operating the food unit'.⁴¹ Tesco told us that its evidence to the inquiry, given on its behalf by DPP, was that Waitrose had expressed an interest and that the grocery unit had been designed specifically to reflect its exact requirements, but that negotiations had not progressed beyond the drafting of a contract. It is not clear to us that Tesco informed the planning inspector of Waitrose's withdrawal of interest in the site in October 2004 (ie four months prior to the 'call-in' of the planning application). Tesco, through DPP, did, however, state to the planning inspector that if Waitrose's interest disappeared, then M&S and Whole Foods were potential operators of the grocery retail unit although, as the planning inspector noted, M&S had opened a Simply Food store in Slough in June 2005. The planning inspector ultimately accepted in his report in October 2005 that 'there is much circumstantial evidence that Waitrose, or another quality food retailer, would be sought for the site, which would be developed to a high physical standard'.⁴²
- 3.28 During the period of the planning inspector's investigation, Tesco commenced the construction of a mezzanine floor at the closed CGL store, which would have increased the gross floorspace of that store by more than 4,000 sq metres to approximately 10,300 sq metres. This work was commenced in advance of a proposed change in planning regulations that would have obliged parties to obtain planning consent for new mezzanine developments.⁴³ Tesco told us that its construction of a mezzanine was in support of a duplicate application for planning consent for the Uxbridge Road development, which had been submitted to Slough Borough Council in April 2005 (11 months after submitting the original planning application, which was the development scheme eventually approved by the Secretary of State). The duplicate application was predicated on the existence of a mezzanine in the CGL store—Tesco received legal advice that an increase in the 'baseline' floorspace in the existing building would mean that there was less likelihood of the application being 'called in', due to the lower risk of the development conflicting with national planning policy when compared with this greater baseline. In the end, this duplicate application was 'called in' on 10 August 2005 and the mezzanine construction work was therefore halted, unfinished, some time after the site was visited by the planning inspector. However, Tesco told us that, in any case, when a new store is acquired by a retailer, it is very unusual if it does not require substantial refurbishment before trading is possible.
- 3.29 Consent for Tesco's proposed development at the CGL site was granted by the Secretary of State on 23 March 2006, approximately one year after the application had been called in. The Secretary of State's consent adopted the delivery hours restriction that had previously been imposed by Slough Borough Council (see paragraph 3.22).
- 3.30 Tesco commenced demolition of the CGL store on 27 November 2006. Demolition was completed in March 2007, and Tesco's construction contractor, McLaren Construction Limited, commenced constructing the new building on the CGL site at this time.
- 3.31 Tesco largely ceased marketing units in the retail park from August 2005 to March 2006 during the 'call-in' process.⁴⁴ In March 2006, when Tesco considered that it had

⁴¹Hoile C J, Inspector appointed by the First Secretary of State, *Application by Spen Hill Developments Limited, 78 Uxbridge Road, Slough, Report to the First Secretary of State*, 5 October 2005.

⁴²*Ibid*, paragraph 87.

⁴³This change in planning regulations came into force in May 2006.

⁴⁴Carter Baynes, *Marketing report prepared for Spen Hill Developments*, May 2007.

become apparent that the application would be approved, it again canvassed retailer interest in the proposed grocery store on the site. The principal interest at this time was from Whole Foods, which submitted an offer on 24 May 2006 for 5,100 sq metres (55,000 sq feet).⁴⁵ However, on 22 August 2006, Whole Foods withdrew, stating that it was no longer interested in the scheme. [redacted] It also told the CC that it had no interest in occupying a unit at the proposed development.⁴⁶ [redacted] submitted a further offer on 11 October 2006 of £[redacted] million for the whole of the Uxbridge Road site, subject to OFT approval.

- 3.32 In November 2006, Tesco made further proposals to the property agents of both Waitrose and Whole Foods, at reduced rents and with the payment of increased premiums by Tesco.⁴⁷ However, Waitrose rejected the proposal, while Whole Foods appears not to have explicitly responded.⁴⁸ Tesco told us that notwithstanding this, a new planning application was submitted to Slough Borough Council on 12 February 2007, seeking to vary the consented scheme to accommodate Whole Foods' preferred store specification in the event that Whole Foods showed renewed interest.⁴⁹ Discussions between the CC and planning officers at Slough Borough Council suggest that Tesco did not inform the Council of Whole Foods' withdrawal in August 2006, and that the Council maintained its belief until recently that Whole Foods was a likely candidate for occupation of a unit in the development. Tesco told us that it believed that it was not necessary to notify the Council of this fact.
- 3.33 Further marketing efforts were made by Tesco in late December 2006, with [redacted], [redacted], [redacted], [redacted] and [redacted] each expressing interest. Both [redacted] and [redacted] expressed interest in acquiring the entire site, with [redacted] making an offer of £[redacted] million for a newly-constructed store, built to its specification having a gross internal area of not less than 7,200 sq metres (78,000 sq feet), a net sales area of not less than 4,400 sq metres (47,500 sq feet) and not less than 500 car-parking spaces. [redacted] expressed an interest in occupying a space smaller than any of the four retail units that were planned for the site. Tesco took forward negotiations with both [redacted] and [redacted], negotiating heads of terms with both parties.⁵⁰ Negotiations with both parties were halted when the OFT referred the transaction to the CC.

OFT inquiry into the merger

- 3.34 The OFT commenced an investigation into Tesco's acquisition of the CGL store shortly after the transaction was completed in October 2003 in response to complaints from local consumers. In its decision of 2 February 2004,⁵¹ the OFT considered that there was a significant prospect that the merger would substantially

⁴⁵The requirement comprised raised ground floor 3,700 sq metres (40,000 sq feet) and mezzanine 1,000 sq metres (10,000 sq feet).

⁴⁶The apparent change in Whole Foods' interest in taking a unit on the CGL site appears to be accounted for by the change in personnel involved. Whole Foods' initial interest was expressed after consideration of the deal by personnel with responsibility for property acquisition, whereas the decision not to proceed was taken after consideration of the proposal by those with business development responsibilities.

⁴⁷The revised offer to Waitrose consisted of an annual rent of £[redacted], [redacted] rent free and an ingoing premium payable by Tesco to Waitrose of £[redacted] million. This represented a small increase in annual rent of £[redacted] on Tesco's original offer to Waitrose in return for Waitrose obtaining a near tripling in the premium payable to it from £[redacted] million to £[redacted] million.

⁴⁸We understand from Whole Foods that Tesco's proposal was looked at within its property department and although the offer was financially attractive, the [redacted] issues had not changed from 2006. As a result, the site was never discussed at its property committee. Tesco's agents in March 2007 informed Tesco that it had not heard back from Whole Foods in regard to the offer, but felt that it was unlikely that Whole Foods would be interested.

⁴⁹We understand that this planning variation is also consistent with the preferences of [redacted] which expressed interest in taking up space in the development in December 2006.

⁵⁰[redacted]

⁵¹OFT, *Completed acquisition by Tesco plc of the Co-operative Group's stores in Uxbridge Road, Slough, as well as Stapleford Lane, Toton, Nottingham and Tower Place, South Shields*, 2 February 2004.

lessen competition at the local level, but decided to suspend its duty to refer the merger to the CC given Tesco's offer of undertakings in lieu of a reference.

- 3.35 In reaching its view that there was a significant prospect that the merger would substantially lessen competition, the OFT applied the analysis adopted by the CC in the *Safeway* case.⁵²
- 3.36 The extensive discussions between the OFT and Tesco on the detailed provisions of the undertakings in lieu initially focused on a sale of the CGL store as it stood. [X]⁵³ Consequently, at an early stage in discussions with the OFT, Tesco proposed that the disposal should only take place after the CGL site had been redeveloped. This option, however, inevitably entailed Tesco taking the proposed redevelopment through the planning process.
- 3.37 The OFT was, in principle, prepared to allow Tesco to redevelop the site, but considered that any market value offers for the CGL store as it stood should take precedence over Tesco's proposed redevelopment, and in the event that the development option was chosen, undertakings would be needed to ensure that the development was actively pursued. In June 2004 the OFT told Tesco that 'on the basis of the information we have at present, the isochrone analysis we have received indicates that none of the major one stop store operators would be eligible purchasers of the [CGL] Uxbridge Road Store. However, we understand there to be at least one non-major one stop store operator who would be eligible and interested'. The OFT has explained to us that this comment was made in the context of how the 'market value' of the CGL store would be determined, and that it was never intended to be an analysis of the merger situation. On the basis of Tesco's submissions, discussions between Tesco and the OFT then began to centre on redevelopment with Waitrose as the proposed grocery tenant (the OFT was told that the CGL store 'as is' was not suitable for Waitrose's needs). The so-called 'Waitrose option' was agreed in principle in July 2004.
- 3.38 As to the eligibility of purchasers other than Waitrose, Tesco did not propose an alternative purchaser or otherwise challenge the OFT's indicative view, and the OFT did not initiate a purchaser approval process.
- 3.39 Negotiations between the OFT and Tesco regarding the undertakings in lieu continued during the remainder of 2004. Although the proposal for redevelopment along the lines of the 'Waitrose option' eventually formed the core of the draft undertakings, the alternative of selling the store as it stood always remained. In particular, it was envisaged that even if the development were to proceed, failure to achieve certain specified milestones, or the occurrence of certain 'negative milestones' would trigger requirement for an immediate divestment of the CGL site.
- 3.40 The OFT was informed by Tesco in March 2005 of the 'call-in' of the planning application for Tesco's redevelopment of the CGL site. As set out in paragraphs 3.20 to 3.29, planning issues were not resolved until March 2006, more than two years after the original OFT decision, when Tesco was granted consent by the Secretary of State to redevelop the CGL site.

⁵²Subsequently, both the CC and the OFT have refined their methodologies to focus more directly on the competitive constraints grocery stores actually impose on each other.

⁵³The OFT told Tesco in its letter of 11 June 2004 that it proposed to deal with the risk of strategic bidding in the same way that it had done in the divestment framework following Morrisons' acquisition of Safeway.

3.41 Tesco told us that it kept the OFT aware of 'all key developments'.⁵⁴ In particular:

- (a) Tesco told us that it informed the OFT in early November 2004 of Waitrose's withdrawal of interest in a unit in the proposed retail park development (see paragraph 3.24). In contrast, the OFT told us that it only became aware that Waitrose had withdrawn ten months later, in August 2005. An OFT letter to Tesco dated 16 November 2004 (after the date at which Tesco told us that it informed the OFT of Waitrose's withdrawal) refers to a 'delay in securing Waitrose's agreement' to the proposed lease of the grocery retail unit in the redevelopment on the CGL site, and also includes a statement that 'Waitrose is not now prepared to sign the agreement for lease'. We consider that during the period from November 2004 to August 2005, it is reasonable to infer that the OFT continued to believe that there was at least some likelihood that Waitrose might occupy the grocery retail unit, despite the fact that Waitrose had withdrawn from negotiations regarding the lease, and that Waitrose's withdrawal had been communicated to Tesco in unequivocal terms in its letter of 18 November 2004. Tesco told us that the statements made by the OFT in its letter of 16 November 2004 and its subsequent agreement to modify the draft undertakings in lieu to replace references to 'Waitrose' with 'approved lessee' show that the OFT was aware that Waitrose was not interested in the site from November 2004 onwards.
- (b) As noted above in paragraph 3.39, the draft undertakings in lieu in mid-2005 continued to contemplate both the sale of the CGL store to a grocery retailer as well as the sale or leasing of a unit in the Tesco redevelopment to a grocery retailer. Tesco told us that it did not inform the OFT of the mezzanine construction work undertaken in mid-2005 (see paragraph 3.28). Tesco has submitted that the construction of the mezzanine was commenced in an attempt to secure planning permission for the redevelopment scheme. Tesco told us that this construction was undertaken at the time because of its focus on obtaining planning permission as soon as possible to meet the OFT's timetable. Planning officers from Slough Borough Council told us that in their view this construction work would have caused significant damage to the CGL store, such that an acquirer of that store would have been forced to undertake significant refurbishment activities.

3.42 During the period after August 2006 the OFT became increasingly concerned that Tesco needed to make more progress in finding a suitable occupant for the proposed grocery retail unit on the site. Tesco's efforts in marketing the site are set out in paragraphs 3.23 to 3.25 and 3.31 to 3.33. At a meeting on 29 January 2007, the OFT told Tesco that for the duty to refer the merger to the CC to remain suspended, Tesco must identify within two months a suitable buyer of either the undeveloped CGL site or the grocery retail unit in the Tesco redevelopment, according to specific terms laid out by the OFT. This was confirmed in a letter from the OFT to Tesco dated 2 February 2007. Tesco told us that the OFT stipulated that offers dependent on new planning permission would not be acceptable.

3.43 During the two months after 2 February 2007, Tesco did not provide to the OFT a proposal for a suitable buyer of either the site or the proposed retail unit. The OFT therefore decided that its duty to refer was no longer suspended, and Tesco's acquisition of the CGL store was referred to the CC on 19 April 2007.

⁵⁴Tesco told us that there was regular correspondence between Tesco and the OFT both in writing and in meetings throughout the period from 2004 to 2007.

Interim measures during the CC's inquiry

- 3.44 As set out in paragraph 3.30, Tesco commenced construction on the CGL site in March 2007, prior to the reference to the CC. On 14 June 2007, the CC accepted interim undertakings from Tesco under section 80 of the Act that permitted Tesco to continue this construction provided that it was in accordance with the works programme set down in the construction contract between McLaren and Tesco. The CC was initially minded to make an interim order halting construction on the CGL site. However, after considering submissions from Tesco, it concluded at that stage that continued construction on the site would not impede the CC from taking appropriate remedial action in the event that it found that the merger gave rise to an SLC.
- 3.45 The CC made its decision following consideration of a number of factors. The CC noted the significant potential liability to Tesco under the construction contract with McLaren if Tesco were to suspend work for the period of the reference, the practical difficulties of suspension at that particular point of construction (as the steel frame had only been partially erected and therefore, for health and safety reasons, could not be left in that state), and initial indications from Slough Borough Council regarding the likelihood of obtaining planning consent for a large grocery store on the CGL site. It also took account of Tesco's representations regarding the continued interest of Waitrose and Whole Foods in the site. Prior to accepting the undertakings, the CC sought, and obtained, an acknowledgement from Tesco that it proceeded with continued construction in full knowledge of the risk that the CC might order a remedy that involved a different structure on the site, and as a result, Tesco might incur construction costs that it could not subsequently recover.
- 3.46 Tesco also undertook to apply to Slough Borough Council for a variation to the planning consent for the CGL site, which would allow the merger of two of the four units in the proposed development, and the use of the merged unit for the sale of food and other 'convenience' goods.
- 3.47 Under the interim undertakings, the CC directed Tesco to appoint a Monitoring Trustee, who would supervise the establishment of any additional mechanisms necessary for ensuring compliance with the interim undertakings pending final determination of the reference, monitor compliance by Tesco with certain elements of the interim undertakings, and, so far as possible, ensure Tesco's continued full and effective compliance with the interim undertakings.
- 3.48 On 7 August 2007, the CC made an interim order in accordance with section 81 of the Act, which had the effect of requiring Tesco to cease construction on the CGL site. The CC revised its view of interim measures in the light of information received after the interim undertakings were accepted on 14 June 2007, which led it to conclude that continued construction on the site would constitute pre-emptive action. In particular, the CC's assessment of the risk of pre-emptive action posed by continued construction on the site changed as a result of further information that it received in relation to four issues:
- (a) The CC had received further evidence from Slough Borough Council, which suggested that the Council would be prepared to consider granting planning permission for a grocery store on the CGL site with a floorspace considerably larger than any of the possible grocery stores likely to form part of the Tesco development.
 - (b) The CC had concerns regarding the attractiveness of the site to Waitrose and Whole Foods (concerns which strengthened after subsequent discussions with Waitrose and Whole Foods—see paragraphs 3.31 and 3.32).

(c) The CC also had concerns that the planning consent restricting delivery hours to the grocery retail unit would seriously reduce the attractiveness of the site to other retailers (see paragraph 3.22).

(d) The CC had gained the impression, from evidence provided by Tesco and its advisers at a hearing on 22 May 2007, that Tesco became legally bound to enter into its construction contract with McLaren prior to Tesco's meeting with the OFT on 29 January 2007 (at which the OFT noted its serious concerns about continued suspension of its duty to refer the merger to the CC). On 4 June 2007, Tesco told us that it signed a binding letter of intent with McLaren for project enabling services (ie to carry out preparatory works and order certain construction materials thus exposing the project to abortive costs should the development not proceed). This letter of intent was issued by Tesco on 20 December 2006 and countersigned and completed by McLaren on 26 January 2007 (ie prior to 29 January 2007). Tesco had 'considered itself to be bound to proceed with the construction' from the date on which the letter of intent was issued. Following a further request for clarification by the CC on 18 June 2007, Tesco provided the CC with a copy of the letter of intent on 28 June 2007 and confirmed that it was legally bound to enter into the construction contract on 9 March 2007, a number of weeks after Tesco's meeting with the OFT on 29 January 2007. If Tesco had terminated the letter of intent prior to commencing construction, its maximum liability to McLaren under the letter of intent would have increased as the proposed commencement date for construction drew closer and as the extent of 'enabling services' performed by McLaren increased. Tesco's maximum liability for terminating the letter of intent in the week commencing 29 January 2007 would have been £[redacted] in total, and this increased to a total of £[redacted] in the week commencing 5 February 2007.

3.49 Under the interim order, the CC directed Tesco to continue the appointment of the Monitoring Trustee.

4. Jurisdiction

4.1 Under our terms of reference (see Appendix A), we are required to investigate and report on whether a relevant merger situation has been created and, if so, whether the creation of that situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK or parts of the UK.

4.2 A relevant merger situation exists where two or more enterprises cease to be distinct and where the share of supply test or the turnover test specified in section 23 of the Act is satisfied. The share of supply test is satisfied if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK. The turnover test is satisfied if the value of the annual turnover of the enterprise being acquired exceeds £70 million.

4.3 Enterprises cease to be distinct if they are brought under common ownership or common control. Tesco and the CGL store in Slough, enterprises for the purposes of the Act, were brought under the common ownership of Tesco, after completion of the acquisition in October 2003. The enterprise formerly carried on by, or under the control of, CGL therefore ceased to be distinct from enterprises carried on by, or under the control of, Tesco.

4.4 The application of the share of supply test is different from the definition of market shares undertaken as part of any analysis of competition within an economic market and simply refers to a share of the specified category of goods or services. In applying the share of supply test in its reference decision, the OFT considered the

supply of groceries from ‘one-stop shops’ (ie stores with a net sales area greater than 1,400 sq metres) in the UK.

- 4.5 At the time of the merger, Tesco’s share of the supply of groceries from ‘one-stop shops’ in the UK in 2003 was 31 per cent,⁵⁵ and that the merger led to an accretion in this share of supply. We note that Tesco did not seek to challenge the OFT’s finding that the share of supply test was met on this basis.
- 4.6 The CC has considered whether the share of supply test would also be met for the supply of groceries from stores with a net sales area greater than 1,400 sq metres within the Borough of Slough. We understand that at the time of the merger, Tesco’s share of sales from grocery stores with a net sales area larger than 1,400 sq metres within the Borough of Slough was more than 25 per cent ([§<]),⁵⁶ and that the merger led to an accretion in this share of supply. The CC considers that the Borough of Slough represents a ‘substantial part of the United Kingdom’ for the purposes of section 23(3) of the Act, having regard to such considerations as population and economic factors. In considering whether the Borough of Slough is a part of the UK ‘of such size, character and importance as to make it worth consideration’⁵⁷ under the Act, the CC has also had regard to the fact that the markets in which the merging parties compete are local in nature (see paragraphs 5.42 to 5.67).
- 4.7 Since, on either basis, the share of supply test is satisfied, we are not required to consider the turnover test.
- 4.8 We therefore find that the acquisition of the CGL store at Uxbridge Road in Slough by Tesco resulted in the creation of a relevant merger situation.

5. Market definition

- 5.1 In this section we consider the appropriate definition of the product and geographic market for the purpose of providing the framework for our analysis in Section 7. We first consider the relevant product market, and second, the relevant geographic market.
- 5.2 As we note in paragraph 1.5, the CC is considering the issue of market definition in the context of its current market investigation into the supply of groceries by retailers in the UK.⁵⁸ In considering the relevant market for this inquiry, we have drawn on the analysis undertaken in the groceries market investigation, and, where relevant, we present that analysis in this section and the related appendices. However, as we also note in paragraph 1.6, this report addresses the statutory questions that the CC must deal with under section 35 of the Act in relation to this merger. The CC’s analyses

⁵⁵*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, Table 2.2 in paragraph 2.122.

⁵⁶The stores included in this share of supply test are Tesco Brunel Way, CGL Uxbridge Road, Safeway Farnham Road and Asda Telford Drive. The Sainsbury’s store in Taplow is outside the Borough of Slough.

⁵⁷*South Yorkshire Transport Ltd v Monopolies and Mergers Commission* [1993] 1 All ER 289 at 297 (per Lord Mustill).

⁵⁸In the groceries market investigation, the CC has, in summary, provisionally found that (a) for larger grocery stores, other larger grocery stores (ie stores larger than 1,000–2,000 sq metres) are in the same product market; (b) for mid-sized grocery stores, other mid-sized (ie stores of 280 to 1,000–2,000 sq metres) and larger grocery stores are in the same product market; and (c) for convenience stores (ie grocery stores smaller than 280 sq metres), all grocery stores are in the same product market. In terms of store fascia, the CC has provisionally found that a store operated by any of the full-range national or regional grocery retailers and symbol groups will be in the same product market as other full-range grocery stores. (Stores operated by the LADs, Iceland and Farmfoods are excluded from the product market.) In terms of the geographic market, the CC has found that: (a) larger stores will, in general, be constrained by other larger grocery stores within a 10- to 15-minute drive-time; (b) mid-sized grocery stores will, in general, be constrained by other mid-sized stores within a 5- to 10-minute drive-time and by larger grocery stores within a 10- to 15-minute drive time; and (c) convenience stores will, in general, be constrained by other convenience stores within approximately half a mile, by mid-sized stores within a 5- to 10-minute drive-time and by larger grocery stores within a 10- to 15-minute drive-time. See CC, *Market Investigation to the Supply of Groceries in the UK, Provisional Findings Report*, 31 October 2007, paragraphs 4.145 to 4.151.

and decisions in this case are linked to, but are separate from, those in the groceries market investigation.

