CASE ME/6752/18

INITIAL SUBMISSION

Sainsbury's

J Sainsbury plc

ASDA

ASDA Group Limited

10 October 2018

Initial Submission

I Introduction

(1) On 30 April 2018, J Sainsbury plc ("**Sainsbury's**") and Walmart Inc. ("**Walmart**"), the U.S. parent company of ASDA Group Limited ("**Asda**"), announced the proposed combination of Sainsbury's and Asda (each a "**Party**" and together the "**Parties**") (the "**Proposed Merger**"). In corporate ownership terms, Sainsbury's will acquire 100% of the share capital of Asda from Walmart, while Walmart will hold a 42% economic stake, and 29.9% of voting rights, in Sainsbury's. Walmart will also appoint two members to the Sainsbury's board.

(2) The Proposed Merger is pro-competitive and will result in substantial benefits to consumers across UK grocery markets.

(3) These benefits arise from the synergies of the Proposed Merger, which will unlock very large cost savings. The scale of savings has independently been calculated to be at least [✂] on an annually-recurring basis, allowing a significant reduction of the Parties' combined cost base post-merger. A large proportion of these savings will be passed on to consumers in the form of price reductions. The cost savings also mean that the Parties can invest in greater quality, range, service and convenience to deliver a more compelling customer proposition overall.

(4) The synergies created by the Proposed Merger will enable the Parties to compete more effectively in a fundamentally changed market, for the benefit of customers. The UK grocery sector is today characterised by stronger-than-ever consumer expectations of increased quality and convenience at lower prices, competition from a wide range of rivals (including those with leaner cost structures), as well as the increasing threat of further disruption from operators such as Amazon.

(5) The Proposed Merger will also result in a dynamic market-wide increase in rivalry. Given the highly competitive nature of the UK grocery market, the merger-specific cost reductions will make the Parties more competitive and, in turn, generate pro-competitive responses from their rivals. Consumers will thus benefit not only directly from the improved offering of the Parties, but from the dynamic and market-wide increase in rivalry that will result.

(6) This Initial Submission sets out in summary form the pro-competitive nature of the Proposed Merger and the appropriate approach to the local assessment of its competitive effects in relation to grocery retailing. The Parties anticipate that the Phase II investigation will focus on local competition, not least because (as discussed below) "national" competition in retail groceries is the aggregate of local competition across all local areas. Nonetheless, the Parties also address a "national" theory of harm articulated in the CMA's Phase I fast-track decision that is predicated on competition between the "Big 4" grocery retailers. In light of the changes in grocery competition in the last ten years, the Parties consider that such a theory of harm is not supported by the evidence. Finally, for completeness, the Parties briefly address other potential theories of harm and product area overlaps.

II The Proposed Merger will lead to a more competitive value proposition for customers

A. Dynamic changes in UK grocery retailing

(7) Over the last ten years or so, the UK grocery industry has undergone significant change.

(8) In terms of consumer demand, there has been a significant increase in cost-consciousness following the financial crisis in 2008, as well as increased consumer recognition of the health benefits of fresh food and the social benefits of reducing food waste. At the same time, customer demographics and the composition, size and urban tilt of UK households have resulted in increased value being placed on time and flexibility. This is further enhanced by technological developments, such as the growth of mobile, tablet and desktop online shopping (whether for home delivery or "click and collect" in-store pick up). The convenience offering of many retailers has increased. Customers are now more likely to purchase food for dinner on the way home from work, use online home delivery, and do smaller-than-historical "main" shopping trips for key items and top-up with (fresh) items as needed, rather than doing a weekly "one-stop-shop" at a larger store.

(9) At the time of the Competition Commission's Safeway inquiry in 2003, competition was driven by the so-called "Big 4" grocery chains competing for customers' once a week shop at large-format stores that are typically located on the edge of town. Fifteen years later, this is no longer how competition in the market works.