- 5.3 In assessing the relevant product and geographic markets, consistent with our guidelines, we considered a range of evidence in the context of the SSNIP test (also known as the hypothetical monopolist test).⁵⁹ The extent to which a hypothetical monopolist would profitably be able to impose a small but significant non-transitory increase in price (SSNIP) is determined by the scope for demand- and supply-side substitution. In the context of grocery retailing, our focus is on demand-side substitution as we consider that the scope for supply-side substitution is limited given the timescales and investments that would be required.

Product market

- 5.4 Consumers, when purchasing groceries, can choose between a wide range of stores. From a consumer's viewpoint, there are many differentiating factors between these stores. These include, among others, price, range of products, quality of products, cleanliness, parking facilities and opening hours.⁶⁰ We refer to the sum of these aspects as the 'retail offer'. The 'retail offer' is essentially the product sold by grocery retailers to consumers. Some of these factors, such as price, product range and opening hours, can be varied by retailers relatively easily and quickly, while other factors, such as parking facilities and store layout, are less easily or quickly changed.
- 5.5 We consider that there are two observable variables which capture many aspects of the retail offer of any given store: store size, and the brand or banner under which the store is operated (hereafter 'store fascia'). As a result, we analyse and describe the relevant product market in terms of, first, store size, and second, store fascia.⁶¹

Store size

- 5.6 In assessing, in the following paragraphs, the extent to which stores of different sizes place a competitive constraint on each other such that it warrants including them in the same product market, we:
- discuss the extent to which product range, store amenities and consumer shopping patterns vary with store size;
 - present an analysis of the impact of entry by new grocery stores on the revenue of existing grocery stores where we vary the size of both the new and existing grocery store;
 - review Tesco's analysis of the competitive constraint between stores of different sizes; and
 - finally, relate our general assessment to the size of grocery stores near to the CGL store and Tesco Brunel Way.

⁵⁹CC2, *Merger References: Competition Commission Guidelines*, paragraph 2.2.

⁶⁰These have sometimes been collectively termed 'PQRS', which is an abbreviation of price, quality, range and service, but also encompasses other factors such as convenience (eg see *Somerfield plc/Wm Morrison Supermarkets plc: a report on the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc*, TSO, September 2005—'Somerfield report').

⁶¹While we consider that store size and fascia capture many aspects of the retail offer and thus represent the most useful way of describing the relevant product market in general terms, this does not mean that all other factors should be disregarded when considering the competitive constraint placed on one store by another. We consider these other factors further in the context of our analysis of the effects of the merger in Section 7 and our analysis of remedy options in Section 8.

5.7 As we set out in paragraphs 2.4 to 2.6, prior to the merger, the CGL store had a net sales area of 4,300 sq metres and the original Tesco Brunel Way store had a net sales area of 5,700 sq metres. As a result, our review of the extent to which grocery stores of different sizes constrain each other focuses primarily on the constraints placed by other different-sized grocery stores on grocery stores of a size similar to the CGL store and Tesco Brunel Way.

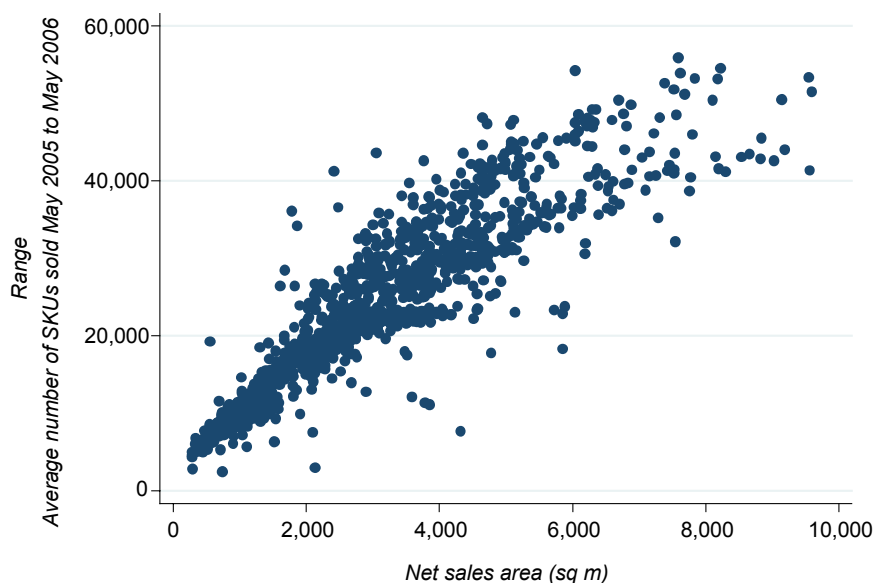
Variation in product range, store amenities and shopping patterns by store size

5.8 In relation to product range, larger stores typically carry a larger number of different products than smaller stores. Figure 3 shows the relationship between store size (net sales area in sq metres) and range (the average number of grocery and non-grocery stock-keeping units (SKUs) sold per month between May 2005 and May 2006) at Asda, Morrisons and Tesco stores in the UK. To the extent that products are available in larger stores but not in smaller stores, this will affect the extent to which consumers view shopping in a smaller store as a satisfactory substitute for shopping in a larger store.

5.9 For larger stores, some of this variation in product range will be driven by non-grocery rather than grocery products. However, the availability of non-grocery products may also influence the extent to which consumers regard different-sized stores as substitutes for one another.

FIGURE 3

Store size and product range



Source: CC analysis of data provided by Asda, Morrisons and Tesco.

5.10 The extent to which different-sized stores will offer different types of amenities to customers, including food counters, is also likely to influence whether customers view these stores as substitutes for one another. In general, larger stores are more likely to offer a greater range of food counters and other amenities, and thus as a group provide a different retail offer to that of smaller stores.

5.11 In terms of food counters, there is a substantial increase in the availability of fish, meat, delicatessen and bakery counters at stores larger than 1,000 sq metres compared with stores of 280 to 1,000 sq metres (see Table 2). For example, 65 per

cent of stores larger than 1,000 sq metres have a fish counter compared with only 1 per cent of stores 280 to 1,000 sq metres. The availability of these counters further increases for stores larger than 2,000 sq metres, but the comparison with stores smaller than 2,000 sq metres is less of a contrast than between stores larger and smaller than 1,000 sq metres.

TABLE 2 Proportion of stores with food counter by size group

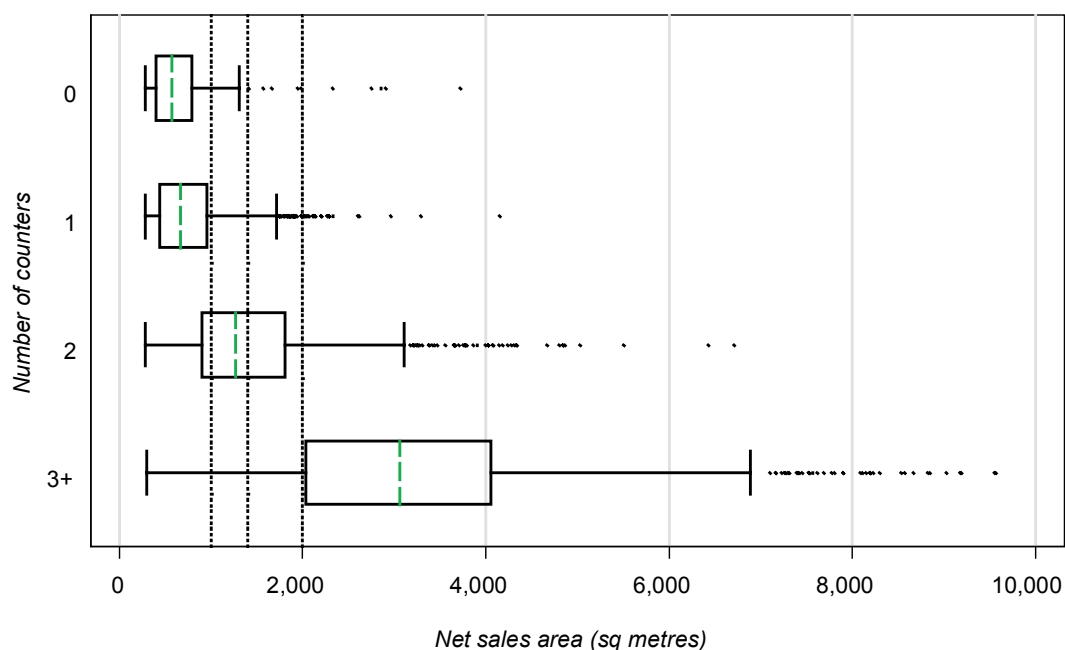
Food counter	per cent			
	280– 1,000 sq m	>1,000 sq m	>1,400 sq m	>2,000 sq m
Fish	1	65	78	87
Meat	2	50	60	66
Delicatessen	19	86	93	97
Bakery	83	97	98	99
Total number of stores	1,486	2,333	1,838	1,385

Source: CC analysis of data provided by Asda, Co-op, M&S, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose.

Note: The bakery data captures both 'bake-off' and 'scratch' offers. As a result, some small stores are classed as having an in-store bakery when in practice they offer a limited 'bake-off' range. However, in other instances bake-off will provide a close substitute to scratch. As a result, some caution is required when interpreting the results.

FIGURE 4

Number of food counters available, by store size



Source: CC analysis of data provided by Asda, Co-op, M&S, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose.

Notes:

1. First dotted line indicates 1,000 sq metres; second dotted line indicates 1,400 sq metres; third dotted line indicates 2,000 sq metres.
2. The area within each box represents the middle 50 per cent of the distribution. The horizontal line to the left of the box represents the first 25 per cent of the distribution and the line to the right the last 25 per cent of the distribution.
3. The dots to the right-hand side of the upper quartile represent outside values. These are stores for which the net sales area is larger than the upper quartile plus 1.5 times the inter-quartile range of values across other stores.

- 5.12 The total number of food counters also increases with store size (see Figure 4). Nearly 75 per cent of stores that have two food counters are larger than 1,000 sq metres, and more than 75 per cent of stores that have three or more food counters are larger than 2,000 sq metres. Similarly, more than 75 per cent of stores that only have one food counter are smaller than 1,000 sq metres.
- 5.13 The availability of a range of amenities, such as parking, ATMs and petrol filling stations, at stores of different sizes is shown in Table 3. For each of the seven amenities shown in this table, there is a substantial increase in availability in stores larger than 1,000 sq metres compared with stores of 280 to 1,000 sq metres. As with the four food counters reviewed in paragraph 5.11, the availability of these amenities further increases for stores larger than 2,000 sq metres, but the comparison with stores smaller than 2,000 sq metres is less of a contrast than between stores larger and smaller than 1,000 sq metres.

TABLE 3 Proportion of stores with each amenity, by size group

Variable	per cent			
	280– 1,000 sq m	>1,000 sq m	>1,400 sq m	>2,000 sq m
Parking	48	93	98	99
Toilets	11	78	90	96
ATM	46	80	88	94
Cafe	3	54	67	77
Petrol	9	44	55	67
Photo processing	2	38	46	54
Pharmacy	1	24	31	35
Total number of stores	1,760	2,403	1,871	1,392

Source: CC analysis of data provided by Asda, Co-op, M&S, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose.

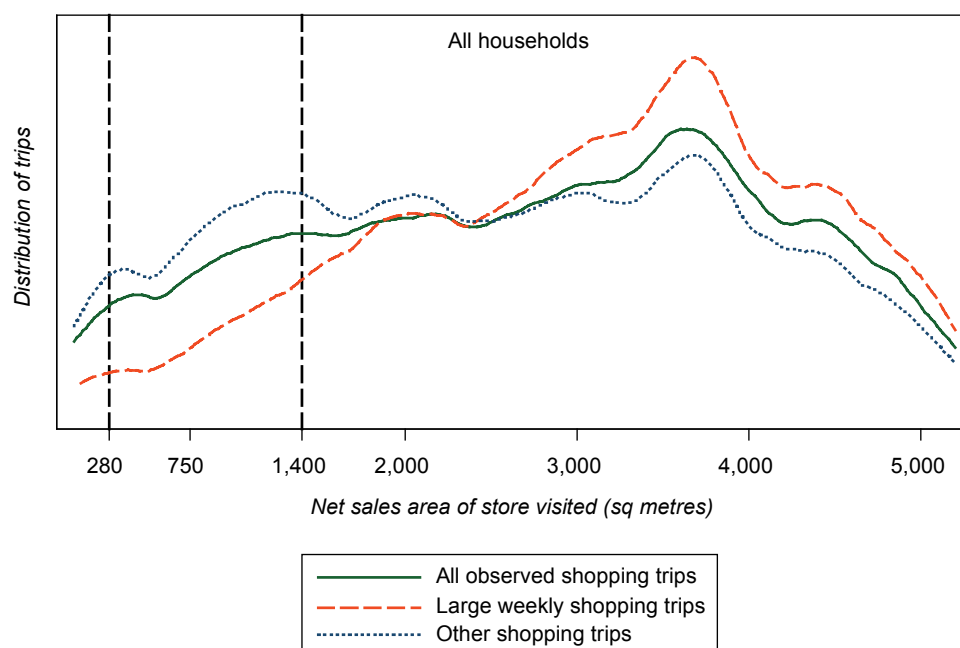
- 5.14 Consumer shopping patterns also indicate that for a substantial proportion of shopping trips consumers are unlikely to consider that smaller stores are a suitable substitute for larger stores. Figure 5 shows a steady increase in the proportion of households conducting large weekly shopping trips in stores of larger sizes.⁶² For other shopping trips, Figure 5 shows a more even distribution of these shopping trips over stores of different sizes. This appears to indicate that for small shopping trips consumers view all stores as good substitutes, but that consumers view larger stores as more suitable for large shopping trips. Large weekly shopping trips are an important source of revenue for stores larger than 1,400 sq metres accounting for nearly three-quarters of all sales.⁶³

⁶²For the purposes of this analysis, we define a large weekly shopping trip as one in which the customer spends more than 60 per cent of their total weekly grocery expenditure.

⁶³CC analysis of TNS household survey data.

FIGURE 5

Store size distribution of household shopping trips, October 2006



Source: CC analysis of cleaned TNS data covering a four-week period during October 2006.
 Note: This distribution is a Kernel density estimate, which is a smoothed histogram.

5.15 The evidence on product range, store amenities, including food counters, and consumer shopping behaviour all indicates that smaller grocery stores are not substitutable for larger grocery stores for a substantial proportion of customers' shopping trips. That is, larger grocery stores are unlikely to face as strong a competitive constraint from smaller stores as they face from other larger stores. We consider that these differences are too great to lead to much consumer switching following a small price increase, and thus larger grocery stores are in a separate product market from other grocery stores. The appropriate delineation between larger grocery stores and other grocery stores will vary between local markets depending on the structure of grocery retailing in that market. However, on the basis of the evidence set out in paragraphs 5.6 to 5.13, we consider that this boundary is likely to be between 1,000 and 2,000 sq metres.⁶⁴

Entry analysis

5.16 In addition to our analysis of product range and store amenities, we have also assessed the extent to which the revenues of larger grocery stores are affected by the entry into the same local area by new grocery stores of different sizes.⁶⁵ This enables us to assess the extent to which customers will, in practice, switch from their existing store to another store of the same or different size when such a store becomes available.

5.17 Our analysis shows that for incumbent stores larger than 1,400 sq metres, entry by a new store larger than 4,000 sq metres within a 5-minute drive-time will reduce revenues at the incumbent store by around 11 per cent, while entry by a new store

⁶⁴This is consistent with our provisional findings in the groceries market investigation.

⁶⁵For the purposes of this analysis, we have defined a large store as larger than 1,400 sq metres in net sales area, and mid-range stores as 280 to 1,400 sq metres in net sales area.

between 1,400 to 4,000 sq metres will reduce revenues at the incumbent store by around 7 per cent (see Table 4). Where the new entrant is a store between 280 and 1,400 sq metres, however, the estimated revenue impact on the incumbent store is much smaller at around 1.7 per cent. These findings indicate that stores larger than 1,400 sq metres place a stronger competitive constraint on each other than they face from grocery stores smaller than 1,400 sq metres. (A full explanation of this analysis is provided at Appendix C.)

TABLE 4 Revenue impact on incumbent stores from new store entry

	<i>Revenue effect (%) on incumbent stores larger than 1,400 sq m</i>
Entry of mid-size store (280–1,400 sq m)	
—within 5 minutes' drive-time	-1.7***
—within 5–10 minutes' drive-time	-0.39
—within 10–15 minutes' drive-time	-0.43
—within 15–20 minutes' drive-time	0.31
Entry of large store (1,400–4,000 sq m):	
—within 5 minutes' drive-time	-7.1***
—within 5–10 minutes' drive-time	-5***
—within 10–15 minutes' drive-time	-2.3***
—within 15–20 minutes' drive-time	-0.7
Entry of very large store (>4,000 sq m):	
—within 5 minutes' drive-time	-11***
—within 5–10 minutes' drive-time	-6.9***
—within 10–15 minutes' drive-time	-2***
—within 15–20 minutes' drive-time	-0.17
Store-quarter observations	21,944

Source: CC analysis.

Note: Medium-term estimates are based on regression coefficients reported in Table 1 of Appendix C. Asterisks indicate that the medium-term estimate is significantly different from zero with the following confidence levels: *90%, **95%, ***99%.

Tesco analysis of the competitive constraint between different-sized grocery stores

- 5.18 Tesco submitted an econometric analysis of TNS household data that it considered supported a finding that there was no relevant store size threshold that defined a separate product market. Tesco stated that the results of its analysis showed that there was no difference in customer preferences in terms of absolute or relative store size for stores larger than 280 sq metres and so there was no basis for identifying separate product markets among stores larger than 280 sq metres.
- 5.19 We have a number of concerns, however, with this analysis. We do not consider that the empirical model used by Tesco credibly explains customers' choice of grocery store. For example, the analysis does not examine the willingness of customers to switch between stores of different sizes, which would inform our understanding of customer substitution patterns.⁶⁶ In addition, Tesco's model does not use actual store sizes but allocates each store to one of 18 arbitrary size categories. We are concerned that the results may be sensitive to the number and scale of size categories used in this analysis. Finally, we consider that Tesco's results appear counter-intuitive, which casts doubt on the robustness of Tesco's analysis. For example, Tesco finds that after controlling for fascia, the larger a store, the less appealing it becomes to customers. Given these issues, we do not consider that the results of

⁶⁶ [X]

this model can usefully inform an assessment of customer substitution patterns between stores of different sizes.

Size of grocery stores in Slough

- 5.20 Given our assessment that larger grocery stores face a stronger competitive constraint from each other than from other grocery stores, we consider that a hypothetical monopolist controlling all large grocery stores in a distinct geographic market could profitably impose a small but significant price increase, and as a result large grocery stores constitute a separate product market. As we set out in paragraph 5.15, the appropriate delineation between larger grocery stores and other grocery stores will vary between local markets, but this boundary is likely to be between 1,000 and 2,000 sq metres.
- 5.21 As a preliminary step in defining the relevant market in which Tesco Brunel Way and the CGL operated, we review the size distribution of grocery stores in Slough. (Our conclusion on the relevant market in which these stores operated prior to the merger, however, must also take into account our findings on store fascia and the relevant geographic market.) Table 5 shows the size range of grocery stores in Slough at the time of the merger. There were four supermarkets each with a net sales area of more than 2,000 sq metres ranging in size from the smallest, Sainsbury's in Taplow at 3,000 sq metres, to Tesco Brunel Way at 5,700 sq metres. The Safeway store on Farnham Road had a net sales area of 1,400 sq metres.
- 5.22 There were also a number of supermarkets smaller than 1,000 sq metres, including a Somerfield store of approximately 500 sq metres, a local independent retailer, Chalvey Supermarket, of approximately 540 sq metres and a Budgens of around 460 sq metres. Lidl, a limited assortment discounter (LAD), and Iceland, a specialist frozen food retailer, also had stores in Slough. Each of these was also smaller than 1,000 sq metres.

TABLE 5 **Range in the size of supermarkets in Slough, October 2003**

<i>Fascia</i>	<i>Address</i>	<i>Store size (net sales area, sq metres) at time of merger</i>
Tesco	Brunel Way	5,700
Asda	Telford Drive	5,500
CGL	Uxbridge Road	4,300
Sainsbury's	Taplow	3,000
Safeway	Farnham Road	1,400
Lidl	Farnham Road	750
Iceland	Farnham Road	570
Chalvey Supermarket	Chalvey	540
Somerfield	Elmshot Lane	500
Budgens	The Harrowmarket	460

Source: CC.

- 5.23 As we indicate in our discussion of store amenities and food counters in paragraphs 5.8 to 5.13, we consider that store size is a useful approximation of the availability of these different amenities and facilities at a store. However, we have also specifically considered the extent to which these amenities and facilities were available at different grocery stores in Slough, and whether this may have influenced the extent to which customers were willing to substitute between these stores.
- 5.24 In terms of food counters, at the time of the acquisition Tesco Brunel Way, Asda Telford Drive and Sainsbury's Taplow each had six food counters (delicatessen,

bakery, fish, meat, hot food and salad bar). We do not have information on the food counters at the CGL store and Safeway Farnham Road store at the time of the acquisition. However, the Farnham Road store, now owned by Sainsbury's, currently has four food counters (delicatessen, bakery, meat and hot food). In terms of amenities, at the time of the acquisition Tesco Brunel Way, CGL and Asda each had petrol stations. Further, Tesco Brunel Way, the CGL store, Asda Telford Drive and Sainsbury's Taplow each had dedicated parking facilities. Safeway Farnham Road did not, however, have dedicated parking, having to share its car park with nearby stores.

- 5.25 Given the size of grocery stores in Slough and their associated amenities, including food counters, we consider that Tesco Brunel Way, Asda Telford Drive, the CGL store and Sainsbury's Taplow were the closest substitutes to one another in terms of store size and associated amenities (ie putting to one side the issue of store fascia and geographic location). Safeway Farnham Road, although of a significantly smaller size, was also likely to represent a substitute for customers at these four stores, but this would have been limited to some extent by its lack of a petrol station and dedicated parking.

Store fascia

- 5.26 In considering the extent to which stores operated by different grocery retailers placed a competitive constraint on the original Tesco Brunel Way and the CGL store, such that it warrants including them in the same product market, we discuss in the paragraphs below:

- grocery retailers' monitoring of their competitors; and
- the revenue impact of different competitors on the stores of different retailers when entering their local market.

- 5.27 We then discuss the fascias that were present in Slough at the time of the merger and consider the competitive constraint from a local independent retailer, Chalvey Supermarket.

Grocery retailers' monitoring of their competitors

- 5.28 If two grocery retailers compete, we might expect them to monitor each other's offerings. The information that we have on grocery retailers' monitoring activities is that, in general, each monitors the prices of at least one other grocery retailer, and in some cases, monitors several. More specifically:

(a) Asda monitors [REDACTED];

(b) Morrisons monitors [REDACTED];

(c) Sainsbury's told us that it [REDACTED]; and

(d) Waitrose monitors [REDACTED].

- 5.29 Tesco told us that it compares prices on around 23,000 lines against [REDACTED], [REDACTED] and [REDACTED]. Tesco also monitors prices on around 800 products in [REDACTED] and [REDACTED]. Tesco also carries out weekly price checks against [REDACTED], monthly checks against [REDACTED] and 12 others and periodic or quarterly checks against a variety of other grocery retailers and symbol groups, including [REDACTED] and [REDACTED].

Entry analysis

- 5.30 In paragraphs 5.16 and 5.17, we discuss our analysis of the impact on the revenues of incumbent stores arising from the entry of new stores of different sizes. We have also examined the extent to which the revenues of stores operated by different grocery retailers are affected by the entry of different competitors in any local area. The full results are in Appendix C.
- 5.31 Our entry analysis indicates that a store operated by each of Asda, Morrisons, Sainsbury's, Tesco and Waitrose can be shown, in most cases, to suffer a significant negative impact on its revenues as a result of the entry of a new store operated by one of these other competitors.⁶⁷ The analysis also shows that Somerfield and Co-op stores (including both CGL and regional Co-ops) suffer revenue losses as a result of entry by Asda, Tesco, Sainsbury's (in the case of Co-op) and Morrisons, Asda and M&S (in the case of Somerfield). New M&S stores are seen to have a negative revenue impact on incumbent stores owned by Asda, Sainsbury's and Tesco as well as Somerfield.
- 5.32 The analysis also shows that the entry of an LAD (Aldi, Lidl and Netto) or Iceland store has a limited revenue impact on stores of other fascias. Similarly, the entry of other stores has a limited impact on incumbent LAD stores.⁶⁸

Store fascias in Slough

- 5.33 Based on the fascia monitoring activities of grocery retailers and our entry analysis, we consider that it would be possible for a hypothetical monopolist to impose a small increase in prices for stores of those fascias offering a full range of grocery products without losing a sufficient volume of sales to stores operated by the LADs or Iceland such that the price increase would be rendered unprofitable.
- 5.34 In paragraph 5.25, we conclude that each of the Asda, CGL, Sainsbury's and Tesco stores in Slough at the time of the merger, and to a lesser extent the Safeway store, each represented substitutes to each other for customers. The evidence on store fascia set out above also indicates that these stores were in the same product market.
- 5.35 Putting store size to one side, we have considered further the extent to which Chalvey Supermarket is a competitor to Tesco Brunel Way. Chalvey Supermarket is a grocery retailer (see paragraph 2.10) that supplies numerous lines of specialist Asian food products in addition to a wide range of standard grocery products at a store of about 540 sq metres.
- 5.36 There is a large Asian population in Slough, accounting for approximately 26 per cent of the total inhabitants of the area. Before the Tesco Brunel Way store expansion, customer research by Tesco found that its Asian customers in Slough occasionally used the key supermarkets in the area (Sainsbury's and Asda) as well as Tesco Brunel Way, but many travelled to Southall for Asian products. Tesco told us that the extended Tesco Brunel Way store provides a large range of products for Asian customers. For at least some of these customers (and others) Chalvey Supermarket may be an effective substitute store.

⁶⁷Not all of the fascias for which we report the results of our entry analysis were necessarily present in Slough at the time of the merger.

⁶⁸The exceptions to this general conclusion are the effect of the entry of a Lidl store on an incumbent Sainsbury's store and the entry of an Asda store on incumbent LAD stores.

- 5.37 CC staff visited Chalvey Supermarket. The store provides customers with standard grocery products in addition to its range of ethnic groceries. Chalvey Supermarket told us that it attracts customers from a wide area around Slough. The owner of Chalvey Supermarket told us that in addition to local shoppers, it attracts customers from Bracknell, Croydon and Swindon who come to do large monthly shopping trips. The store has a small adjacent car park and although the store does not meet the size threshold necessary to fall within the relevant product market defined above, we recognize that Chalvey Supermarket has a strong and attractive retail offer.
- 5.38 There is some evidence of competition between Chalvey Supermarket and Tesco Brunel Way. Chalvey Supermarket told us that it was competitively constrained by Tesco Brunel Way; store revenue fell by between £[x] and £[x] a week when the larger store opened in August 2005. In response, Chalvey Supermarket undertook a leafleting and marketing campaign in which it compared its prices with those of Tesco and Asda. Chalvey Supermarket told us that it had since made good the revenues initially lost following the opening of the larger Tesco Brunel Way. We understand that Chalvey Supermarket continues to compare its prices with those of Asda Telford Drive and Tesco Brunel Way in its advertising material.
- 5.39 However, Chalvey Supermarket told us that it did not compete directly with Tesco Brunel Way and considered itself to be more of a complement to Tesco. This is consistent with evidence from Tesco's internal documents, which do not identify Chalvey Supermarket as a key competitor. We do not consider that Chalvey Supermarket imposes a significant competitive constraint on Tesco Brunel Way.

Findings on product market

- 5.40 In summary, we consider that the relevant product market to assess the impact of Tesco's acquisition of the CGL store comprises the Asda, CGL, Sainsbury's and Tesco supermarkets in Slough. We also include in the relevant product market the Safeway store in Farnham Road, although we consider that at the time of the merger, and currently, it places a weaker competitive constraint on these other four stores in product market terms as a result of a combination of its smaller size, its relative lack of parking facilities and its lack of a petrol filling station.
- 5.41 We set out in the following paragraphs our reasons for considering that the scope of the geographic market for the supply of groceries is limited to these stores rather than stores located in a wider, or narrower, geographic area.

Geographic market

- 5.42 This section sets out our assessment of the relevant geographic market in which the original Tesco Brunel Way store and the CGL store operated. We describe the relevant geographic market for the supply of groceries in terms of drive-times between competing stores. Specifically, the geographic market is defined by the distance to the furthest store in a collection of stores that effectively constrain the behaviour of the store (or merging stores) that are of interest for our analysis.
- 5.43 In considering the geographic market in which the original Tesco Brunel Way and the CGL store operated, the following paragraphs:
- first, review consumer demand-substitution patterns between stores in geographic terms;

- second, present the results of our analysis of the revenue impact on incumbent grocery stores of local entry by new grocery stores;
- third, review internal assessments by Tesco and CGL of the local stores that constrained their own stores in Slough;
- fourth, examine topographic features in and around Slough and the extent to which these are likely to influence the extent of the geographic market in which the Tesco and CGL stores operate;
- fifth, consider evidence on the catchment areas for grocery stores in Slough and the extent to which these extend outside Slough; and
- finally, consider Tesco's submissions on the scope of the geographic market, including the presence of chains of substitution and the results from its SSNIP simulation model for Slough.

Demand substitution between grocery stores

5.44 The starting point for any analysis of the geographic market is that consumers shop within a reasonable drive-time from their home or, in some cases, work. As a result, we expect that shoppers at Tesco Brunel Way and the CGL store would only consider other local grocery stores as alternatives. While this indicates that the geographic market is likely to be local, it is necessary to define the scope of the term 'local'. We also consider further factors, such as chains of substitution, that might further expand the geographic market.

Entry analysis

5.45 The extent to which revenues at an existing grocery store are affected by the entry of a new grocery store will be indicative of the extent to which customers are willing to substitute from an existing store to a new store. We have analysed the impact of new store entry on incumbent store revenues where the new store is located varying distances away from the incumbent store (see Appendix C). This shows that the impact of new store entry decreases with the distance that a new store is located from the incumbent store. The most substantial effects are observed within a 5-minute drive-time and little effect is observed beyond 10 to 15 minutes in the case of new entry by stores larger than 1,400 sq metres.

Internal assessments by Tesco and CGL

5.46 Tesco, in an internal assessment of the local competition facing Tesco Brunel Way and the CGL store, set out as part of a submission to the relevant Tesco board committee ([X]) in June 2003 (see paragraph 3.11), mentioned three other stores in Slough. These were Asda Telford Drive, Safeway Farnham Road and Sainsbury's Taplow. Tesco told us that this list was not intended to be exhaustive, but that these three stores were 'the most significant competitors'. There was no discussion in this document of the competitive threat posed by stores outside Slough, for example in Windsor or Uxbridge, that have subsequently been cited by Tesco during this inquiry.

5.47 CGL, in considering the sale of its Slough store, also looked at competition in the Slough area. This assessment was included in the Proposed Superstore Disposal report to CGL's South East Regional Board considered in June 2003. CGL identified

the same three stores as in the Tesco assessment (the Asda, Sainsbury's and Safeway stores), as well as Tesco Brunel Way and the Tesco store in Windsor.⁶⁹

Topographic features of Slough

- 5.48 The ability of consumers shopping at Tesco Brunel Way and the CGL store to have switched to competitor stores will, in part, have depended on the topographic features of Slough. Slough forms a distinct urban area, separated from Windsor to the south, Maidenhead to the west, urban London to the east, and Uxbridge to the north-east. There are, in a number of cases, barriers impeding easy travel between Slough and its neighbouring urban centres:
- to the south, Slough is separated from the town of Windsor by the M4 and the River Thames;
 - to the east; Slough is bounded by the M25; and
 - to the north and west, the area is relatively sparsely populated.
- 5.49 These barriers, particularly the motorways and the River Thames, are likely to represent greater barriers to travel between Slough and its neighbouring towns than might be implied by estimated drive-times. At certain times of the day, in particular, the presence of these barriers is likely to result in significantly longer travel times and thus represent a further barrier to switching from grocery retailers within Slough to those outside the geographic area.

Overlap in catchment areas for grocery stores in and around Slough

- 5.50 We define the catchment area of a grocery store as the area in which a large majority of its customers are located. When stores have similar or largely overlapping catchment areas, they tend to compete for the same customers, and therefore we generally include these stores in the same geographic market. It follows that we might gain an understanding of whether grocery stores in Slough compete with grocery stores outside Slough, by the extent to which customers buying groceries in Slough live outside Slough.
- 5.51 Tesco told us that, based on its Clubcard data, [X] per cent of sales at Tesco Brunel Way are generated by customers that live outside Slough, although our analysis of its Clubcard data shows that almost [X] per cent of the customers at Tesco Brunel Way reside within the Slough postal districts of SL1, SL2 and SL3. Tesco told us that this showed that the catchment area of Tesco Brunel Way was wide, and substantially wider than the CC's provisional geographic market would suggest. It considered that those customers living outside Slough would be highly likely to switch away in the event of a SSNIP. Our review of this data shows that about [X] per cent of sales at Tesco Brunel Way are from customers who appear to live significant distances from Slough.⁷⁰ While this includes customers in the London region, it also includes customers with home addresses in towns as far away as Milton Keynes, Southampton, Leicester, Bournemouth, Manchester, Norwich, Swindon, Cambridge, Ipswich, Nottingham, Birmingham, Coventry, Sheffield, Peterborough, Leeds, Cromer, Withernsea and Aberdeen. On this basis, the total proportion of sales from

⁶⁹CGL Retail Division, Proposed Superstore Disposal, Slough, South East Region, 17 June 2003.

⁷⁰This is based on sales from customers living beyond Slough and the surrounding areas of Windsor, Iver, Maidenhead, Gerrards Cross and Uxbridge.

customers living outside Slough might not be a useful measure of the willingness of customers to switch away in response to a SSNIP.

- 5.52 Tesco further told us that [X] per cent of customers who live within 10 minutes of Tesco Brunel Way are within 5 minutes of the edge of the isochrone (ie live between 5 and 10 minutes' drive-time from the store), so could readily switch away in response to a SSNIP. On this basis, Tesco suggested that it was more likely that significant switching to stores located outside a 10-minute drive-time would occur.

FIGURE 6

Sales distribution for Tesco Brunel Way

[X]

Source: Tesco.

- 5.53 While customers at Tesco Brunel Way may live outside Slough, or on the edge of a 10-minute drive-time isochrone, this does not necessarily indicate that these customers are marginal customers who would switch to a store closer to their residence in the event that large grocery stores in Slough increased their prices.⁷¹ For example, we consider it likely that many of these customers, while living outside Slough, work in Slough and shop on their way to or from work given the large number of commuters travelling into Slough each day to work (see paragraph 2.2). Given that some of these customers are likely to be shopping in Slough as a result of its convenient location relative to their place of work, we do not consider that these customers should necessarily be regarded as marginal customers likely to shift to alternative shopping locations in the event that prices were to increase in Slough.
- 5.54 Tesco Brunel Way, in particular, is likely to benefit from this commuter trade. Slough Borough Council told us that 'Tesco [Brunel Way] is a very different location. It must be one of the best sites in the country, because not only is it on the main road, it is right by the town centre, immediately next to the bus station and immediately next to a major railway station. It has got everything going for it, really.'
- 5.55 Tesco, however, told us that we had significantly overestimated the number of people shopping in Slough on work trips. Tesco submitted evidence from an online survey conducted by Decision Technologies in June 2005, and told us that the results of the survey show that, outside central London, it is estimated that less than 10 per cent of grocery trips originate from the workplace and that many of those customers will also shop from home. Tesco also presented evidence based on Clubcard shopping data that it told us showed that only a small minority of sales are likely to be attributable to customers shopping from work.⁷²
- 5.56 However, we consider it unlikely that there are large numbers of customers living in neighbouring towns, such as Windsor, Maidenhead or Uxbridge, that are specifically travelling to Slough for their grocery shopping. Slough is not generally considered to be a destination centre for shopping (although we are aware of the effort Slough Borough Council is currently making to improve the attractiveness of the town centre

⁷¹More formally, whether these customers would switch to other stores in the event that a hypothetical monopolist of supermarkets in Slough implemented a SSNIP.

⁷²Tesco told us, on the basis of survey evidence that customers who shop from work have more switching options than those who shop from home, that commuters are more likely to be marginal. However, it is possible that these customers are more time sensitive than other shoppers and therefore less willing to switch in response to a SSNIP. For example, we consider it likely that these consumers may have a higher opportunity cost for their free time and therefore be less willing to spend more time at the weekends shopping for groceries. In this case, they may be less willing to incur extra travel time to switch in response to a SSNIP.

for shopping). The Planning Inspector's report regarding Tesco's proposed development of the CGL site in 2005 notes that 'market perceptions of Slough's attractions and its image require improvement'.⁷³ Tesco Clubcard data indicates that few of the sales at Tesco Brunel Way originate from customers living in the Windsor area.

- 5.57 We consider further evidence on catchment areas in Section 7, in discussing the extent to which different grocery stores in Slough place a competitive constraint on each other. The evidence that we review in Section 7 does not, however, support a finding that the geographic area for grocery retailing is narrower than the set of large grocery stores located in Slough.

Tesco's submissions on the scope of the geographic market

- 5.58 Tesco, as part of its submissions to the CC's groceries market investigation (see paragraph 1.5), has submitted that the relevant geographic market for grocery retailing in the UK is national. Tesco told us that if the CC found that there were local markets for grocery retailing, it believed that the relevant local markets were all different, significantly wider than 10 minutes' drive-time in the vast majority of cases and, often, wider than 30 minutes' drive-time. In support of this, Tesco provided the CC with arguments regarding the scope of competitive initiatives undertaken by grocery retailers,⁷⁴ chains of substitution between local markets, and a simulation model of the SSNIP test, which sought to demonstrate that most local markets were at least 30 minutes wide. Tesco has drawn on these arguments in its submissions to this merger inquiry to argue that our analysis of its acquisition of the CGL store should be considered in the context of a national market for grocery retailing.

Chains of substitution

- 5.59 Although consumer demand substitution is local, Tesco submits that, based on a chain of substitution, the market is national, or that if the CC found that there were local markets for grocery retailing, it believed that the relevant local markets were all different, significantly wider than 10 minutes' drive-time in the majority of cases, and often wider than 30 minutes' drive-time. A chain of substitution implies that two stores that are not direct substitutes for customers may be still in the same geographic market. Unlike Tesco, we consider that the chain of substitution is likely to break at a point that suggests the market is unlikely to be national. In Appendix D, we provide more detailed analysis on this point.

Tesco's SSNIP simulation model

- 5.60 Tesco, as we set out in paragraph 5.58, has submitted a quantitative model to the groceries market investigation which seeks to simulate the application of the SSNIP test to assess the extent of the geographic market for grocery retailing. Based on this model, Tesco considers that the geographic market for grocery retailing in Slough is at least 30 minutes' drive-time wide, and includes 35 stores larger than 1,400 sq metres operated under seven different fascias, and 93 stores larger than 280 sq metres operating under at least 15 different fascias.

⁷³Hoile C J, Inspector appointed by the First Secretary of State, *Application by Spen Hill Developments Limited, 78 Uxbridge Road, Slough, Report to the First Secretary of State*, 5 October 2005, paragraph 50.

⁷⁴For example, Tesco referred to the fact that it reduced prices in response to competitors such as Morrisons that were not present in the local area, and the fact that its offer was designed, planned and implemented centrally and reflected conditions of national competition.

5.61 We have tested the robustness of this simulation model by relaxing some of the underlying assumptions of the model. After this analysis we have some concerns that the wider geographic markets are the result of the assumptions of the model. In Appendix E we review the model provided by Tesco in detail. We note that when we varied some of the assumptions, Tesco’s model suggests that the geographic market in which Tesco Brunel Way operates includes stores within 10 minutes’ drive-time, consistent with the other evidence we have reviewed. However, we place limited weight on this result, given the significant concerns we have regarding the robustness of this model.

Findings on the geographic market

5.62 We set out in Table 6 the estimated drive-time between Tesco Brunel Way and each of the large grocery stores in Slough that we identified in paragraph 5.40 as being part of the same product market as Tesco Brunel Way and the CGL store. This shows that each of these stores was within 10 minutes’ drive-time of Tesco Brunel Way.

TABLE 6 Drive-times between Tesco Brunel Way and other large grocery stores

<i>Grocery store</i>	<i>Drive-time to Tesco Brunel Way mins</i>
CGL, Uxbridge Road	3
Safeway, Farnham Road	6
Asda, Telford Drive	10
Sainsbury’s, Taplow	10
Waitrose, Windsor	10
Tesco, Windsor	13

Source: CACI analysis.

5.63 Based on our entry analysis, the internal assessments of Tesco and CGL, and our assessment of the overlap in catchment areas for these grocery stores, we consider that Safeway Farnham Road, Asda Telford Drive and Sainsbury’s Taplow were each part of the same relevant geographic market as the original Tesco Brunel Way and the CGL store. In relation to Sainsbury’s Taplow, however, we consider that its location means that it is unlikely to be a particularly strong competitor to Tesco Brunel Way.

5.64 We have also considered whether the Waitrose and Tesco stores in Windsor should be included in the relevant geographic market. CGL identified the Tesco store in Windsor as part of its competitive assessment at the time of selling its Slough store (see paragraph 5.47), and Tesco has noted that it is located a similar drive-time away from Tesco Brunel Way as Sainsbury’s Taplow. Further, according to Tesco Clubcard data, the proportion of customers living in Windsor is somewhat higher than that living in Maidenhead (which incorporates Taplow).

5.65 However, we do not conclude that these stores should be included in the same geographic market as Tesco Brunel Way and the CGL store for the following reasons. First, Tesco did not identify either store in Windsor in its internal assessments and investment appraisals (see paragraph 5.46). Second, there are topographic barriers between Slough and Windsor, namely the River Thames, and as a result, the limited road access between these two destinations that are likely to result in significantly longer travel times between Slough and Windsor than those set out in Table 6 (see paragraph 5.49). Third, while Tesco Clubcard data indicates that more sales originate from the Windsor area than Maidenhead, the total proportion of sales

from customers living in each area remains relatively small. In our view, this emphasizes the relatively weak constraint placed on Tesco Brunel Way by Sainsbury's Taplow (see paragraph 5.63). Further, customers' switching opportunities from Tesco Brunel Way to the Waitrose store in Windsor have been significantly limited in the period since the merger by the closure of the Waitrose store in Windsor during the period from mid-2004 to October 2007.

- 5.66 Finally, we consider that in product market terms, there are grounds for distinguishing between Waitrose Windsor and Sainsbury's Taplow, and thus the extent to which customers would be willing to substitute either of these stores for Tesco Brunel Way. In particular, Sainsbury's Taplow has a net sales area of 3,000 sq metres compared with 1,300 sq metres for Waitrose Windsor at the time of the merger. (We discuss the subsequent extension of this store in paragraph 7.60.) Further, Waitrose Windsor faces significant parking constraints in that it shares a multi-storey car park with a large number of comparison goods retailers, which reportedly suffers from capacity problems.⁷⁵
- 5.67 In summary, we consider that the relevant geographic market in which Tesco Brunel Way and the CGL store operated includes both of these stores as well as Asda Telford Drive, Sainsbury's Taplow and Safeway (now Sainsbury's) Farnham Road.