(10) Aldi and Lidl have had a profound impact on the UK retail market, moving from niche (low cost, low quality) players to mainstream UK grocery retail competitors. The Parties estimate that today Aldi and Lidl sell over £15 billion of groceries per year in the UK,[1] with average basket sizes that are greater than the average across all grocery retailers.[2] They are perceived by customers as offering equal quality to Tesco, Asda, Morrisons and Sainsbury's but at a substantially lower price,[3] making them the "value for money" leaders. In addition, Aldi and Lidl have a publicly-stated policy of not being beaten on price, which they made clear both in response to the Proposed Merger[4] and the recent launch of Tesco's Jack's stores.[5]

(11) Aldi and Lidl have a combined volume share of 20.5% for fresh food and 16.6% for packaged food.[6] Their product range is not in any way limited to "basic" or "essential" items, but is geared fully to cover a "main shop". For example, Aldi's "Specially Selected" premium range has sales of over £1 billion, comparable in size to Sainsbury's "Taste the Difference" and larger than Asda's "Extra Special". Aldi & Lidl's store expansion plans have received widespread publicity; they have opened approximately 650 new stores since 2010 (the equivalent of a new store opening every four-five days over eight years) and are projected to open another 480 stores by 2022.[7]

(12) At the same time, competition from bargain stores has increased significantly, with chains like B&M, and Home Bargains increasingly being seen by customers as offering a viable

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1 Indeed, in October 2018, Aldi announced that its annual sales in both the UK and Ireland exceeded £10 billion.

2 Based on Nielsen data for Trended KPIs by Retailer for the period ending 28th July 2018 for the UK total grocery retail market (Copyright © 2018, Nielsen), attached as **Annex_004_133**.

3 Merger Notice, Chapter 7, fig 36.

4 "Aldi and Lidl square up to Sainsbury's and Asda over price promise", iNews, 9 May 2018, available at: https://inews.co.uk/news/consumer/aldi-lidl-sainsburys-asda-price-promise/.

5 "Aldi's UK sales top £10bn as expansion continues", The FT, 1 October 2018, available at: https://www.ft.com/content/df4d6f84-c53e-11e8-8670-c5353379f7c2.

6 Based on Nielsen Homescan data for the Total FMCG category for the 12-month period ending 28th July 2018 for the UK total retail market (Copyright © 2018, Nielsen), attached as **Annex_004_188**.

7 Aldi and Lidl store opening figure for 2018-2022 from IGD data centre, 5 March 2018. Aldi plans to open 130 stores in the UK over the next two years, creating 5,000 jobs and taking it closer to its target of 1,000 stores by 2022. It also expects to beat its 2022 target and has publicly stated that it intends to have 1,200 stores by 2025 (see "Aldi vows to take on Jack's as UK sales top £10bn for first time", The Guardian, 1 October 2018, available at: https://www.theguardian.com/business/2018/oct/01/aldi-sales-exceed-10bn-for-first-time-in-uk-and-ireland).

alternative for grocery shopping - [✂].[8] Traditional grocery retailers have expanded into convenience and food-to-go – including Tesco Express, M&S Simply Food, Little Waitrose, Co-op and Sainsbury's Local – and are investing further in online home delivery. Iceland is growing and broadening its product range, with its larger Food Warehouse format offering a greater range of products, including fresh and ambient products. Iceland's online service is also growing strongly and has picked up a number of awards. New "pure play" entrants have also emerged in the online space, such as Ocado and Amazon. Amazon, in particular, is increasing its UK e-commerce presence through its acquisition of Whole Foods, leveraging its Amazon Prime customer base and extensive delivery system to build a new Amazon Fresh offering.[9]

(13) These developments have led to greater consumer choice, increased availability of food shopping alternatives, and increased value for money as retailers improve quality without increasing prices. The competitive impact of these developments, in particular the move away from the old "Big 4" dynamic of the market, can be seen in the financial and market data of Asda, Morrisons, Tesco and Sainsbury's, which shows that they have seen a significant decline in profit since 2013/14, with their market share dropping by almost 6 percentage points (which represents over £6 billion worth of sales based on 2017 overall market sales).[10]

B. Challenges for the Parties' operating models

(14) The above developments have blurred the boundaries between "formats" and "channels", with customers increasingly purchasing groceries across a range of large and small grocery store formats, from Aldi and Lidl and other "discounter" stores, online players, convenience stores and bargain retailers. At the same time, customers are moving away from the big "weekly" shopping mission that was the norm pre-2008, towards smaller "main" shopping missions with top-up shopping as needed; in an average week, consumers carry out 3.3 grocery shops in 2018.[11] Indeed, whilst the decline in the traditional model is clear from industry measures of grocery sales and share, this arguably understates the extent of the change. In particular, these measures do not capture many of the ways in which customers purchase food overall, as they increasingly turn to options such as food-to-go and food delivery specialists.