Findings on the relevant market

- 5.68 We consider that the relevant market in which Tesco Brunel Way and the CGL store competed also included Asda Telford Drive, Sainsbury's Taplow and Safeway Farnham Road⁷⁶ although, for the reasons set out in paragraphs 5.25 and 5.63, we do not consider that each of these latter three stores exercised at the time of the merger an equivalent competitive constraint on the merging stores.

6. The counterfactual

- 6.1 In deciding whether the merger gives rise to an SLC, we must compare the competitive constraints on the merged entity after the merger with the competitive situation that would have been expected to prevail without the merger (the counterfactual).⁷⁷ In determining the appropriate counterfactual for this merger inquiry, we consider below two key elements:
- (a) ownership of the CGL store absent the Tesco purchase; and
 - (b) the likely scope of any redevelopment of Tesco Brunel Way absent Tesco's purchase of the CGL store.

Ownership of the CGL store absent a Tesco purchase

- 6.2 We consider that the most likely outcome in the event that Tesco did not acquire the CGL store was the purchase of the store by Sainsbury's.⁷⁸ Based on CGL's valuations, the bid from Sainsbury's was the second highest (and the cash component of its bid was highest), while the difference between CGL's valuation of the bids from

⁷⁵Ascot, *Windsor & Eton Express*, 'Car parking crisis in the run up to Christmas', 2 November 2007.

⁷⁶That is, a hypothetical monopolist of these five stores would have profitably been able to implement a small, but significant, non-transitory price increase (ie a 5 per cent price increase).

⁷⁷CC, *Merger References: Competition Commission Guidelines*, CC2, paragraph 1.22.

⁷⁸The purchase of the CGL store by Sainsbury's under the counterfactual differs from that set out in our provisional findings in that we are now more specific as to the identity of the purchaser of the CGL store that we consider most likely in the absence of a purchase by Tesco.

Tesco and Sainsbury's was less than £500,000.⁷⁹ Moreover, CGL told us that if Tesco had pulled out of the acquisition, it was unlikely to have gone back to other bidders and would have sold the store to Sainsbury's. Further, Sainsbury's was able to provide for the ongoing employment of CGL staff at the store, which was an additional non-financial consideration for CGL.

- 6.3 An acquisition of the CGL store by Sainsbury's would potentially have raised competition issues, given that we have identified its supermarket in Taplow as being part of the relevant market. For the purpose of determining the counterfactual, we have considered how the OFT would have examined an acquisition of the CGL store by Sainsbury's.
- 6.4 The Act does not oblige parties to notify the OFT of acquisitions, and, given that Sainsbury's submissions to the OFT in relation to Tesco's acquisition of the CGL store contended that the Taplow store was outside a 10-minute drive-time isochrone around the CGL store, it seems unlikely that Sainsbury's would have informed the OFT of this acquisition. The OFT has noted that Tesco did not inform the OFT of its acquisition of the CGL store, and that it was only following the receipt of consumer complaints that a merger investigation was commenced by the OFT. We therefore consider that Sainsbury's similarly may not have contacted the OFT if it had acquired the CGL store. It is possible that the OFT would not have commenced any investigation of a Sainsbury's acquisition of the CGL store.
- 6.5 Even if the OFT had commenced an investigation into the acquisition of the CGL store by Sainsbury's, the OFT only has jurisdiction to refer a merger to the CC or accept undertakings in lieu of a reference if it believes that a 'relevant merger situation' has been created. As explained in paragraph 4.2, a 'relevant merger situation' is created where two or more enterprises cease to be distinct and where the share of supply test or the turnover test specified in section 23 of the Act is satisfied. The share of supply test is satisfied if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK.
- 6.6 We understand that the OFT's usual practice when investigating mergers involving grocery retailers at that time was to apply the share of supply test based on the acquirers' national share of all grocery sales or such grocery sales from stores within a particular size band since this tended to be the basis on which data was available. This is reflected in the OFT's conclusion that Tesco's acquisition of the CGL store created a relevant merger situation (see paragraphs 4.4 and 4.5). If the OFT had adopted this approach to an acquisition of the CGL store by Sainsbury's, then the acquisition would not have satisfied the share of supply test, since Sainsbury's share of share of the supply of groceries from 'one-stop shops' in the UK in 2003 was 21 per cent.⁸⁰ The OFT could, however, have claimed jurisdiction if it applied the share of supply test for a substantial part of the UK ('the South' or 'South together with London'), where Sainsbury's share exceeded 25 per cent.⁸¹
- 6.7 As discussed in paragraph 3.35, the OFT, when assessing the current merger, applied the methodology used by the CC in the Safeway case. If the OFT had decided that the share of supply test was satisfied, we consider that an application of the Safeway methodology would not have raised competition concerns, since

⁷⁹CGL had its Slough store independently valued at £[redacted] million in January 2003. CGL told us that meeting the valuation of £[redacted] million was important to the sale as were additional non-financial factors, [redacted].

⁸⁰*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*, September 2003, Table 2.2 in paragraph 2.122.

⁸¹*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*, September 2003, Table 5.18 in paragraph 5.180.

Sainsbury's Taplow store is more than 10 minutes' drive-time from the CGL store. Alternatively, if the Sainsbury's Taplow store was considered to be within 10 minutes' drive-time of the CGL store, the 'fascia count' approaches outlined in the Safeway report would not have given rise to competition concerns.

- 6.8 The OFT told us that its comment to Tesco in June 2004, that 'on the basis of the information we have at present, the isochrone analysis we have received indicates that none of the major one stop store operators would be eligible purchasers of the [CGL] Uxbridge Road Store', was made in the context of how the 'market value' of the CGL store would be determined under the proposed undertakings in lieu. The OFT told us that this comment was never intended to be an analysis of each potential merger situation (ie the acquisition of the CGL store by each of the major one-stop-store operators), but rather a recognition of the factors that would need to be taken into account in any valuation of the CGL store upon a divestiture by Tesco.
- 6.9 As a result, we conclude that even if the OFT had decided that Sainsbury's acquisition of the CGL store was a 'relevant merger situation' under the Act, it would not have concluded that there was a duty to refer the acquisition to the CC or seek undertakings in lieu of a reference to the CC.
- 6.10 The second aspect of our counterfactual scenario is the extent of Tesco's redevelopment of its Brunel Way store had it not acquired the CGL store. Tesco's preferred development option for its Brunel Way store was an F100 format store (ie 100,000 sq feet or approximately 9,300 sq metres) that required it to temporarily relocate to another store or cease trading in Slough (other than through its convenience stores) for the period of the redevelopment.
- 6.11 Tesco in its initial submission to this inquiry stated that had it not acquired the CGL store, it would have redeveloped the Brunel Way store into an F80 or F90 format store (ie a store of either 80,000 or 90,000 sq feet, or approximately 7,400 or 8,400 sq metres) compared with the F100 store that was ultimately developed on the site. In relation to the F100 option, it stated that 'a significant disadvantage with this option was that a F100 store could only be developed by demolishing the existing store, making it impossible for us to trade from the site during redevelopment' due to the lack of available space for an on-site temporary retail unit.
- 6.12 Later in our inquiry, Tesco submitted that it was 'very possible that [Tesco] might have been able to build [its] ideal F100 store even without acquiring the [CGL] store'. However, Tesco also stated that 'such a possibility was not considered at the time', because the CGL store coming on to the market in early 2003 was a 'fortuitous event' which provided Tesco with the ability to build its preferred format and maintain its offer during the expansion of the Brunel Way store.⁸²
- 6.13 Tesco's successful application for planning approval to replace the original Brunel Way store with a new F100 format store indicates that it was also likely to have obtained planning approval for an F80 or F90 format store under the counterfactual scenario. Sainsbury's, however, has questioned whether this would have been the case, given its own plans to extend the CGL store had it been successful in acquiring it (see paragraph 6.4). However, Tesco told us that there was an underprovision of retail space in Slough suggesting sufficient demand to have accommodated

⁸²Tesco also made further submissions on this subject regarding its experience in other locations since the merger, and the possibility of it acquiring additional trading sites in Slough in addition to a temporary site at Brunel Way during the development. We do not consider that these points affect our expectation regarding the likely outcome in relation to Tesco's redevelopment of the Brunel Way store.

extensions to both Tesco Brunel Way and the CGL store, while Sainsbury's also told us that there was an underprovision of retail space in the Slough area.

- 6.14 Tesco's financial appraisal of the Brunel Way store extension shows that the cash return on investment for extending the store, assuming a competitor acquired the CGL store, was estimated at [X] per cent for an F90 store and [X] per cent for an F80 store. These projected returns were substantially below Tesco's portfolio investment hurdle rate of [X] per cent and, in isolation, suggests that Tesco may not have extended the Brunel Way store at all if a competitor acquired the CGL store.
- 6.15 Tesco, however, told us that its [X] per cent investment hurdle rate was a target that was applied to the entire store development portfolio rather than individually to each project. As a result, it submitted that projected returns below the [X] per cent hurdle rate would not have inhibited a store extension, and in support of this it provided us with a number of examples of store developments taking place despite having projected returns of less than [X] per cent. Tesco also submitted that projected returns would often change during a project, and provided examples of store developments commencing with projected returns of less than [X] per cent, but significantly increasing as the development took place.
- 6.16 Finally, while the projected returns from the extension of the Brunel Way store may have been less than Tesco's hurdle rate, extending the store may still have been a better strategy in the face of a stronger competitor operating the CGL store than continuing to trade from the existing Brunel Way store.
- 6.17 Therefore, we consider it likely that, absent Tesco acquiring the CGL store, Tesco would still have replaced the original Brunel Way store with the largest store that it could place on the site while still continuing to trade from the site during the re-development (ie an F80 or an F90 format store). However, we cannot be certain which of these formats Tesco would have chosen. Conservatively, we have conducted our competition analysis on the basis that Tesco would have chosen the smaller of those formats (ie F80).
- 6.18 In summary, we conclude that under the counterfactual, the relevant market would have comprised the following stores: Tesco Brunel Way expanded to an F80 format; the CGL store, operated by Sainsbury's; Asda's store at Telford Drive; the Farnham Road store operated by Safeway/Morrisons; and Sainsbury's store at Taplow.

7. Competitive effects of the merger

- 7.1 In this section we analyse Tesco's acquisition of the CGL store and consider whether the merger has resulted, or may be expected to result, in an SLC within any market or markets in the UK for goods or services, and in particular, the relevant market identified in Section 5. In doing so, we consider the impact of Tesco's acquisition of the CGL store compared with our counterfactual, ie an acquisition of the CGL store by Sainsbury's.
- 7.2 In considering the competitive effects of this merger, we are concerned to assess whether Tesco gained the ability to increase prices unilaterally or otherwise worsen its retail offer to customers.⁸³ In general, a merged firm will have a greater incentive and ability to worsen its offer when a sufficient proportion of customers of the two merging businesses consider their products to be close substitutes. This means that the merged business is less likely to lose customers as a result of any deterioration in

⁸³See CC, *Merger Guidelines*, paragraph 3.29.

its offer, and to the extent that customers are lost, the lost profits from these customers will be more than compensated for by the additional profits retained from the remaining customers. As a result, in considering the effect of the merger we are particularly concerned to assess the closeness of competition between Tesco Brunel Way and the CGL store.

- 7.3 In addition to the effect described above, we are also concerned with whether the merger may have reduced the competitive pressure faced by all stores in the relevant market that we have identified. Such an effect might arise if a reduction in grocery retailing floorspace increased demand for groceries at the other stores in the market, thus allowing each of the stores to weaken profitably their retail offer.
- 7.4 In defining the relevant market in Section 5, we identify four stores that competed with Tesco Brunel Way prior to the merger: the CGL store, Asda Telford Drive, Safeway Farnham Road, and Sainsbury's Taplow. However, as we set out in paragraph 5.68 and further elaborate below, we do not consider that each of these stores exercised an equivalent competitive constraint on Tesco Brunel Way.
- 7.5 Our assessment of the effects of the merger in this section considers the following matters:
- first, changes in the structure of the market as a result of the merger, including changes in market shares and the Herfindahl-Hirschman Index (HHI) of market concentration;
 - second, evidence on the extent of competition for customers between large grocery stores in the market (and, in particular, the closeness of competition between Tesco Brunel Way and the CGL store) arising from an analysis of catchment area overlaps, internal assessments by Tesco, and an assessment of the anticipated and actual revenue impact of store openings and closures;
 - third, arguments that Tesco has put to us on changes in the retail offer in Slough since the merger;
 - fourth, the extent to which Tesco's acquisition of the CGL store may have given rise to adverse effects in terms of customer choice; and
 - finally, post-merger developments in terms of entry and expansion by other grocery retailers and the extent to which these may have addressed any SLC or adverse effects arising from the merger or could be expected to do so in the future.

Impact of the merger on market structure

- 7.6 A change in concentration in a market following a merger provides an initial indication of the effect of the merger on intra-market rivalry.⁸⁴ As set out in Table 6, Tesco's acquisition of the CGL store resulted in a significant increase in Tesco's market share, and industry concentration generally, compared with the counterfactual of a Sainsbury's acquisition of the CGL store.
- 7.7 The immediate result of the merger was to bring Tesco Brunel Way and the CGL store under common ownership. However, in considering the effect of the merger on

⁸⁴As noted in our merger guidelines, the CC will consider the expected effect that a structural change brought about by a merger will have on the competitive constraints existing in the market (paragraph 3.22).

market shares and concentration, we have also taken account of developments that were a direct effect of the merger, namely expansion of Tesco Brunel Way to an F100 format, and closure of the CGL store. We are satisfied that Tesco did not intend, in the long run, to trade from both stores (see paragraph 7.19). We are also satisfied that in the absence of regulatory intervention by the OFT or the CC there would not be a replacement grocery store on the CGL site (see paragraph 7.59). As such, the direct effect of the merger was that the relevant market comprised: Tesco Brunel Way expanded to an F100 format, Asda Telford Drive, Sainsbury's Taplow and Safeway Farnham Road. The market structure under the counterfactual (see paragraph 6.17) would have been Tesco Brunel Way at an F80 format, Sainsbury's operating both the CGL store and its Taplow store, Asda Telford Drive and Safeway Farnham Road.

7.8 In terms of market concentration, the HHI,⁸⁵ based on total net sales area, was 3,042 under the counterfactual compared with 3,566 in the period when Tesco operated both the Tesco Brunel Way store and from the CGL site. This represented an increase of 524 relative to the counterfactual. In April 2007, immediately prior to the reference to the CC, the HHI was 3,629 representing an increase of 587 compared with the counterfactual.⁸⁶ As can be seen in Table 7, there were further fluctuations in the HHI during this period due to the changing shape of Tesco's operations in Slough, the Asda store extension and Sainsbury's acquisition of the Safeway store.

7.9 The HHI figures in paragraph 7.8, however, reflect events that were both a direct result of the merger and other factors that were not directly related to the merger (eg the expansion of Asda Telford Drive). Abstracting from these non-merger-related impacts on the HHI, the HHI as a result of the merger was 3,463 compared with the counterfactual of 3,042, an increase of 421.

TABLE 7 Floorspace and HHI as a result of the merger, under the counterfactual and post-merger

<i>Event</i>	<i>Date</i>	<i>Total net sales area sq metres</i>	<i>Tesco market share %</i>	<i>HHI</i>	<i>Change in HHI against counterfactual</i>
Pre-merger		19,900	29	2,328	-714
Counterfactual		22,432	33	3,042	0
CGL closes	30.9.03	15,600	37	3,028	-13
Tesco reopens CGL store	26.1.04	19,900	50	3,566	524
Asda extends Telford Road store	Sept 04	20,900	48	3,507	466
Tesco closes original Brunel Way store	23.1.05	15,200	28	3,103	62
Tesco opens new Brunel Way store and closes CGL store	1.8.05	20,190	46	3,423	381
Sainsbury's acquires Safeway store on Farnham Road	23.8.05	20,190	46	3,629	587

Source: CC analysis.

7.10 It can also be seen from Table 7 that compared with the counterfactual, the total floorspace among large grocery stores in the relevant market declined. This is relevant to our consideration of the extent to which the merger may have increased

⁸⁵A common measure of market concentration is the HHI. The HHI is defined as the sum of the squares of all the market shares in the market. As noted in our guidelines, the CC may consider any market with an HHI in excess of 1,800 as highly concentrated, and a merger which increases the HHI in such a market by more than 50 may give rise to potential competition concerns (CC2, paragraph 3.10).

⁸⁶While we do not consider that the Waitrose and Tesco stores in Windsor are part of the relevant geographic market for Tesco Brunel Way, we have also considered the increment in the HHI if we were to include either, or both, of these stores in the relevant geographic market. The inclusion of either or both of these stores would not, in our view, substantially alter the impact of the merger on the degree of concentration as measured by the change in HHI.

demand at all relevant grocery stores in Slough, thus allowing each of the stores to weaken profitably their retail offer (see paragraph 7.3).

- 7.11 In terms of market share, in the period January 2004 to January 2005, when Tesco operated from both the Tesco Brunel Way store and from the CGL store, it had a market share of approximately 50 per cent compared with 33 per cent under the counterfactual. In April 2007, immediately prior to the reference to the CC, Tesco's market share was 46 per cent.⁸⁷ As with the HHI, Tesco's market share, based on share of floorspace, fluctuated throughout this period as a result of the changing shape of its operations in Slough and initiatives by other grocery retailers, such as Asda's store extension.
- 7.12 The market share figures in paragraph 7.11 reflect events that were both a direct result of the merger and other factors that were not directly related to the merger (eg the expansion of Asda Telford Drive). Abstracting from these non-merger-related impacts on market shares, Tesco's market share as a result of the merger was 48 per cent compared with the counterfactual of 33 per cent, an increase of 15 percentage points.
- 7.13 Some care should, however, be taken in interpreting these market share and HHI figures. When products included in the market are differentiated the change in market structure brought about by a merger may not reflect the impact of a merger. In particular, when the products of the merged firm are close substitutes, a simple analysis of market shares and HHI figures might under-estimate the increase in market power brought about by the merger. We consider further below the extent to which Tesco Brunel Way and the CGL store, in particular by virtue of their location, had a product offering that was a relatively close substitute but differentiated from that of other grocery stores in Slough.

TABLE 8 Market shares as a result of the merger, under the counterfactual and post-merger

Event	Date	<i>per cent</i>				
		Tesco	CGL	Sainsbury's	Asda	Safeway
Pre-merger		29	22	15	28	7
Counterfactual		33	0	36	25	6
CGL closes	30.9.03	37	0	19	35	9
Tesco reopens CGL store	26.1.04	50	0	15	28	7
Asda extends Telford Road store	Sept 04	48	0	14	31	7
Tesco closes original Brunel Way store	23.1.05	28	0	20	43	9
Tesco opens new Brunel Way store and closes CGL store	1.8.05	46	0	15	32	7
Sainsbury's acquires Safeway store on Farnham Road	23.8.05	46	0	22	32	0

Source: CC analysis.

⁸⁷Market shares are based on total net sales area. We considered alternative measures of market shares. First, we considered share of groceries net sales area. However, we consider that the extent of the non-grocery offering at stores of different sizes should not be completely discounted. The availability of non-grocery products may also influence the extent to which customers regard one store as a substitute for another store. Second, we considered share of total revenue. However, we consider that the pre-merger revenue of the CGL store is an unsuitable measure of that store's revenue in the counterfactual.

Competition for customers between large grocery stores in Slough

7.14 The following paragraphs directly assess the extent to which the large grocery stores in the relevant market were competing for the same customers prior to the merger. We consider evidence on:

- first, overlaps in the catchment areas for Tesco Brunel Way and the CGL store;
- second, the impact on revenues at the Tesco Brunel Way and CGL store (when operated by Tesco) arising from the closure of these stores;
- third, Tesco's internal financial analysis of its acquisition of the CGL store; and
- finally, competition for customers between Tesco Brunel Way and other large grocery stores in the relevant market.

Overlaps in catchment areas between Tesco Brunel Way and the CGL store

7.15 The extent of the overlap in catchment areas of Tesco Brunel Way and the CGL store provides an indication of the extent to which the stores competed for the same customers. In considering the extent of this overlap, we have reviewed the geographic positioning of these two stores in Slough, evidence from Tesco's Clubcard data and Tesco's internal analysis.

7.16 Given the geographic positioning of Tesco Brunel Way and the CGL store, the potential overlap in their catchment areas appears to have been particularly acute in the area of Langley to the east of Tesco Brunel Way and the CGL store. Langley is bordered by two motorways, the M25 and the M4, making it difficult for customers to travel to grocery stores to the south or east (see Figure 7). This suggests that many people living in Langley travel towards Slough town centre for their grocery shopping. Prior to the merger, the first store they would reach would have been the CGL store on Uxbridge Road, and the second, Tesco Brunel Way. The other supermarkets in Slough would be at least a further 5 to 10 minutes' drive-time away.

FIGURE 7

Sales at Tesco Brunel Way before and after the closure of the CGL store

[REDACTED]

Source: Tesco analysis of Clubcard data.

7.17 Tesco Clubcard sales data, which provides information on the location of customers at each Tesco store, illustrates the extent of the overlap in the catchment area between Tesco Brunel Way and the CGL store. Data for 2004 and 2005, which covers the period when Tesco was operating both the CGL store as well as the original Tesco Brunel Way store, shows that customers living in the area north of the A4 and between the M25 and Farnham Road accounted for [REDACTED] per cent of sales at the CGL store and [REDACTED] per cent of sales at Tesco Brunel Way. That is, approximately half of total sales at each store came from customers living in the same geographic area.

7.18 Internal documentation from Tesco also provides substantial evidence of the extent of the overlap in the catchment areas for Tesco Brunel Way and the CGL store. Relevant documents include [REDACTED].

- 7.19 In March 2003, after the launch of the sales process for the CGL store, minutes of Tesco's [REDACTED] noted that '[t]here's no strategic advantage to having two F60s (ie trading both stores as Tesco stores) with equivalent offer so close to each other, and we should instead continue to pursue the ideal of extending the existing store to F100' implying that the two stores had substantially overlapping catchment areas. [REDACTED]
- 7.20 In June 2003, a report to the relevant Tesco board committee [REDACTED] stated that: '[g]iven the close proximity to our existing store, the Co-op unit would undoubtedly be claiming trade directly from our own Slough Extra store', and '[g]iven the proximity of the Co-op store to our existing store, there would be a high transfer of trade during any closure period'.⁸⁸ (The closure period referred to Tesco's consideration of the possible closure of Tesco Brunel Way for redevelopment prior to its acquisition of the CGL store.)
- 7.21 The report went on to state that competition from Tesco Brunel Way to the west of the CGL store meant that the CGL store's main catchment area was to the east of the store: '[g]iven this strong competition directly to the west of the store, the Co-op's main catchment lies directly to the east [in the] affluent Langley area of east Slough'.⁸⁹ Tesco believed that the CGL store performed well in Langley, where it faced 'minimal competition' due to the trade barriers of the M25 and M4.⁹⁰
- 7.22 The report stated that 'the proximity of two stores means that there would be high impacts in the event of a competitor acquiring the Co-op'. Further, in considering alternative scenarios for the CGL and Brunel Way stores, the report estimates that if Morrisons, for example, were to acquire the store it would have an approximately [REDACTED] per cent impact on sales at Tesco Brunel Way.⁹¹
- 7.23 These internal assessments by Tesco were supported by its main submission to this inquiry where it told us that 'we had not intended to trade the existing Extra store and the Uxbridge Road store together, as they were close to each other in terms of size and offer'.

FIGURE 8

Choice of stores over 1,400 sq metres in 10 minutes

[REDACTED]

Source: Tesco analysis.

- 7.24 Tesco told us that these conclusions were consistent with its belief that customers shopped locally, but that these conclusions should not be used for the purpose of defining the geographic market. Tesco told us that Slough residents had a large number of switching options available to them and that customers could easily switch if the retail offer at Tesco Brunel Way worsened. Tesco noted that there were 92 stores larger than 280 sq metres operating under 14 different fascias within 30 minutes' drive-time of Tesco Brunel Way, and that within 11 minutes' drive-time of Tesco Brunel Way nine fascias were present for stores larger than 280 sq metres. However, as we set out in Section 5, the relevant market for the consideration of this

⁸⁸[REDACTED]

⁸⁹ibid.

⁹⁰ibid.

⁹¹Tesco told us that Morrisons was merely used in the Capital Investment Appraisal (CIA) as an example of the effect of a rival operator buying the CGL store. We consider that there would be little difference between the impact of an acquisition by any of Sainsbury's, Asda or Morrisons.

merger includes the large supermarkets operated by Asda, CGL, Sainsbury's and Tesco in Slough prior to the merger. That is, we do not consider that the large majority of stores highlighted by Tesco provide an effective competitive constraint on Tesco Brunel Way.⁹²

- 7.25 Tesco further stated that even if there were some customers that faced a reduction in choice as a result of its acquisition of the CGL store, there would have been no reduction in competition and no change in the retail offer to these customers as they are protected by marginal customers in the western part of Slough, who have a greater choice of stores and would be able to switch to these stores in the event of a deterioration in the retail offer at Tesco Brunel Way.
- 7.26 Despite these arguments by Tesco, our analysis of its Clubcard data also shows that customers to the east and north-east of Slough, that account for approximately [redacted] of sales at Tesco Brunel Way, have a more limited choice of stores. The acquisition of the CGL store reduced the possibility of switching for these customers.
- 7.27 In summary, the geographic location of Tesco Brunel Way and the CGL store, as well as evidence from Tesco Clubcard data and Tesco's internal analysis, points to a substantial overlap in the catchment areas for these two stores. Further, the geographic proximity of the two stores and the absence of a competitor to the east meant that many customers to the east of the CGL store would have considered the CGL store and Tesco Brunel Way to be their first and second choice of large grocery store. This means that following Tesco's acquisition of the CGL store Tesco Brunel Way would be less likely to lose these customers as a result of any deterioration in its retail offer, and that therefore there was a substantial lessening of the competitive constraint that Tesco Brunel Way, in particular, faced.

Tesco's financial assessment of acquiring the CGL store

- 7.28 Tesco's internal financial analysis of the acquisition of the CGL store sheds further light on the extent of competition between Tesco Brunel Way and the CGL store as well as the possibility that one of Tesco's motivations when acquiring the CGL store and deciding on the value of its bid was to prevent future use of the site by one of its competitors as a large-scale grocery store. In response, Tesco told us that the acquisition of the CGL store enabled it to build the store it wanted at Brunel Way while minimizing the disruption to its customers.
- 7.29 Tesco's financial appraisals of alternative development scenarios for the CGL site were considered at the relevant Tesco board committee ([redacted]) meeting. In particular, Tesco estimated that the total cost of acquiring and redeveloping the CGL site for non-grocery use, after deducting the profit gained by trading the CGL store for one year, would be £[redacted] million. However, Tesco expected only to realize a maximum

⁹²Tesco also told us that very few customers would need to switch away from Tesco Brunel Way to make a 1 per cent price increase unprofitable. Tesco told us that a 1 per cent price increase at Tesco Brunel Way would be defeated if [redacted] per cent of revenues were to switch. Tesco's argument appears to be based on a critical loss computation using an average store margin of [redacted] per cent. The critical loss for an x per cent price increase is the percentage reduction in volume sales required for the price increase to leave profits unchanged. If the actual loss of sales is less than the critical loss, then the x per cent price increase is not profitable. Critical sales loss is computed with the following formula: $x/(x+m)$, where x represents the percentage price increase and m the profit margin measured in percentage of the price. We have a number of concerns with this critical loss analysis. The question of whether a price increase at Tesco Brunel Way would be profitable with the acquisition of the CGL store cannot be answered without accounting for the change brought about by the merger, which is not taken into account in Tesco's critical loss calculation. A robust analysis would account for the fact that a merger alters the set of stores under Tesco's control. As a result, a critical loss calculation to determine whether a price increase would be profitable post-merger must take into account cross-elasticities. Therefore, we do not consider that this analysis is able to inform our assessment. We also note that Tesco has interpreted the results of its analysis in terms of a change in revenue; however, the [redacted] per cent would correspond to change in quantity, not revenues. We also note that in its calculations Tesco has used an average store margin instead of the store margin at Brunel Way.

capitalized rental value of £[redacted] million from the redeveloped CGL site.⁹³ That is, Tesco expected to make a loss on the acquisition and redevelopment of the CGL site of £[redacted] million.

- 7.30 Tesco argued that the above calculation did not take account of an expected 'goodwill benefit' of £[redacted] million, resulting from Tesco temporarily trading from the CGL site during the development of Brunel Way. We note, though, that this 'benefit' was not included in Tesco's Property Acquisition Report. Tesco argued that if this amount was included there was no expected loss on the redevelopment. However, the 'goodwill benefit' would have accrued to Tesco regardless of whether Tesco had sold the CGL site to a grocery retailer or redeveloped the site with no grocery retailer. On this basis the 'goodwill' benefit does not make a difference to our assessment of the relative investment position that was taken by Tesco on the CGL site. As set out in paragraph 3.16, we found that grocery retailers were prepared to pay a higher price than non-grocery retailers for the CGL site. Therefore, by pursuing only a non-grocery use for the CGL site, Tesco accepted lower returns, even taking into account its calculation of 'goodwill benefit', as it was taking a suboptimal investment position for the CGL site.
- 7.31 One view of these documents is that Tesco was prepared to incur a loss on the acquisition and redevelopment of the CGL site so as to protect sales at Tesco Brunel Way. Tesco's CIAs for the acquisition showed that it expected that sales at Tesco Brunel Way, prior to its expansion, would be about [redacted] per cent greater if there were no CGL store compared with the store being operated by another grocery retailer. Using Tesco's own assumptions, this outcome equates to approximately £[redacted] million a year in sales, and about £[redacted] million a year in profit.⁹⁴ We estimate that this equates to a net present value of around £[redacted] million,⁹⁵ significantly greater than the anticipated loss on the acquisition and redevelopment of the CGL site of £[redacted] million.
- 7.32 Tesco told us that the fact that a store might have greater revenue when a competitor was not present did not necessarily imply that prices would be higher or other aspects of its retail offer would be weakened. However, we consider that Tesco's internal assessment of the impact of the merger in terms of the anticipated revenue increase at its Brunel Way store (approximately [redacted] per cent) is indicative of these two stores competing for a substantial group of customers.

Revenue impact analysis

- 7.33 In the period following Tesco's acquisition of the CGL store, Tesco closed each of Tesco Brunel Way and the CGL store at different times (see paragraph 3.19).⁹⁶ These store closures allow us to assess the extent to which customers switched to the other store and thus provides an insight into the extent to which the two stores are substitutes for each other. In other words, we are able to examine the actual revenue impact of these events, albeit with the two stores under CGL and Tesco

⁹³The rental value of £[redacted] million relates to open A1 use. The equivalent calculation of the costs of development for non-food bulky goods use is £[redacted] million with a realizable value from leasing of £[redacted] million.

⁹⁴Sales at Tesco Brunel Way before the store extension and the acquisition of the CGL store were about £[redacted] million a year, based on average weekly turnover in the previous 12 months. If Morrisons had acquired the store Tesco expected sales at the unextended Tesco Brunel Way store to be about [redacted] per cent lower, or about £[redacted] million a year. If the CGL store closed, Tesco expected sales at Tesco Brunel Way to be about [redacted] per cent higher at £[redacted] million a year. The difference between these two scenarios is £[redacted] million a year or about [redacted] per cent of Tesco Brunel Way sales. [redacted] On that basis, the impact of the merger was about £[redacted] million a year in additional profit to Tesco.

⁹⁵This calculation is based on Tesco's cost of capital of [redacted] per cent as used in its CIAs, a period of [redacted] years.

⁹⁶In summary, CGL closed its store in Slough just prior to its acquisition by Tesco in October 2003. Tesco then reopened the store under the Tesco fascia in January 2004. Tesco then closed the original Tesco store for redevelopment in January 2005, and opened the new Brunel Way store, while closing the CGL store, in August 2005.

ownership, compared with paragraphs 7.28 to 7.32 where we consider the revenue impact anticipated by Tesco were the CGL store to come under the ownership of a competitor.⁹⁷

7.34 Figure 9 shows weekly sales at Tesco Brunel Way from July 2002 until its closure in February 2005 (excluding the weeks around Christmas). Tesco's analysis of this data shows that:

- (a) sales at Tesco Brunel Way increased by [redacted] per cent when the CGL store closed in October 2003 (seen as the difference between the green and red lines);
- (b) sales at Tesco Brunel Way were [redacted] per cent lower when Tesco was also trading from the CGL site compared with the period when CGL operated the store (seen as the difference between the blue and black lines); and
- (c) sales at Tesco Brunel Way were [redacted] per cent lower when Tesco traded at both stores, compared with when the CGL store was closed (seen as the difference between the blue and the green lines).

FIGURE 9

Tesco assessment of impact on sales at Tesco Brunel Way

[redacted]

Source: Tesco.

Note: [redacted]

7.35 These figures indicate that Tesco Brunel Way gained sales of approximately [redacted] per cent as a result of CGL's exit from the market. Under our counterfactual of Sainsbury's operating the CGL store and providing a significantly improved retail offer, we consider that it is likely that its store would have had similar sales to those achieved by Tesco at the CGL store during the 12 months when it operated from both Tesco Brunel Way and the CGL store or possibly higher. This implies that Tesco Brunel Way may have gained sales of around [redacted] per cent compared with the counterfactual. This is broadly consistent with the revenue impact anticipated by Tesco were a competitor to have acquired the CGL store (see paragraph 7.31).

7.36 Consistent with our analysis of catchment area overlaps, our review of Tesco's assessment of the anticipated revenue impact of a competitor acquiring the CGL store as well as the analysis of the actual revenue impacts associated with the closures of the Tesco Brunel Way and CGL stores at various times following Tesco's acquisition supports the view that these two stores were the closest substitutes for many of the customers.

Competition for customers from other stores in the market

7.37 Competition for customers was also provided by the other stores that we have identified as being part of the relevant market, namely Asda Telford Drive, Safeway Farnham Road and Sainsbury's Taplow. The ability of customers to switch to these other stores in response to a worsening of the retail offer at Tesco Brunel Way would, in principle, put pressure on Tesco to maintain the level of its retail offer at its Brunel

⁹⁷We considered using revenue data from all stores in the relevant market to identify the diversion of revenue following the closure of the CGL store and the reopening of the CGL store under the Tesco fascia. However, we have not been able to undertake such an analysis because of limited data.

Way store following its acquisition of the CGL store. However, as we set out in paragraph 5.67, we do not consider that each of these other stores and the CGL store exercised the same level of competitive constraint on Tesco Brunel Way.

- 7.38 Tesco's internal assessment of competition⁹⁸ from these other stores suggested that, at the time of the merger, the Asda Telford Drive and Sainsbury's Taplow stores both offered suitable alternatives for shoppers, but raised questions about the Safeway store. This assessment stated that:
- 'Other competitors for the Slough Co-op include Asda Slough [REDACTED].'
 - '3.9 miles to the West along the A4 is [REDACTED], Sainsbury's. [REDACTED]'
 - 'Also at c.7 minutes drivetime to the north-west [REDACTED] Safeway. [REDACTED]'
- 7.39 Sainsbury's, the current owner of the Farnham Road store, told us that it was constrained by limited car-parking spaces. The store has only 110 car-parking spaces, which are shared with other nearby stores. Sainsbury's also told us that although the store has a net sales area of 1,400 sq metres, it does not effectively operate in the same market as larger grocery stores.⁹⁹
- 7.40 Sainsbury's also provided evidence to show that the primary catchment of the Safeway store is to the north of that store. Sainsbury's told us that access to the Safeway store to the south was impeded as just before the store the main road from the town centre to the south narrowed to cross the Great Western Railway line. Sainsbury's described this as an 'effective barrier' between the Safeway store and Tesco Brunel Way for customers south of the railway line who were deciding whether to shop at Farnham Road or at Tesco Brunel Way. However, Tesco told us that [REDACTED] per cent of sales at Tesco Brunel Way are from customers located to the north of this railway line, and that [REDACTED] per cent of sales comes from customers that live closer to the Safeway store than to Tesco Brunel Way.
- 7.41 Even though Tesco's data suggests some overlap in the catchment area of the Safeway store and the Tesco Brunel Way store, it also shows that the Safeway store at Farnham Road is a relatively weak alternative to Tesco Brunel Way, as some people who live close to that store actually shop at Tesco Brunel Way. The fact that the Safeway store operates more as a mid-sized store and that it has restricted parking facilities could explain why some people living near the Safeway store shop at Tesco Brunel Way.
- 7.42 In terms of Asda Telford Drive, Asda told us that it did not believe that there was a significant overlap of customers between its Slough store and the CGL store. Asda provided an analysis that showed the store's estimated share of total grocery sales in different areas of Slough. [REDACTED] The analysis showed that Asda's share of sales in the area around the Tesco Brunel Way and CGL stores was much lower than in the areas around, and to the north of, its Telford Drive store. [REDACTED]
- 7.43 In terms of Sainsbury's Taplow, Sainsbury's told us that it did not consider that store to be a competitive constraint on Tesco Brunel Way and the CGL store based on the configuration of the stores in Slough and the surrounding areas. That is, Sainsbury's submitted that its Taplow store was not a direct competitor to Tesco Brunel Way

⁹⁸[REDACTED]

⁹⁹Sainsbury's provided evidence that it told us shows an 'increased spike' in lunchtime trade, relative to large Sainsbury's stores. It also provided information on the distribution of basket sizes compared with large Sainsbury's stores, which shows that a larger proportion of sales at the Farnham Road store are from transactions of less than £[REDACTED] and only a relatively small proportion of transactions are sales of more than £[REDACTED].

because there were other large grocery stores located between them. In addition, Sainsbury's submitted evidence that it said showed that, because of their locations, there is little overlap in the catchment areas of its Taplow store and the Tesco Brunel Way and the CGL stores.¹⁰⁰ Finally, Sainsbury's provided an analysis of the impact of the opening and closing of stores in Slough centre, which it said did not provide any clear evidence of competitive interaction between Sainsbury's Taplow, and Tesco Brunel Way and the CGL store.¹⁰¹

- 7.44 While we believe that Sainsbury's Taplow store should be included in the relevant market (see paragraphs 5.63), we consider that the location of that store, together with information on catchment areas and some evidence provided by Sainsbury's, might indicate that that store is not a particularly strong alternative to Tesco Brunel Way for some customers.

Conclusion on competition for customers between large stores in Slough

- 7.45 The evidence we have reviewed in paragraphs 7.14 to 7.44 supports the view that there are considerable differences in the extent of the competitive constraint exercised on Tesco Brunel Way by each of the other grocery stores in the relevant market.
- 7.46 The strength of the competition between Tesco Brunel Way and the CGL store is evidenced by the analysis of catchment areas, including Tesco's own analysis and Tesco Clubcard data, the impact on store revenues of the closure of Tesco Brunel Way and the CGL store subsequent to the acquisition by Tesco, and Tesco's internal assessment of the financial impact of a competitor acquiring the CGL store. The geographic location of Tesco Brunel Way and the CGL store means that many customers located to the east of the CGL store would have considered the CGL store and Tesco Brunel Way to be their first and second choice of large grocery store.
- 7.47 In comparison, the evidence on catchment area overlaps and, particularly in relation to Safeway Farnham Road, the weaknesses of that store's retail offer indicates that competition for customers provided by Asda Telford Drive, Safeway Farnham Road and Sainsbury's Taplow was significantly less than that provided by the CGL store.
- 7.48 In conclusion, we consider that the CGL store was the closest competitor for the customers of Tesco Brunel Way, and this situation would have been further emphasized had the CGL store been operated by Sainsbury's. We also believe that the acquisition of the CGL store, and the consequent loss of the closest competitor to Tesco Brunel Way, provided Tesco with the ability and incentive to worsen its retail offer to customers at Tesco Brunel Way.

Changes in the retail offer in Slough since the merger

- 7.49 The focus of our analysis is the extent to which the loss of a competitor, as a result of Tesco's acquisition of the CGL store, has impacted on rivalry between grocery stores in the relevant market. A reduction in rivalry would be expected to lead to a deterior-

¹⁰⁰Sainsbury's provided analysis that showed that the principal catchment area of the Taplow store is directly around that store and to the west in the direction of Maidenhead. On that basis, Sainsbury's told us that Tesco Brunel Way and the CGL store fulfilled 'a qualitatively different consumer need to Sainsbury's Taplow'.

¹⁰¹Sainsbury's showed that the closure of the CGL store in October 2003 had only a very small impact on sales at its Taplow store and the reopening in January 2004 did not discernibly affect sales. Sainsbury's told us that the closure of the original Tesco Brunel Way store in January 2005 was followed by a slight uplift in sales and that in the period until June 2005, when Sainsbury's closed its store in Maidenhead, which had a noticeable impact on sales, sales at the Taplow store increased by about £[§<] per week.

ation in the offering of either the Tesco Brunel Way store unilaterally or all stores in Slough (see paragraphs 7.2 and 7.3) compared with the counterfactual.

7.50 Tesco told us that since the acquisition of the CGL store in 2003:

- prices had fallen in real terms at Tesco Brunel Way (in the same way as in other Tesco stores given its national pricing);
- the number of SKUs at Tesco Brunel Way had increased by more than 70 per cent, the number of own-label SKUs had doubled, and there had been a substantial increase in non-food and ethnic lines;
- the number of customer complaints at Tesco Brunel Way had halved;
- Tesco's mystery shopper research showed no change in the retail offer at Tesco Brunel Way; and
- Tesco research showed that Slough shoppers were satisfied and considered that value for money in food and groceries had improved over the last five years.

7.51 The improvements in the retail offer at Tesco Brunel Way since the merger, however, are compared with the pre-merger situation rather than with the counterfactual. As a result, the improvements cited by Tesco do not address the issue of whether there has been a deterioration compared with the counterfactual (see paragraph 7.1). In Section 8, we consider improvements in the retail offer at Tesco Brunel Way subsequent to the merger in the context of relevant customer benefits arising from the merger (see paragraphs 8.112 and 8.113).

7.52 Tesco submitted that it does not set the level of its retail offer in response to the level of local competition. Rather, its retail offer is driven by competition at the national level, which means that all its customers receive the same offer irrespective of the number of competing local stores. While we recognize that large parts of Tesco's retail offer are determined at the national level, we do not agree that there is no variation at the local level, and that Tesco's retail offer would not be influenced by the presence, or otherwise, of competing local stores. There is substantial evidence that grocery retailers seek to improve the retail offer at the individual store level in response to changes in the level of local competition. Examples of such changes include vouchering, localized leafleting and marketing, improved product ranges, product availability initiatives and increased or improved staffing (see Appendix H).

7.53 Given this evidence, we have no reason to believe that the management of Tesco Brunel Way would not have been sensitive to the ability of a large competing Sainsbury's store within close proximity to attract customers. We consider it likely that the retail offer at Tesco Brunel Way would, as a result, have been adjusted so as to gain and retain customers. This may have resulted in a better retail offer than is currently the case. Alternatively, it may have resulted in a different retail offer that better reflects customer preferences. In either case, the degree of intra-market rivalry would have been significantly higher under the counterfactual.

7.54 Tesco, however, provided evidence that it told us showed that there was no relationship between the level of nine individual measures of the retail offer and the degree of local concentration. It also provided evidence that it told us showed that the level of the nine individual measures of the retail offer in its large stores was unrelated to the distance from the store of its nearest large competitor. We have a number of concerns with Tesco's analysis, and as a result we place only limited weight on this evidence (see Appendix F).

- 7.55 Tesco also submitted an analysis of variable profit margins at Tesco stores. According to Tesco, this shows that no SLC could take place as long as at least two competitors remain in each local area. This is because Tesco's analysis does not identify an effect on store margins when the number of competitor fascias is reduced from four to three, or three to two. However, we do not consider that Tesco's analysis is sophisticated enough to identify non-linear effects associated with market concentration.
- 7.56 Our own analysis of grocery store margins using shares of net sales area shows that a single competing store has a stronger impact on a grocery store's profit margin than a second store, but the impact of the second and third rival stores are also significant (see Appendix G). We would note that this analysis does not include stores larger than 6,000 sq metres due to the 'noise' in the data created by non-grocery sales.¹⁰² However, we see no reason to consider that similar effects are not experienced by stores larger than 6,000 sq metres, such as Tesco Brunel Way.