(15) These changes pose serious challenges to the Parties, given their "big-box" format stores, often situated on the edge of town (which were developed to cater for traditional planned large "one-stop shop" weekly shops).

(16) Further, competitor expansion has significantly increased the competitive pressure on the Parties. From 2011 to 2017, Aldi has trebled in market share, Lidl has doubled in share, and B&M has tripled its share.[12] Waitrose and M&S have also grown share over this

[8] [✂].

[9] Amazon has said that food is one of its key categories and the UK one of its most important markets (see "Amazon turns to toys, home goods in latest brick-and-mortar trial", Reuters, 26 September 2018 available at: https://uk.reuters.com/article/us-amazon-com-store/amazon-turns-to-toys-home-goods-in-latest-brick-and-mortar-trial-idUKKCN1M62X6 and "Amazon continues heady UK expansion with new distribution centre", Reuters, 16 August 2017 available at: https://www.reuters.com/article/us-amazon-britain-employment/amazon-continues-heady-uk-expansion-with-new-distribution-centre-idUSKCN1AW0UG).

[10] Profit information drawn from publicly available statutory accounts and annual reports; market share information drawn from Kantar market reports.

[11] Based on Nielsen data for Average Shops for the period ending January 2018 for the UK total grocery retail market (Copyright © 2018, Nielsen).

[12] For Aldi and Lidl see Table 15, Merger Notice Chapter 7, Kantar Total Grocery Market Shares 2011 to 2018; For B&M see IGD Data Centre Channel Analysis (2017) attached as **Annex 004_019**.

period, through store opening programmes and with their greater emphasis on quality/convenience which has been aligned with the shift in consumer demand. More generally, as convenience formats (in which Asda has no presence), online, and bargain stores all continue to grow and Amazon continues to develop its grocery offer, there is no reason to think that this pressure will abate.

C. The Proposed Merger will allow the Parties to offer a better value proposition to customers

(17) The Parties have retained independent advisers to verify that the Proposed Merger will generate a transformational level of variable and fixed cost savings. Prior to announcement, these independent advisers assessed the level of expected efficiencies in order to ensure that there was a large quantum available for investment in lower prices and the customer offer, and sufficient synergies net of this to provide the necessary return to shareholders. The level of gross synergies was assessed at [✂] of annually-recurring efficiencies from year three following completion, of which the vast majority ([✂]) are purchasing synergies that lower variable/marginal costs.

(18) To stay competitive in such a price-sensitive and highly competitive market, the Parties must pass a substantial share of these cost reductions on to customers in the form of lower prices and improved quality, range and service. These cost savings can be incorporated directly into the CMA's economic model (the "**GUPPI**" model, measuring lost rivalry) in its competitive assessment.

(19) Other synergies include an improved multi-channel and multi-product proposition, bringing Argos in-fills to Asda stores to enhance the productivity of the space in stores and increase convenience for Argos shoppers, and expanding the range of general merchandise, clothing and financial services available to customers across the Sainsbury's and Asda businesses (a benefit to customers that only the Proposed Merger could deliver).

(20) All of these will result in significant benefits to consumers through reduced prices and an improved customer proposition.

III The appropriate methodological approach to assessing the Proposed Merger

A. Competition is "fundamentally local"

(21) The CMA (like its predecessors, the Competition Commission ("**CC**") and the Office of Fair Trading) has consistently taken the view that competition in UK grocery retailing is "*fundamentally local*".[13] With respect to how local retail competition relates to competition at the UK-wide or "national" level, grocery is a clear example of the CMA's general approach to retail mergers: a grocery retailer "*will take account of the extent of local competition faced by its stores when making decisions regarding prices and other competitive variables, even if these are set uniformly across all stores*"[14] (i.e. on a UK-wide basis). In other words, the CC found after two years' inquiry that even national decisions are, therefore, taken on the basis of what is *"fundamentally local*" competition.[15] The Parties' businesses operate in a way consistent with the CMA's insight that national

[13] See CC, The Supply of Groceries in the UK, para 4.134; cf. Tesco/Booker, para. 6.24, attached as **Annex_005_002**.