Customers' choice of grocery store in Slough

- 7.57 Tesco's acquisition of the CGL store has reduced store choice for Slough residents, particularly those located to the east of the CGL store in the Langley area (see paragraph 7.16). This loss of choice can be seen in Figure 8, which shows that residents in a substantial area to the east of Tesco Brunel Way are able to access only one store within a 10-minute drive-time.

Post-merger developments in grocery retailing in Slough

- 7.58 In this section we assess the extent to which entry or expansion by other grocery retailers might have addressed, or could in the future address, any SLC that would have otherwise arisen as a result of Tesco's acquisition of the CGL store.
- 7.59 In the four-year period since Tesco's acquisition of the CGL store, Asda expanded its Telford Drive store from 5,500 sq metres to 6,500 sq metres in September 2004, and, as noted in paragraph 2.7, Sainsbury's acquired the Safeway store in August 2005.¹⁰³ We do not consider that either of these events address the loss of competition arising from Tesco's acquisition of the CGL store. The Safeway store, as operated by Sainsbury's, continues to be faced with the constraints identified in paragraphs 7.39 to 7.41, and we consider that the Asda store neither provides as strong a competitive constraint on Tesco Brunel Way as the CGL store nor does it constitute a better alternative than Tesco Brunel Way for many CGL customers.
- 7.60 There has also been new entry by other stores in Slough and the surrounding area since the merger, primarily a new 500 sq metre M&S Simply Food store in Slough, opened in June 2005. Further away Sainsbury's opened a redeveloped store in Maidenhead in March 2007, while Waitrose has significantly expanded its store in Windsor with the extended store opening in October 2007. Tesco submitted that within a 30-minute drive-time isochrone, eight new stores had opened since the acquisition, four new stores were about to open and two stores had been replaced or substantially extended. Each of these stores, however, is outside the relevant product or geographic market that we identify in Section 5. We set out in paragraphs 5.64 to 5.66 our reasons for not including Waitrose Windsor in the relevant market,

¹⁰²Following the merger, the number of competing stores was reduced by one. However, under the counterfactual, the number of fascias in the relevant market is also reduced by one as Sainsbury's was already present in the relevant market through Sainsbury's Taplow.

¹⁰³Sainsbury's acquisition of the Safeway store was part of a package of nine stores acquired from Morrisons in 2005.

which are based on the topographic barriers between Slough and Windsor as well as parking issues at the extended Waitrose store.

- 7.61 Looking forward, Sainsbury's told us that extending its Farnham Road store would be possible, subject to the normal full financial appraisal, but it does not currently have any realistic prospect of acquiring the land to undertake such an extension. [REDACTED] It also told us that such an extension would require planning permission and it had not discussed the possibility of such an application with Slough Borough Council.
- 7.62 Slough Borough Council, however, told us that it would like to see the Sainsbury's on Farnham Road expanded. It told us that Farnham Road was the number two shopping centre in Slough and an expanded Sainsbury's would provide a better anchor for retailing in that area. It said that it had been in discussions with SEGRO plc (formerly Slough Estates Group) on this subject for more than ten years. It told us that SEGRO had identified room for expansion further into the estate rather than further along the road frontage, which would displace one or more existing businesses. The Council told us that while it had not discussed such an expansion with Sainsbury's, it assumed that the expansion plan recently discussed with SEGRO (as part of the Council granting planning permission to SEGRO for non-food retail development next to Sainsbury's Farnham Road) would take into account Sainsbury's preferences.¹⁰⁴
- 7.63 In terms of other retail development in Slough, Slough Borough Council told us that it had been looking for a long time at the opportunity to get a medium-sized supermarket in the Langley area to even up the geographical spread of grocery retailing in Slough, but it had not identified any suitable sites. It told us that it did not consider there to be any other sites in the Borough of Slough that were suitable for larger grocery stores and were not currently used for that purpose other than the Farnham Road site.
- 7.64 We also note that Tesco has a [REDACTED] drive-time of the Tesco Brunel Way store. This [REDACTED], purchased in [REDACTED], is described by Tesco as [REDACTED]. Tesco told us that [REDACTED]. The site is, in any case, not sufficiently large for a large grocery store. As a result, we do not consider that the site represents a potential entry opportunity for an effective competitor in the foreseeable future.
- 7.65 We have also considered the nature of any grocery retailing on the CGL site were Tesco free to pursue the development of the site absent regulatory intervention by the OFT or the CC. We expect that there would not have been a grocery store trading on the CGL site in this case. Tesco told us that the highest-value use of the CGL site was for non-grocery retailing. Moreover, as noted in paragraph 3.11, the internal Tesco documents reviewed by the CC show that Tesco concluded that the acquisition of the CGL store by a competitor would reduce sales at Tesco Brunel Way by [REDACTED] per cent. Further, in the absence of possible action by the competition authorities, we consider it unlikely that Tesco would continue to offer the terms to potential grocery retailer occupants that were on offer immediately prior to the reference (see footnote to paragraph 3.32). Even if a grocery retailer were to commence operating from this site, it would face delivery restrictions (see paragraph 3.22), which are likely to result in restricted weekend trading hours for this store.¹⁰⁵
- 7.66 As a result, looking forward, we do not expect that the retail park being developed by Tesco on the CGL site would include a grocery store that would create a competitive constraint sufficient to remedy the SLC.

¹⁰⁴[REDACTED] told us that the plans submitted as part of this application provided for a store of 4,600 sq metres (50,000 sq feet).

¹⁰⁵[REDACTED]

Conclusion on the SLC test

- 7.67 Tesco's acquisition of the CGL store resulted in a significant increase in concentration in the relevant market compared with the counterfactual of a Sainsbury's acquisition of this store. We consider that the CGL store was the closest competitor for the customers of Tesco Brunel Way, and this situation would have been further emphasized had the CGL store been operated by Sainsbury's. As a result, Tesco's acquisition of the CGL store removed a substantial competitive constraint that would otherwise have been faced by Tesco Brunel Way. The constraint provided by other large grocery stores on Tesco Brunel Way was, in our view, significantly less than that provided by the CGL store prior to the merger, and even more so had the store come under Sainsbury's ownership.
- 7.68 Although there have been developments in grocery retailing since the merger, these are not, in our view, sufficient to offset the reduction in competition resulting from the merger.
- 7.69 Looking forward, we do not expect further entry or expansion to address the loss of the competitive constraint that would have been provided by the CGL store under Sainsbury's ownership. On the basis of the evidence from Slough Borough Council, we do not expect any sites in Slough that are suitable for the construction of larger grocery stores to become available in the medium term. In addition, we do not believe that any expansion of Farnham Road is likely to take place in the next two to three years given the undeveloped nature of the expansion plans for this site. Moreover, for the reasons explained above, we do not expect that the retail park being developed by Tesco on the CGL site would include a grocery store that would create a competitive constraint sufficient to remedy the SLC.
- 7.70 We conclude that the acquisition of the CGL store by Tesco constitutes a relevant merger situation. We also conclude that the acquisition of the CGL store by Tesco has resulted, and may be expected to result, in an SLC in the relevant market. We also find that Tesco's acquisition of the CGL store has given rise to reduced store choice for Slough residents, particularly those located to the east of the CGL store in the Langley area.

8. Proposed remedies

- 8.1 This section discusses possible remedies to the SLC identified in paragraphs 7.67 to 7.70 with respect to Tesco's acquisition of the CGL store in Slough. We consider the likely effectiveness of various possible divestiture options associated with the CGL site as well as risks associated with these remedy options. We also consider possible behavioural remedies as well as relevant customer benefits. Taking this into account, we conclude this section by setting out our decision on the remedy to the SLC that we have identified.
- 8.2 Consistent with our remedies notice, published on 21 September 2007, we consider that there are two broad options for a divestiture remedy, namely:
- (a) the sale of the entire site for the development of a large grocery store; and

(b) a sale or lease¹⁰⁶ of one or more units within Tesco's planned development scheme. This might involve, for example, unit 3, a combined unit 1 and 2, or a combined unit 3 and 4.

8.3 In assessing whether a divestiture remedy would be effective in addressing the SLC, it is necessary to consider the following three risks:¹⁰⁷

(a) whether the scope of the divestiture package is sufficient to address the SLC (taking into account any possible requirements for further planning permission), while also providing an attractive and viable platform for a purchaser (composition risk);

(b) whether suitable purchasers are present (purchaser risk); and

(c) whether the competitive potential of the assets to be divested might be eroded (asset risks).

The following paragraphs consider each of these risks in relation to the two broad divestiture options identified in paragraph 8.2.

Composition risk

8.4 The following paragraphs assess the composition risk associated with each of the two divestment remedies identified in paragraph 8.2 (ie a new large grocery store, or a grocery store within the Tesco development).

8.5 As we set out above, any divestiture package should create the opportunity for an effective competitor to operate within the relevant market. For a grocery store on the CGL site to compete effectively, the proximity of Tesco Brunel Way means that it will, in particular, need to offer a viable alternative for customers at this store. As such, this will require a comprehensive retail offer.¹⁰⁸

8.6 For each of the two divestment remedies we, first, discuss factors impacting on the ability of the new grocery store under each option to act as an effective competitor, and second, planning and timing issues associated with each option.

Grocery store within Tesco's development scheme

Factors affecting the competitive effectiveness of a grocery store within Tesco's development scheme

8.7 In discussing market definition in Section 5, we identified two key observable variables that capture many aspects of the retail offer of any given store: store size and store fascia (see paragraph 5.5). We subsequently define the product market in terms of these two variables. However, as we note in paragraph 5.4, the retail offer of a store reflects a range of factors including price, range of products, quality of products, cleanliness, parking facilities and opening hours. We consider that defining

¹⁰⁶We consider the leasing of one or more units in the Tesco development as a 'divestiture remedy' because, even though such a lease does not necessarily include a transfer of assets, it raises many of the same issues in terms of composition, asset and purchaser risk.

¹⁰⁷See CC8, *Application of divestiture remedies in merger inquiries*, paragraph 2.4.

¹⁰⁸We note that the retail offer at Tesco Brunel Way includes: an in-store bakery; an extensive fresh fruit and vegetable offer; a fresh meat counter, a fresh fish counter, a delicatessen counter and a chicken counter; an extensive range of ethnic products; an extensive non-food offer including a pharmacy, an optician and a jewellery counter; a number of concessions on the ground floor, including a doughnut shop, a hairdresser, a Halal butcher and a shop specializing in Asian confectionery; a cafe and a petrol filling station; and the store is open 24 hours and has parking for around 850 cars.

the relevant product market in terms of store size and fascia allows us to identify those stores that will provide the strongest competitive constraint to each other. However, in considering the effectiveness of our remedy, we need to consider the extent to which a particular divestiture package might be used to restore the level of competition that would have existed absent the merger, which may involve considerations beyond those strictly involved in market definition.

8.8 To assess whether a store in the Tesco redevelopment will be an effective competitor, particularly with Tesco Brunel Way, we consider that we need to go beyond store size and fascia and assess a range of more specific factors related to the likely retail offer at any store in this development that have come to our attention. These include:

- (a) store size;
- (b) delivery restrictions;
- (c) car parking;
- (d) availability of a petrol filling station; and
- (e) Tesco as landlord.

We consider store fascia in the context of purchaser or lessee risk in paragraphs 8.52 to 8.69.

Store size

8.9 When reviewing the size distribution of grocery stores in Slough in the context of defining the relevant product market in terms of store size (see paragraph 5.20), we draw a distinction between the Safeway store at 1,400 sq metres and the Chalvey store at 540 sq metres (see Table 5). As a result, the starting point for our consideration of whether one or more units in the Tesco development could represent an effective competitor is the extent to which any store in the Tesco development would be larger than 1,400 sq metres.

8.10 There are four units available in the Tesco redevelopment, and various combinations of these units are potentially available for a grocery store within the development. Table 9 shows the space available in each unit individually as well as in a combined unit 1 and 2 (on the upper floor) and a combined unit 3 and 4 (on the ground floor).

TABLE 9 Potential size of grocery stores in the Tesco development

			'000 sq metres (sq ft)		
	Floor area (gross internal area)	Mezzanine	Total	Tesco value for net sales area assuming trading also on mezzanine	Tesco value for net sales area assuming mezzanine used for storage and back- office facilities
Unit 1	1,394 (15,000)	1,050 (11,300)	2,443 (26,300)	1,709 (18,400)	
Unit 2	929 (10,000)	697 (7,500)	1,626 (17,500)	1,143 (12,300)	
Unit 3	2,527 (27,200)	1,096 (11,800)	3,623 (39,000)	2,536 (27,300)	2,313 (24,900)
Unit 4	929 (10,000)	697 (7,500)	1,626 (17,500)	1,143 (12,300)	
Units 1 & 2 combined	2,323 (25,000)	1,747 (18,800)	4,069 (43,800)	2,852 (30,700)	2,304 (24,800)
Units 1 & 2 combined under variation application	3,716 (40,000)	511 (5,500)	4,227 (45,500)	2,964 (31,900)	3,214 (34,600)
Units 3 & 4 combined	3,459 (37,233)	1,791 (19,278)	5,250 (56,511)	3,623 (39,000)	

Source: Tesco.

Notes:

1. Tesco net sales area estimates assume net sales area is 70 per cent of gross internal area.
2. Conversion to sq metres undertaken by CC.

- 8.11 As can be seen in Table 6, both unit 3 and unit 1 are able to be configured so as to provide a net sales area larger than 1,400 sq metres. This is also the case for a combination of units 1 and 2, and a combination of units 3 and 4. In each case, the estimate of the sales area available to a grocery store within the development assumes that a mezzanine floor in the unit could be used as either additional trading space or for storage and back-office facilities.¹⁰⁹
- 8.12 A further consideration, however, is the extent to which a store in one of these larger units, or combination of units, would provide an effective alternative for customers at Tesco Brunel Way. Tesco Brunel Way has a net sales area of approximately 8,100 sq metres, comprising [X] sq metres food and [X] sq metres non-food. A grocery store in either units 1 and 2 or units 3 and 4 would represent around 30 to 40 per cent of the total net sales area at Tesco Brunel Way.¹¹⁰ We consider that the much smaller size of any grocery store in the Tesco development in comparison with Tesco Brunel Way will limit the ability of this store to attract customers shopping at Tesco Brunel Way.

Delivery restrictions

- 8.13 The existing planning permission for a grocery store on the Tesco development (in unit 3) prohibits deliveries outside 08.00 to 18.00 Monday to Friday and outside 09.00 to 13.00 Saturday as well as prohibiting deliveries on Sundays and bank holidays. We understand that a similar delivery hours restriction would also be applied to any other grocery store in any other unit or combination of units on the site. We are concerned that these restrictions would impact on the opening hours of a grocery store on the site, and thereby affect its ability to trade on Sundays and bank holidays.

¹⁰⁹Tesco told us that Waitrose, Whole Foods and Chalvey Supermarket had all shown interest in trading from a mezzanine floor, but that some retailers may prefer not to trade from the mezzanine and use the space for storage and back-office facilities instead.

¹¹⁰A store in the Tesco development would be able to offer a net sales area that represents around 50 to 70 per cent of the food sales area at Tesco Brunel Way. However, this comparison does not take into account the fact that groceries are defined to include a number of non-food products, such as cleaning products and pet food.

- 8.14 Tesco told us that these delivery restrictions were not unusual given the location of the site. It told us that there were sites from which it traded successfully under similar restrictions. However, Sainsbury's considered that these delivery restrictions were 'truly exceptional'. Both Asda and Morrisons as well as Sainsbury's considered that these restrictions would affect their ability to trade successfully from the site.
- 8.15 Sainsbury's noted that the restrictions would mean that over bank holiday weekends there would be no deliveries for a period of some 67 hours. It drew attention in particular to the impact of the delivery restrictions on its fresh food offer, especially in relation to products with a shelf-life of three days or less, such as sandwiches, short-life seafood, salads and soft fruit. It said that it could 'pump-prime' the store to deal with the weekend and bank holiday restrictions but this could result in wastage (if too much produce was ordered) or insufficient stock (if too little was ordered).
- 8.16 Tesco suggested that it might be possible to offer Slough Borough Council a package of measures, such as enclosed delivery bays, acoustic fencing between the site and adjoining residential dwellings, and quieter delivery vehicles, in return for a relaxation in the delivery hour restrictions.¹¹¹ Morrisons told us that it would seek a relaxation of these restrictions if it were to trade from the site. Asda told us that it was generally successful in negotiating extended delivery slots with local planning authorities through scheme design ([X]) and operational features ([X]).
- 8.17 Tesco told us that instead of challenging a delivery restriction at the time a planning application was determined, it would normally make an application to vary the restriction once consent had been achieved. It said that once the store was operational, it was possible to assess the actual rather than merely the expected impact of the store on local residents, taking into account measures that had been put in place to mitigate the noise from delivery vehicles. Sainsbury's told us it had been normal practice among some operators to negotiate relaxations of delivery restrictions after they had been imposed and, although it preferred to address the issue at the design and planning stage, it had previously done this itself. However, it noted that, even if the planning condition in relation to delivery restrictions were relaxed, environmental legislation would still apply and could restrict deliveries. This meant that it was important to deal with possible nuisance to neighbours and noise issues in the design of the site. Overall, it considered that it would be extremely difficult to obtain any meaningful relaxation of the delivery restrictions on the Tesco scheme.
- 8.18 Slough Borough Council suggested to us that some relaxation of the delivery restrictions may be achieved to allow some deliveries to take place on Sundays and bank holidays, depending on the steps that retailers might offer to address its concerns about the impact on local residents. Slough Borough Council told us that the alternative arrangements that had been proposed by Tesco would deal with the issue of noise, but it noted that Tesco's proposals (which involve delivery lorries entering across the customer car park) were such that deliveries would only be able to take place when the store was closed. It noted that it would need to balance delivery access with the operation of the car park. It suggested that the proposal would not allow unrestricted deliveries (as are permitted, for example, at Tesco's Brunel Way store).
- 8.19 In the light of the concerns expressed by other retailers, we consider that there is a significant risk that the existing delivery restrictions would have an impact on the opening hours of a grocery store in the Tesco development and its ability to act as an

¹¹¹Tesco said that instead of challenging a delivery hours restriction at the time the planning application was determined, it would normally deal with such matters by way of a variation application once the consent has been achieved. Section 73 of the Town and Country Planning Act 1990 provides a procedure for doing so.

effective competitor. We consider that it may be possible for retailers, taking steps such as those proposed by Tesco, to secure some relaxation of the delivery restrictions and that this could mitigate some of the challenges in providing a fresh food offer through weekends and holiday periods. However, we consider that the current design of the development of the site, with the service yards located adjacent to residential property makes continued delivery restrictions likely. It is not clear to us that, even with measures such as sealed delivery yards and acoustic fencing, the current design of the site will allow a relaxation of the delivery restrictions to address our concern.

Car parking

- 8.20 Approximately 370 car-parking spaces have been approved under the existing planning consent for the Tesco development, which provides for a grocery store in unit 3. This may increase to approximately 400 spaces were, for example, planning consent to be granted for a grocery store in units 3 and 4.
- 8.21 Morrisons told us that for a store with a net sales area of [redacted], approximately [redacted] car-parking spaces would be needed. It told us that the more limited number of car-parking spaces in the Tesco development was ‘the overriding issue’ for it. It noted that if it were to operate from units 3 and 4 it would have two other—as yet unknown—retailers operating alongside, sharing the car park.¹¹² With this number of car-parking spaces, it expected that customers would complain that they could not park and the store would be unable to compete successfully on this important aspect of service. Sainsbury’s and Asda also considered that car parking would be a major issue with a grocery store on the Tesco development.

Petrol filling station

- 8.22 Morrisons told us that it would be desirable to have a petrol filling station on the site as this would help to facilitate one-stop shopping. The Tesco development does not appear to lend itself to a petrol filling station, the inclusion of which would reduce the car-park spaces even further. We note that there is a petrol filling station at Tesco Brunel Way.

Tesco as landlord

- 8.23 Tesco currently owns the freehold of the CGL site and would potentially continue to do so were a grocery store on the site to be established on a leasehold basis. Tesco told us that it would seek to let the grocery retail unit on commercial terms, which would not limit the retailer’s freedom to run its business as it saw fit. Tesco told us that it intended to sell the freehold once the units had been let and this had always been its intention.
- 8.24 Waitrose told us that it would be unusual for it to lease from a competitor, but it would not be prohibitive given the structure of the lease that it had discussed with Tesco (a £[redacted] reverse premium, a [redacted] rent-free period and a [redacted] break clause). Asda and Morrisons both expressed concerns at having a tenancy relationship with Tesco.¹¹³ Sainsbury’s said that [redacted].

¹¹²Tesco did not accept that sharing car-parking spaces with other retailers would cause difficulties for the grocery retailer. It noted that customers visiting a mixed-use development often conducted shared trips, shopping at both the food and non-food outlets within a development in one visit.

¹¹³Morrisons told us that it had a strong preference for owning the freehold of the properties from which it traded.

- 8.25 In general, we have concerns where a vendor and a purchaser in a divestiture remedy have ongoing links and where these links might undermine the parties' ability and incentive to compete. Tesco suggested that we might review the proposed lease and, provided that the terms of the lease were subject to our prior approval, this would address any potential concerns. However, even if we were to approve the initial terms of a lease, there would be scope for Tesco to exert influence, for example, in considering applications by the tenant to make changes to the leased store. There is also the possibility that the requirement to notify the landlord of changes to the store would give Tesco a competitive advantage. In addition, the need for the tenant to maintain a good relationship with Tesco as its landlord may undermine the incentive to compete.

Planning risk and timing

- 8.26 A further component of composition risk is the certainty and timing that is associated with the delivery of the remedy. In relation to the Tesco development, construction has commenced and planning consent has been granted for a grocery store in either unit 3 or units 1 and 2.¹¹⁴ Tesco considered that, were it to have recommenced construction at the end of October 2007, the units would have been 'ready for occupation' by summer 2008.
- 8.27 In relation to placing a grocery store in units 3 and 4 (ie the largest grocery store possible in the Tesco development), Tesco told us that it had submitted a planning application on 7 November 2007. Slough Borough Council told us that this application raised slightly different issues from the combination of units 1 and 2, in that the location of the units was different and involved additional car parking.¹¹⁵ However, the Council told us that it was not expected to be a difficult application, and subject to staff resources, it should be able to make a decision within 13 weeks of its receipt.
- 8.28 It does not seem to us that any of the outstanding planning issues associated with the various options for a grocery store in the Tesco development will be difficult to resolve. It seems likely that a grocery store on the Tesco development would be in a position to begin trading by Christmas 2008.

Attractiveness of a grocery store on the Tesco development to potential purchasers

- 8.29 As we set out in paragraph 8.3, a further component of composition risk is the extent to which a divestiture package provides an attractive and viable platform for a purchaser. [X],[X] and [X] told us that they did not expect that any combination of units in the Tesco development would be an effective and therefore attractive, trading format. Sainsbury's has particular concerns about the impact of delivery restrictions on the amount and quality of fresh produce that it could offer in comparison with its

¹¹⁴Slough Borough Council told us the application to combine units 1 and 2 for grocery retail use was currently agreed subject to a variation or alteration to the existing section 106 agreement. In particular, Slough Borough Council told us that it was keen to ensure the maintenance of the condition requiring tenants in the development who were also present in the town centre to remain in the town centre for a minimum of five years after they had opened in the development. Slough Borough Council also told us that it was keen to ensure that the section 106 agreement included a mechanism by which it would be informed as to which planning consent (unit 3, units 1 and 2 or units 3 and 4) was to be exercised and built. Subject to these matters being resolved, the consent was likely to be granted.

¹¹⁵Slough Borough Council understood that the application would involve a small area to the east of the development, which was not previously planned as car parking, becoming car parking. It expected that this would involve the creation of perhaps 10 to 20 additional spaces. At the time we spoke to Slough Borough Council, it had yet to see the actual application but thought that in essence it would be 'fairly comparable' to the application for the combination of units 1 and 2 for grocery retail use and found it difficult to see why the application would not be agreed (subject to an assessment of the impact of the additional car-parking spaces).

other smaller stores. Morrisons, as we note above, has particular concerns about the lack of car-parking spaces and a petrol filling station.

- 8.30 Waitrose told us that, provided acceptable lease terms could be agreed, it would be content to operate [redacted]. However, we note that Waitrose expects the store to under-trade [redacted] (see paragraphs 8.57 and 8.58).

Development of a new large grocery store on the entire site

- 8.31 As we set out in paragraph 8.2, the alternative to a grocery store within the Tesco development is a completely new development on the entire site that provides for a much larger grocery store. [redacted], [redacted] and [redacted] all stated that this would be their preferred course of action. Sainsbury's proposes a store with a net sales area of 5,100 sq metres and 420 parking spaces, Morrisons proposes a store with a net sales area of [redacted] sq metres and [redacted] to [redacted] parking spaces, and Asda proposes a store with a net sales area of [redacted] sq metres and [redacted] parking spaces. Sainsbury's has already made a planning application to Slough Borough Council for a store of its preferred dimensions.
- 8.32 The following paragraphs consider, first, the competitive constraint that a new large grocery store on the entire CGL site would represent for other grocery stores in Slough, and in particular, Tesco Brunel Way. Second, the attractiveness of a sale of the entire site to potential purchasers. Finally, the planning risks associated with such a development both in terms of the nature of the store that could be constructed and the timing of such a development.

Competitiveness of a new large grocery store

- 8.33 Each of these stores would be significantly larger than any grocery store that might occupy one or more units in the Tesco development. The larger size of the stores proposed by these three retailers would provide a stronger competitive constraint to other larger grocery stores in Slough, and in particular, might be expected to provide a significantly more attractive alternative to shoppers at Tesco Brunel Way. A larger store would be able to carry a significantly larger number of products as well as other amenities and facilities, such as a greater number of specialist food counters, that would enable it to compete more effectively with other grocery stores.
- 8.34 A complete redevelopment of the site would allow a grocery retailer to incorporate all the elements, such as a sufficient car parking and a petrol filling station, that it considers most important for its ability to compete effectively. Redevelopment would also allow the retailer to address the underlying issues that have resulted in the delivery restrictions on the Tesco development by designing new access arrangements such as moving the service yards so that they are further away from the residential properties or designing an enclosed service yard.
- 8.35 Any grocery retailer would be constrained in what it constructs on the site by the need to obtain planning consent. Obtaining planning consent takes time, which affects the timescale for implementation of the remedy, and which may also affect the attractiveness of the redevelopment option to retailers. We consider both of these aspects of planning risk below.

Planning risk and timing

- 8.36 Any new store development on the CGL site would require new planning permission from Slough Borough Council and would be subject to a potential call-in and public

inquiry. Each of these processes could have a significant impact on, first, the nature of any store that was ultimately developed on the site, particularly in relation to factors such as store size, the extent of car parking and the presence of a petrol filling station, and second, the time that would be required before such a store could be constructed and commence operations.

- 8.37 Slough Borough Council told us that, in principle, it could support a new food store on the CGL site. However, an application for a single large store on the site would raise issues that needed significantly more consideration than had variations of the existing consent (eg to combine various units within the Tesco development for grocery retail use). Slough Borough Council told us that while the identity of the applicant in an application for planning consent was not a material consideration, it would be concerned about the balance between convenience goods and comparison goods in any new large store on the CGL site and that it might seek and enforce restrictions on this as part of any planning consent.¹¹⁶
- 8.38 Slough Borough Council told us, in the context of the Sainsbury's planning application for a new store on the site, that one of the problems was the impact on traffic in Slough. It said that if a store on the CGL site did not take business from Tesco Brunel Way, it would create additional traffic, which may be problematic. However, it also noted that if the new store on the CGL site did take business from Tesco Brunel Way, this could create additional traffic in the town centre by freeing up car-parking spaces at Tesco Brunel Way, which may also be problematic.
- 8.39 As noted in paragraph 8.31, Sainsbury's has already submitted a planning application to Slough Borough Council for a store on the CGL site of its preferred dimensions. [redacted] Slough Borough Council told us that it was concerned to ensure continued trading from the grocery store on Farnham Road (currently operated by Sainsbury's) as this was an anchor store for the district centre. Slough Borough Council told us that it would seek to apply conditions to any planning consent in relation to the CGL site such that Sainsbury's could not close its Farnham Road store.¹¹⁷ [redacted]
- 8.40 Morrisons told us that if it were to acquire the site as a whole, it would seek to construct a store with a net sales area of at least [redacted] sq metres and around [redacted] car-parking spaces. The configuration it had identified as maximizing floor space and car-parking spaces would provide it with [redacted] sq metres gross internal area and [redacted] car-parking spaces. Morrisons also told us that it was considering whether and how a petrol filling station might be accommodated on the site and noted that this might entail acquiring additional land adjacent to the site. Morrisons said that it thought that the delivery arrangements envisaged in its design would not present noise problems.
- 8.41 Morrisons told us that in discussions with consultants representing it, Slough Borough Council had raised issues relating to the mix of comparison and convenience goods on the site and also about traffic generation. [redacted]
- 8.42 Asda provided [redacted].

¹¹⁶It noted that a split of 80 per cent convenience goods and 20 per cent comparison goods might be acceptable, but that this was something that Slough Borough Council would want to make sure was implemented. It noted that Sainsbury's non-food lines were quite limited but that it would wish to ensure that it did not move more into goods such as clothes, electrical goods, games and mobile telephones and would need to consider how to enforce this. It noted that if Asda were to operate from the site the split could be 60 per cent convenience goods, 40 per cent comparison goods or even a 50:50 split. It noted that Morrisons were 'basically grocers' and suggested that there would be less concern about the convenience-comparison split in their case.

¹¹⁷Slough Borough Council told us that it had in mind a section 106 agreement similar to that in place in relation to the Tesco scheme. That is, an agreement that would require anyone operating from the CGL site to keep any existing store in Slough open for five years.

- 8.43 Asda told us that its in-house town planner had had a telephone conversation with Slough Borough Council about the potential to redevelop the site. The planning officer told Asda that any application would need to pass the need and sequential test and the retail impact assessment as well as not prejudicing residential amenity, but nevertheless the Council was keen to see a retail development on the site. [REDACTED]
- 8.44 In terms of timing, Slough Borough Council told us that it would need to refer the application to the Government Office for the South East, and although the application would not necessarily be 'called-in' it was very difficult to make a judgement on whether this would occur. In relation to the Sainsbury's application, Slough Borough Council told us that it could not deal with this within the 13-week statutory timescale. Sainsbury's said that [REDACTED]. Morrisons told us that it could have an application ready to submit in [REDACTED]. It expected that the planning process would take [REDACTED] from submitting its application to decision. Morrisons would not expect the decision to be called in although, if it was, it expected the decision to take between [REDACTED] and [REDACTED] depending on the examination process.
- 8.45 Asda told us that it could take around two months for it to enter into a conditional contract to purchase the CGL site from Tesco. Having done this, it would be in a position to apply for [REDACTED]. Asda considered that it would take around nine months to secure consent from submission of the planning application. The process would involve producing the retail impact assessments, discussing with the planning authority, gathering data for the residential and environmental impact assessments and consulting with local residents. Asda said that it saw the chances of its application being called in as being [REDACTED]. Overall, Asda thought that the time from signing the contract with Tesco for the purchase of the site to the start of building work on the site could be around 12 months. It would then take a further six to nine months to construct a store on the site.

Attractiveness of the CGL site to purchasers seeking to develop a new large grocery store

- 8.46 We consider that a sale of the entire site to a grocery retailer for the purpose of developing a new large grocery store on the site would be attractive to potential purchasers. As we set out in paragraph 8.31, Asda, Morrisons and Sainsbury's all stated that this would be their preferred option compared with a grocery store within the Tesco development, and Sainsbury's had already submitted a planning application to Slough Borough Council for such a development.

Conclusion on composition risk

- 8.47 We consider that there is a significant risk that the Tesco development will not provide scope for a grocery retailer to compete effectively with other large grocery stores in Slough, and in particular, with Tesco Brunel Way. This is primarily due to the restricted nature of the size of the store in the development, and the implications that would have in terms of the range of products and store amenities and facilities, the limited number of car-parking spaces in the development, and likely restrictions on delivery hours and their impact on store opening hours. We also have concerns about any arrangement whereby Tesco would remain as freeholder of the development although we note that this could be dealt with by requiring Tesco to divest the freehold of the site to a suitable purchaser.
- 8.48 We consider that a new large store on the entire CGL site would place a much more effective competitive constraint on other large grocery stores in Slough, particularly Tesco Brunel Way. However, there is a greater degree of risk in terms of planning

consent and timing associated with this option compared with a divestiture package comprising one or more units within the Tesco development. We consider that Slough Borough Council is likely to approve an application for a large grocery store on the CGL site. Although Slough Borough Council has highlighted particular issues that any such application would need to address (for example, traffic and the impact on the town centre), its view is that it should be possible for these issues to be addressed.

- 8.49 We consider that a sale of the CGL site for the purposes of developing a large grocery store is significantly more attractive to those grocery retailers best placed, in terms of their product offering, to compete with existing operators of large grocery stores in Slough. [redacted]
- 8.50 While the option of a new grocery store in the Tesco development is likely to result in a new grocery store sooner than the alternative of a sale of the CGL site for the purposes of a larger grocery store, it is not clear that this advantage would be significant. Further, we consider that the timing advantage of the Tesco development is offset by the lesser effectiveness of this option as a remedy.
- 8.51 Overall, we conclude that the composition risk associated with the Tesco development is significantly higher than that in respect of a sale of the CGL site as a whole for the development of a new large grocery store.

Purchaser or lessee risk

- 8.52 Any divestiture remedy would only be effective in addressing the SLC if the divestiture package could be sold to a suitable purchaser. In general, a suitable purchaser will be one who is:¹¹⁸
- (a) *independent* of the merger parties, ie no connection to the merger parties that would reduce its incentive to operate the divestiture package as an effective competitive constraint;
 - (b) *capable* of using the divestiture package to compete effectively in the relevant market, in particular with access to the necessary financial resources and operational expertise; and
 - (c) *free from competition concerns*, ie will not itself raise concerns about a potential SLC from the purchase of the divestiture package.

We consider each of these aspects of purchaser risk below.

- 8.53 In considering each of these elements of purchaser risk, we take into account the possible set of purchasers identified by Tesco in September/October 2007. [redacted], [redacted] and [redacted] have each expressed interest in the CGL site. Tesco told us that [redacted] and [redacted] expressed interest in leasing a unit in the Tesco development¹¹⁹ and suggested that [redacted] might be interested in acquiring a freehold interest in all or part of the site.¹²⁰

¹¹⁸CC8, paragraph 4.1.

¹¹⁹Although not on the list provided, we understand that Chalvey Supermarket was also interested in acquiring part of the Tesco development.

¹²⁰However, [redacted] suggested to us that it had no great interest in the site.

TABLE 10 Interest in 78 Uxbridge Road

Retailer	Interest sought	Size of unit

Source: Tesco.

Independence

8.54 Each of the potential purchasers identified in Table 7 is a business independent of Tesco. We would have concerns where any grocery retailer operating a store in the Tesco development had a leasehold relationship with Tesco. However, it would be possible to limit this aspect of purchaser risk while still pursuing a remedy based on a grocery store in the Tesco development. This could be achieved by requiring Tesco, after having concluded a lease agreement with a suitable tenant, to sell the freehold of the development to a suitable purchaser (ie to someone who, acting as landlord, would not undermine the ability and the incentive of the grocery retailer operating from the development to compete).

Capability

8.55 We need to be confident that a prospective purchaser or lessee is capable of:

- (a) either acquiring the site as a whole and redeveloping it or leasing a unit or units in the Tesco development as appropriate;
- (b) capable of creating a suitable store; and
- (c) capable of operating that store on an ongoing basis and operating as a competitor in Slough.

8.56 We have noted that Aldi and Waitrose were interested in leasing a unit or units in the Tesco development and Farmfoods, Lidl and Netto may be interested in purchasing the freehold for part or all of the site. However, our view, as expressed in our provisional findings in the groceries market investigation,¹²¹ is that stores operated by the LADs (ie Aldi, Lidl and Netto), Iceland and Farmfoods are not in the same product market as Tesco and CGL.¹²² Although we have not reached a view about their suitability as possible purchasers, we would have concerns about the capability of non-major grocery retailers, including the LADs, Iceland and Farmfoods, to compete

¹²¹www.competition-commission.org.uk/inquiries/ref2006/grocery/provisional_findings.htm.

¹²²Groceries provisional findings, paragraph 4.84, said:

We consider that the evidence in the preceding paragraphs shows that stores operated by the LADs, Iceland and Farmfoods are not close substitutes for the stores of other grocery retailers and should not be included in the same product market when the starting point for a SSNIP test is stores operated by grocery retailers. However, we consider that it is likely that LAD, Iceland and Farmfoods stores are constrained by other grocery retailers, and that there is a one-way or asymmetric constraint between these fascias analogous to that observed in relation to stores of different sizes.

effectively with other grocery stores in Slough and, in particular, with Tesco Brunel Way.¹²³

8.57 Waitrose told us that it expected that a store in the Tesco development would under-trade by [redacted] per cent (ie sales per sq metre would be [redacted] per cent less than the average for Waitrose stores of that size). [redacted]

8.58 [redacted]

8.59 We currently have no reason to doubt the capability of other major grocery retailers to operate the sort of large, full-range grocery store that we consider would be needed to compete effectively with other grocery stores in Slough and, in particular, with Tesco Brunel Way. However, prior to taking any decisions on the approval of such purchasers we would need to consider their ability to finance the acquisition and to create the store, and also their plans for the store in terms of retail offer and their expectations as regards trading.

8.60 It may be possible for another grocery retailer from outside the set of ‘majors’ to operate a store on the CGL site in such a way as to compete effectively with other grocery stores in Slough and, in particular, with Tesco Brunel Way. However, we would need to be satisfied about the quality and breadth of their retail offer, their expertise and their financing, among other things. We would need to see strong evidence in relation to these factors.

Competition concerns

8.61 We have considered whether any potential purchaser might raise competition concerns. As we set out earlier in the report, Asda and Sainsbury’s currently operate large grocery stores elsewhere in Slough. As a result, we consider possible competition issues that might arise as a result of their opening a large grocery store on the CGL site.

8.62 Asda told us that it would wish to acquire the CGL site with a view to redeveloping it as a single large grocery store of around [redacted] sq metres ([redacted] sq feet). It told us that the core trade area for its existing Telford Drive store was [redacted]. It would see the core trade for a store on the CGL site coming from [redacted].

8.63 Sainsbury’s, as we note previously, currently operates large grocery stores at Taplow and Farnham Road in Slough. Sainsbury’s has argued that the majority of customers for its Taplow store live in close proximity to the store, predominantly in the direction of Maidenhead to the west. Sainsbury’s stated that the CACI gravity model used in the Slough local development framework predicts that the majority of Tesco Brunel Way’s demand originates from households based to the north and south of Slough. Sainsbury’s also submitted an analysis of Slough store openings and closings that it suggested meant that it was highly implausible that the Taplow store could have exerted a competitive constraint on a hypothetical monopolist of the Tesco, CGL, Asda and Safeway stores. However, our analysis (in paragraph 5.67) shows that the Sainsbury’s store in Taplow is within the market for grocery retailing in Slough, such that Sainsbury’s acquisition of the CGL site would represent an increase in concentration in that market.

8.64 Sainsbury’s told us that: [redacted].

¹²³We also note that these retailers—with the possible exception of Netto—appear to have expressed interest in units the size of which we would be concerned would not restore the level of competition that would have existed absent the merger.

- 8.65 [✂]
- 8.66 We have considered whether a disposal by Sainsbury's of its Farnham Road store might serve to address these competition concerns. [✂]
- 8.67 We also note the concerns expressed by Slough Borough Council that a strong grocery store should remain on Farnham Road as the anchor for that district centre. Slough Borough Council told us that in considering Sainsbury's planning application for a large grocery store on the CGL site it would consider seeking a section 106 agreement requiring Sainsbury's to remain in its Farnham Road store for at least five years.

Conclusion on purchaser risk

- 8.68 We recognize that there is a relatively small pool of potential purchasers who would wish to acquire the entire site in order to construct a large grocery store. However, we are confident that a number of retailers would bid for this site on this basis and that a number of those bidders would be suitable, according to our criteria of independence, capability and freedom from competitive concerns. We note that there is a larger pool of retailers apparently interested in acquiring the lease for a unit or units within the Tesco development. However, we are less confident that these retailers would be suitable purchasers, in particular having regard to whether they would be capable of operating a store from the Tesco development that would compete effectively in Slough and in particular with Tesco Brunel Way. Given that our aim is to ensure that a suitable purchaser operates a grocery store from the CGL site, we consider that the degree of purchaser risk in relation to the acquisition of the entire site for redevelopment is lower than that associated with the operation of a store from the Tesco development.
- 8.69 We have not reached any conclusions on the suitability of individual potential purchasers. Before doing so, we would need to consider that purchaser having regard to independence, capability and freedom from competitive concerns.

Asset risk

- 8.70 In general, the longer a divestiture takes to complete, the greater the risk that the divestiture package, by accident or design, will degrade, impacting on the effectiveness of the remedy. The degradation of assets is less of a concern here than in most divestitures since the site is unfinished.
- 8.71 We note that one possible purchaser for the site as a whole has said that, rather than demolish the Tesco development, it would seek to dismantle it and recycle materials as appropriate. We consider that it would be possible to degrade the Tesco development in such a way as to make this more difficult. However, the interim order currently in force would effectively prevent this until final determination of the reference and that provisions could be included in final undertakings or a final order that would have the effect of continuing that protection against asset risk until any sale had been completed.
- 8.72 We consider that there is a relatively low level of risk attached either to a structural remedy involving sale of the site as a whole for redevelopment or to the occupation of one or more units in the Tesco development. We consider that this risk could effectively be managed by the inclusion of appropriate provisions in interim or final remedies.

Conclusion on structural remedies

- 8.73 We have assessed the composition risk, purchaser risk and asset risk associated with structural remedies involving sale of the site as a whole for redevelopment and also the occupation of one or more units in the Tesco development. In relation to composition risk, we consider that there is a significant risk that the Tesco development will not provide scope for a grocery retailer to compete effectively with other large grocery stores in Slough, and in particular with Tesco Brunel Way. We recognize that there is a risk that planning consent for a single large grocery store on the entire site would not be granted. However, in the light of our discussions with Slough Borough Council, we consider that is likely to approve an application for a large grocery store on the CGL site. Overall, we consider that the composition risk associated with the Tesco development is significantly higher than that in respect of a sale of the CGL site as a whole for the development of a new large grocery store.
- 8.74 In relation to purchaser risk, we note that although there appears to be a larger pool of retailers interested in operating from the Tesco development, we are less confident that there would be more suitable purchasers interested in operating from the Tesco development than in acquiring the entire CGL site for development of a large grocery store. We also consider that, if a grocery store were to operate from the Tesco development, it would be unacceptable for Tesco to remain as landlord as this would create ongoing links between Tesco and the competing operator. We consider that asset risk could adequately be dealt with both in respect of the Tesco development and in respect of the sale of the site as a whole.
- 8.75 Overall, our assessment of risk leads us to conclude that the sale of the entire CGL site as a whole for development as a large grocery store is significantly more likely to be an effective remedy than the operation of a grocery store from a unit or units within the Tesco development.

Behavioural remedies

- 8.76 There do not appear to be any behavioural remedies available in this case that would restore the level of competition lost as a result of the merger. Behavioural remedies could be put in place to address the adverse effects of the merger, but we have serious concerns about whether it would be practicable to control outcomes (in terms of PQRS) in any meaningful sense. No such behavioural remedies have been considered further. However, we have considered whether we should include any behavioural remedies as an adjunct to a structural remedy.
- 8.77 We noted that it was not unusual for grocery retailers to make comments or provide other inputs in the process associated with other grocery retailers' planning applications. Sainsbury's also pointed out that it was possible to have an effect on the planning process by indirect means, for example by lobbying MPs to encourage a call-in. It accepted that there may be difficulties in monitoring and enforcing compliance with such remedies, but still believed that there would be value in obliging Tesco to cooperate with the planning process in respect of any application by the purchaser of the CGL site. Tesco told us that it would be prepared to cooperate with a third party's planning application if such cooperation were sought and that it would not hinder such an application.
- 8.78 We consider that a requirement on Tesco to do what it reasonably could to assist the purchaser of the site in obtaining planning consent for a single large grocery store, and not to hinder the purchaser of the site in its pursuit of that planning consent, would be a useful adjunct to a structural remedy.

Other remedies suggested by third parties

- 8.79 Sainsbury's suggested that Tesco should not gain a competitive advantage through its acquisition of the CGL store. It suggested that our remedy should create a situation as similar as possible to that which would have existed absent the merger, and in order to achieve this, it suggested that we should require Tesco to reduce the size of its Brunel Way store to 7,400 or 8,350 sq metres (80,000 or 90,000 sq feet), with the remaining space being leased to another retailer of comparison goods.
- 8.80 Through our remedy we intend as far as possible to restore the competition that has been, or is expected to be, lessened as a result of the merger. Although store size facilitates are important to the retail offer, this does not mean that an effective remedy would need to recreate the store sizes that would have existed absent the merger. It is our view that it should be possible for there to be a grocery store on the CGL site with a retail offer that allows it to compete effectively with other large grocery stores in Slough without also requiring Tesco to reduce the size of its Brunel Way store.
- 8.81 Sainsbury's suggested that, if Tesco maintained that the Tesco development would be competitive, then, as an alternative to the divestment of the CGL site, we should consider requiring Tesco to operate from the designated unit (ie unit 3) in the Tesco development while divesting its Brunel Way store. However, in implementing a divestiture remedy our aim would be as far as possible to restore the level of competition that would have existed absent the merger. Tesco's operating from unit 3 while another grocery retailer operated from the Brunel Way store does not seem more likely to restore that level of competition than would another grocery retailer operating from unit 3 on the Tesco development with Tesco operating from Brunel Way. It would also be considerably more costly for Tesco. Thus, as long as a competing grocery retailer could be found to operate from unit 3, such a remedy would be disproportionate. We have not therefore considered this option further.
- 8.82 Sainsbury's noted that a grocery retailer's ability to develop a large store on the CGL site would depend on Slough Borough Council granting planning consent for such a store. Sainsbury's therefore suggested that we should consider making a recommendation to the Council to approve an application for such a store. However, we do not consider that it would be appropriate for us to recommend to Slough Borough Council a particular outcome of the performance of its statutory functions in respect of planning.
- 8.83 We do not intend to pursue Sainsbury's suggestions in relation to reducing the size of Tesco Brunel Way, requiring Tesco to operate from the Tesco development, or making recommendations to Slough Borough Council to approve an application for a large grocery store on the CGL site.

Choice of remedy

Effectiveness

- 8.84 On the basis of the above assessment, we consider that only a structural remedy would be effective in addressing the SLC we have identified. We also consider that a structural remedy involving the sale of the entire CGL site for development as a large grocery store is significantly more likely to be effective than a remedy based on the operation of a grocery store in the Tesco development.
- 8.85 Having considered the effectiveness of the different remedy options, before choosing our remedy, we must also consider proportionality. CC guidance states that it will not

normally consider the costs of divestiture to the parties in completed mergers as these costs are in essence avoidable and the CC would normally expect the risk of divestiture to be reflected in the acquisition price. However, as we have noted elsewhere, this case is highly unusual and we have considered whether our usual approach is appropriate in the light of the facts.

- 8.86 Tesco has argued that the changing regulatory landscape has meant that it has potentially been subject to three different competition rules in relation to the acquisition of a single store and therefore exceptional circumstances arise such that the CC is not entitled to disregard the cost of divestment to Tesco when assessing the proportionality of possible remedies. Tesco said that when it exchanged contracts to acquire the Co-op in 2003 the 'Safeway Rules' had not been announced by the CC.
- 8.87 Although the analysis of grocery retail mergers has evolved over time, we note that Tesco's acquisition of the CGL store was always subject to merger control and was always subject to the risk that Tesco would have to divest the CGL store. We also note that, at the point at which Tesco demolished the CGL store and began the construction of the Tesco development, it was aware that the OFT wished to maintain the option of it divesting the whole site.
- 8.88 However, given the wholly exceptional nature of this case, we consider it appropriate to have regard to the cost to Tesco of the different remedy options. We have therefore considered whether the sale of the CGL site for development as a large grocery retail store would generate less value for Tesco than a grocery retailer leasing a unit or units within the Tesco development and then Tesco selling the freehold of the development.
- 8.89 We note that independent valuations carried out on our behalf,¹²⁴ together with a valuation carried out on behalf of another retailer,¹²⁵ suggest that Tesco would have received more from the sale of the entire CGL for redevelopment as a large grocery store than the net present value of the Tesco development. Our independent valuation and the valuation carried out on behalf of another retailer suggest that a reason for Tesco choosing to build its development on the CGL site was the effect it expected a single large grocery store on the site to have on trade at Tesco Brunel Way. Given that the aim of our remedy is to restore the competition that has been, or is expected to be, lessened as a result of the merger, we do not consider it appropriate to take account of the cost to Tesco from the loss of trade at its Brunel Way store should an effective competitor operate from the CGL site.
- 8.90 We have considered whether Tesco would suffer a loss as a result of being required to sell the CGL site for redevelopment rather than completing its own development and leasing the units within it. Tesco told us that [redacted]. On the basis that [redacted] bid £[redacted] million in March 2007 for a completed store (to its specification and with 47,500 sq feet net sales area) on the CGL site, Tesco calculated that the net present value to Tesco of selling the entire CGL site for development as a large grocery store was £[redacted] million. Tesco's figures therefore suggested that the sale of the entire CGL site would see it lose £[redacted] million. However, we also considered a valuation carried out on our behalf by an independent valuer and a valuation carried out by another retailer. We noted that these valuations used different rent and yield assumptions to the Tesco valuation. We also noted that another major difference in the valuations results from Tesco having included in its valuation the costs it incurred in starting

¹²⁴A report prepared for the CC by Gerald Eve on 7 September 2007 estimated a value for a new-build grocery superstore of gross internal area 86,000 sq feet and net sales area 55,000 sq feet to be £22–£25 million. This compared with the value of £15–£17 million estimated for the Tesco development assuming unit 3 was groceries and the rest comparison goods.

¹²⁵[redacted] commissioned [redacted] to value the scheme. [redacted] estimated the value of [redacted].

construction on the development. These costs totalled some £[redacted] million¹²⁶ (construction costs £[redacted], demolition costs £[redacted] and contract costs on withdrawal £[redacted] million). Tesco also suggested that it would incur an additional £[redacted] million for the cost of capital accrued on the acquisition price for the period while gaining planning permission.

- 8.91 Given the differences in the valuations, it is our view that it is not clear that the sale of the entire CGL site for development as a large grocery store would be a lower-value option to Tesco than completing the existing development, securing a grocery tenant for a unit or units within it, and then selling the freehold. This is especially so bearing in mind that, as noted in paragraph 8.88, we do not consider the costs to Tesco of having a more effective competitor on the CGL site. Bearing in mind the effectiveness of our remedy, we retain a strong preference for a divestiture of the entire CGL site for development as a large grocery store. However, acknowledging the wholly exceptional nature of this case, we will have regard to the costs to Tesco implementing our remedy, and the way in which we will do this is discussed in relation to the implementation of the remedy, below.

Implementation of remedy

- 8.92 Our preferred remedy is the divestiture of the CGL site as a whole for redevelopment and use as a site for a large full-range grocery retail store. However, acknowledging that the need for planning consent might mean that our preferred remedy cannot be implemented, we consider that it is appropriate to have in place a fallback remedy, comprising the operation by a large, full-range grocery retailer of a store from the largest unit or combination of units in the Tesco development. In general, the CC designs divestiture processes in such a way as to minimize the risks associated with divestiture remedies which might limit their effectiveness in addressing a substantial lessening of competition, as far as it is reasonable to do so. We have given careful consideration to the design of the divestiture process in this case, bearing in mind the unusual nature of our remedy which, as explained above, comprises a preferred remedy and a fallback remedy. In particular, we have considered three different options, and the way in which the sale process might be designed around them:

- The ‘redevelopment option’: divestment of the site as a whole to a suitable purchaser with commitments from the purchaser to apply for planning permission for a single large grocery store on the site.
- The ‘fallback option’: lease of the largest possible unit or units in the Tesco development to a suitable tenant on the understanding that Tesco would sell the freehold of the development to a suitable purchaser, such as the tenant or a property investor, within a specified period.
- The ‘redevelopment plus fallback’ option: divestiture of the site as a whole to a suitable purchaser with commitments from the purchaser to apply for planning permission for a single large grocery store on the site and, a commitment that should it fail to obtain planning permission within a specified period it would complete the Tesco development within a further specified period and either operate itself the largest possible grocery store within that development or find a tenant that the CC agrees is suitable to operate the grocery store.

- 8.93 In relation to the fallback option and the ‘redevelopment plus fallback’ option we considered how the requirement on the purchaser should be specified. In particular,

¹²⁶Tesco estimated that this has now increased to some £[redacted] million.

we considered whether the purchaser should be required to operate from a combination of units 3 and 4 in the Tesco development, which is currently the largest single floor unit that could be created within that development, or from a combination of units 1 and 2, which is the largest single floor unit for which planning permission has already been granted (subject to conclusion of a section 106 agreement). However, given that the purpose of the fallback option, either stand-alone or in combination with the redevelopment option, is to provide a safeguard remedy in case our preferred remedy is not implemented, we do not consider it appropriate to specify the fallback option too tightly. We therefore consider that the fallback option, alone or in combination with the redevelopment option, should remain in operation from the largest possible unit or configuration of units on the Tesco development.

- 8.94 We have also considered how long a period the purchaser of the entire site should be permitted in the 'redevelopment plus fallback' option to secure planning permission for a large grocery store on the site. We noted that Slough Borough Council had told us that it would be unlikely to be able to determine the Sainsbury application within 13 weeks and that such an application would require significantly more consideration than had the variations to the existing consent (see paragraph 8.36 et seq above). We also noted that the scale of an application for a large grocery store on the CGL site would mean that the application would need to be notified to the Government Office for the South East, which would add further weeks to the consent process. Balancing our desire to see the most effective remedy implemented with our desire to see an effective remedy implemented as is reasonably practicable, we consider that a period of 12 months should be specified as the period within which the purchaser of the redevelopment option should be required to secure planning consent, failing which the fallback option will be triggered.
- 8.95 Further, we have considered how long a period a purchaser implementing the fallback option (either stand-alone or after having attempted a redevelopment) should be permitted to ensure that a competing grocery retailer is operating from the largest possible unit or units within the Tesco development. We noted that this period would need to be sufficient both to allow the completion of the Tesco development, the securing of a suitable grocery tenant, and the fitting out of the store as appropriate. We noted that [✂] (see paragraph 8.44). Given this, we consider that a 12-month period would be sufficient to allow the purchaser to complete the Tesco development, find a suitable tenant (or occupy a unit or units itself), to fit out the store as appropriate and for trading to begin.
- 8.96 Noting our preference for the sale of the site as a whole for redevelopment, with the fallback of a grocery retailer operating from the largest possible combination of units in the Tesco development, Tesco argued that we should allow the redevelopment option and the fallback option to be marketed simultaneously but as distinct options. It argued in particular that we should not require the marketing of a single 'redevelopment plus fallback' option that would see bids invited for the purchase of the entire site for redevelopment and, if planning consent were not granted, the completion of the Tesco development and the operation of a grocery store from units from that scheme. [✂]
- 8.97 Tesco proposed that bids for the redevelopment option and the fallback option be sought separately and that in relation to each option the highest-value bid (from a suitable purchaser) should be chosen, thus in effect there would be two selected bids for a period, one for the redevelopment option and a second for the fallback option. It said that the winner of the redevelopment option should acquire the site subject to receiving planning consent for a large grocery store. While the planning application was being dealt with, the site would remain the property of Tesco. The winner of the fallback option should be required to keep its bid for the lease of unit(s) in the Tesco

development open for whatever period the winner of the redevelopment option was given by the CC to secure planning consent. Should the winner of the redevelopment option fail to secure planning consent within that period, the winner of the fallback option would then enter into an agreement with Tesco to lease unit(s) in the Tesco development. Tesco would then sell the freehold to a suitable purchaser. Tesco did not say whether it would sell the freehold before or after having completed the Tesco development.

- 8.98 Tesco argued that it should be permitted to conduct the sale process and suggested that any concerns we had about the sale process should be capable of being dealt with by the appointment of a monitoring trustee and the agreement of a methodology for the evaluation of bids. Tesco also argued that it was critical that there should be [redacted]. Tesco also argued that the CC should approve potential purchasers upfront, in advance of the auction process. [redacted]
- 8.99 We considered whether the redevelopment option and the fallback option should be marketed as two distinct options or whether a combined 'redevelopment plus fallback' option should be marketed. We also considered (a) the implications of marketing sequentially and simultaneously the separate redevelopment, fallback and 'redevelopment plus fallback' options, including their attractiveness to potential purchasers and timescale impact for implementation; (b) the cost to Tesco of various effective options, including the number of likely bidders for each option; (c) the nature of Tesco's incentives in running an auction process seeking separate bids for the redevelopment and fallback options as well as its evaluation of bids. We also considered (a) the ability and the incentive that Tesco would have to produce a less effective remedy outcome; and (b) the timescale for implementation. Each of these questions is considered in turn below.

Sequential or simultaneous marketing of options

- 8.100 We considered whether it might be appropriate to conduct an auction first in relation to the redevelopment option with the prospect that if consent was not obtained by a specified date the marketing of the fall back option would then begin. Such an approach would imply that the purchase of the site for redevelopment would be conditional on obtaining planning consent, so that the site would remain the property of Tesco until planning consent had been obtained. However, we were concerned that the sequential marketing of these two options would, if it proved necessary to implement the fallback option, delay the implementation of the remedy compared with the marketing of the 'redevelopment plus fallback option'. Critically, the 'redevelopment plus fallback option' would see the identity of the purchaser for the fallback option known at the outset of the process, so that it would be possible to move seamlessly to the implementation of the fallback option should planning consent not be obtained for the redevelopment of the site. By contrast, the sequential marketing of the redevelopment option and the fallback option would necessitate the fresh marketing of the fallback option at this stage, delaying the implementation of the remedy.
- 8.101 In principle, it would be possible to address this issue by marketing the redevelopment option and the fallback option simultaneously at the outset, and then requiring the bidders for the fallback option to bid on the basis that their bids must remain open for a period sufficient to allow the purchaser of the redevelopment option to obtain planning permission. This would avoid the delay involved in marketing the fallback option afresh should it become necessary to implement this option. However, we considered that this would create considerable uncertainty and complexity for bidders. In particular, bidders for the fallback would be required to bid without knowing whether or when they would be in a position to operate a grocery store from the

Tesco development and would not be in a position to know this until up to 12 months after the auction process had been completed. We considered that this would make the fallback option significantly less attractive for bidders.

- 8.102 In contrast, in bidding for the ‘redevelopment plus fallback’ option, bidders would know that, should they win the auction, they would be in a position to operate from the site, either through redevelopment or, should planning consent not be granted within 12 months, from the completed Tesco development, and they would know whether their bid had been successfully immediately after the auction process had been completed. [X] However, [X], we did not consider that a ‘redevelopment plus fallback’ option would be at risk of receiving significantly fewer bids from potentially suitable purchasers.
- 8.103 When compared with the sequential marketing of the redevelopment option and the fallback option, we consider the timing advantages associated with the sales process mean that this is the more effective of the options. Ownership of the site would be transferred from Tesco to a suitable purchaser immediately following the sale process, and the approved purchaser would have the ability and the incentive to install an effective competitor on the site as quickly as possible. However, in order to guard against the possibility that no reasonable bids are received from suitable purchasers for the ‘redevelopment plus fallback’ option we consider that it would be prudent simultaneously to market the fallback option.

Evaluation of bids

- 8.104 The CC will not normally consider the costs of divestiture to the merger parties in completed mergers.¹²⁷ However, we consider that the circumstances of this case are wholly exceptional and do require us to have regard to the costs to Tesco of our remedy. We do therefore consider that the financial loss to Tesco resulting from a sale is a factor that it should take into account, but that this has to be considered alongside other factors, and in particular the public interest in remedying the SLC, in determining a remedy which is reasonable.
- 8.105 In order to achieve this, the evaluation of the bids received for the ‘redevelopment plus fallback’ option and the fallback option will be evaluated by the CC (not by Tesco or by a divestiture trustee). In evaluating the bids, the CC will have regard to (a) the effectiveness of the remedy and our strong preference for the ‘redevelopment plus fallback’ option over the fallback option; (b) the size of the unit or units from which the purchaser intends a grocery retailer to operate under the fallback option (alone or in combination with the redevelopment option); (c) the suitability of the purchaser (bearing in mind the factors discussed in paragraphs 8.52 to 8.69); (d) the price of the bid; and (e) the value of the bid to Tesco (excluding any cost to Tesco as a result of loss of trade at its Brunel Way store). The CC will not require Tesco to accept a bid which is, in the CC’s view, wholly unreasonable.

Appointment of divestiture trustee

- 8.106 It is the CC’s usual approach to allow the merger parties an initial period of time in which to secure the sale of a divestiture package to a suitable purchaser, and only to require the appointment of a divestiture trustee should they fail to do so. However, we consider that the circumstances of this case are such that the sale of the

¹²⁷CC2, *Merger References: Competition Commission guidelines*, paragraph 4.10.

'redevelopment plus fallback' option and the fallback option should be conducted by a divestiture trustee from the outset.

- 8.107 As discussed above, in order to ensure that an effective remedy is implemented within a reasonable time period, we consider that it is necessary to market the 'redevelopment plus fallback' option and the fallback option simultaneously. As is often the case in divestiture remedies, we consider that Tesco has an incentive to secure the implementation of the option that would result in a lesser competitive constraint on it (depending on the relative value of the bids and the expected loss of trade to a competitor). If Tesco were permitted to market the two options simultaneously, we consider that this would give it the ability to act on this incentive and it would be likely to seek to influence the sale process to secure its preferred outcome. It could, for example, deter bidders for the 'redevelopment plus fallback' option or influence the level of the bids for that option such that the CC might consider them wholly unreasonable.
- 8.108 We have considered whether it would be possible to guard against this risk by the appointment of a monitoring trustee to oversee a sale process that was conducted by Tesco. However, while this would be helpful, we consider that there are very many ways in which the sales process could be influenced and that it would in practice be extremely difficult for a monitoring trustee to retain sufficient oversight of every aspect of the process to provide an adequate safeguard.
- 8.109 Tesco told us that the appointment of a divestiture trustee from the outset risked considerable detriment to Tesco and that Tesco itself was in the best position to conduct the sale process. We do not consider that this is the case. We note that this divestiture remedy does not involve the sale of an ongoing business, in which the owners and managers of that business might well be best placed to market it on the basis of their knowledge understanding of it. This divestiture remedy involves the sale of a site, in relation to which the knowledge and understanding of the existing owners will add little, and which we consider can be conducted equally effectively by a divestiture trustee.
- 8.110 Tesco also told us that it considered that requiring the appointment of a divestiture trustee from the outset will send a signal to bidders that bids will be accepted regardless of value. However, we note that we have said that in evaluating bids, the CC will have regard to the cost to Tesco and will not require Tesco to accept a bid that is wholly unreasonable.
- 8.111 We note that the appointment and remuneration of the trustee will involve Tesco in incurring cost. However, unless the sale process is conducted by a divestiture trustee, there is a significant risk that the remedy will not be effective. While noting this cost, we consider that requiring the appointment of a divestiture trustee is reasonable.

Relevant customer benefits

- 8.112 Once the CC has identified its chosen remedy it may '... in particular have regard to the effects of any remedial action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned'.¹²⁸ Relevant customer benefits

¹²⁸Sections 35(5) and 36(6) of the Enterprise Act 2002.

might be lower prices, greater choice, higher quality and higher levels of innovation.¹²⁹

8.113 We accept that the acquisition of the CGL store by Tesco enabled Tesco to develop its Brunel Way store into a 100,000 sq ft store, rather than into an 80,000 or 90,000 sq ft store. This additional floorspace does not in itself constitute a relevant customer benefit. However, we consider it likely that Tesco has used this additional floorspace in ways that have benefited customers, for example carrying a wider range of products. We do not consider it likely that our chosen remedy would jeopardize these benefits. On this basis, we consider that there is no reason for the Group to modify the choice or design of its remedy to take account of relevant customer benefits.

Conclusion on remedies

8.114 We have decided that a divestiture remedy should be implemented in this case. We have decided that this remedy should involve the simultaneous marketing of:

- (a) the CGL site to a suitable purchaser with commitments from the purchaser to apply for planning permission for a single large grocery store on the site, and a commitment that should it fail to obtain planning permission within 12 months it would complete the Tesco development itself within a further 12-month period and either operate itself the largest possible grocery store within that development or find a tenant that the CC agrees is suitable to operate the grocery store; and
- (b) a lease of a unit or units in the Tesco development to a suitable tenant on the understanding that Tesco would sell the freehold of the development to a suitable purchaser, such as the tenant or a property investor, within a specified period.

8.115 Taking into account the cost to Tesco, but bearing in mind the importance of the sale process to the effective implementation of our chosen remedy, we have decided that Tesco should appoint and remunerate a divestiture trustee to control the sale process. The way in which the sale process will be conducted will be subject to the agreement of the CC. The CC will evaluate the bids received for the different options and will not require Tesco to accept a bid that the CC considers wholly unreasonable.

¹²⁹CC's guidance: *Merger References*, CC2, paragraph 4.37.