[14] CMA, Retail Mergers Commentary (revised April 2017), para. 1.14.

[15] ibid footnote 13, para. 4.134.

competition is the sum of local competition:[16] their respective centrally-set competitive parameters, such as "national pricing", are the aggregate position derived from the inputs of local store performance which, in turn, is driven by local competition and other local supply/demand factors.

(22) The Parties recognise that the local nature of competition means, whilst the merger will offer customers better value overall and across local areas, the strength of local constraints varies locally and that there could be a subset of overlap areas where the Proposed Merger could raise substantial lessening of competition ("**SLC**") concerns. The Parties intend to engage in a constructive fashion with the CMA and all relevant stakeholders to address any such local competition concerns.

B. A "weighted" approach is the best way to identify local grocery store overlap areas of concern

(23) The CMA recently found that *"[i]n grocery retailing … the main factors in local competition, in addition to price, are store size, distance from other stores and the fascia of the store".*[17] In other words, the number of brand (or fascia) choices alone does not capture other main factors in local competition, including store size and proximity. A one-dimensional focus on any one of these factors identified by the CMA, without regard to the others, would be to assume that customers only cared about price, or only brand, or only store location. This would contradict the CMA's recent findings, as well as the evidence in the Merger Notice.

(24) As such, the richness of consumer preferences is best captured by tools developed by the CMA in earlier retail cases. Indeed, the available evidence clearly confirms that competitive constraints on local stores vary according to a number of factors (such as store location, size, and brand) that influence the intensity of constraints faced by a given store. To properly take such factors into account, the Parties submit that the Weighted Share of Shops (or "**WSS**") diversion ratio methodology is most appropriate. In particular, traditional tools such as simple (or complex) fascia counting, which operate on a "binary" approach, are not supported by the evidence – competitors are not either a 100% entirely equal constraint to each other (regardless of store location, store size, or brand); nor are they a zero constraint (regardless of store location, size or brand).

(25) It is the ability to assign different weights to competitors that allows the WSS to recognise and take account of the fact that different store locations, sizes or retailer brands may place a greater or lesser constraint on the Parties stores. The WSS can account for the impact of proximity and distance on the intensity of a competitive constraint – clearly a key factor in local retailing where convenience is important to customers. The same is true for store size and store brand.

(26) The WSS can also accommodate other constraints – such as online retailing, bargain stores, convenience stores, and stores beyond the chosen catchment area – that exist and should be recognised. Finally, the WSS and the related GUPPI model used by the CMA in *Ladbrokes/Coral* and *Tesco/Booker* provides an ideal method also to account for variable cost saving efficiencies that exert downward pressure on price and are thus rivalry-enhancing. Adapted to the contemporaneous evidence, the WSS analysis therefore provides a comprehensive methodology for analysing the effect on competition across all the local areas in which the Parties compete.

[16] CMA, Retail Mergers Commentary (revised April 2017), para. 1.15.

[17] CMA Report, Tesco/Booker, para. 19.

IV The Proposed merger will not lead to a substantial lessening of competition at "national" level

(27) As grocery retail competition is fundamentally local and "national is the sum of local", all relevant unilateral effects from the Proposed Merger can fully be captured in the above local analysis.[18] So long as there is no expectation of an SLC in any individual local area, there can be no SLC in aggregate. Thus, any "national" concerns can be resolved by an appropriate local remedy package that comprehensively removes all local SLC concerns.

(28) In any event, even if the CMA were to consider the impact of the Proposed Merger on a "national" basis, as a reasonable sense check, the evidence shows that, even absent divestments, the Parties have a combined national grocery market share of no more than 27%[19] and they face an array of strong competitors (including Aldi, Co-op, Lidl, M&S, Morrisons, Tesco, Waitrose and others). Relative to these rivals, the Parties are not particularly close competitors, whether in terms of brand perception or otherwise. Nor are the Parties' respective stores particularly strong rivals on average across local markets, given the distribution of their store portfolios and the strong presence of rivals in areas of overlap.[20] As a result, there would be no substantial reduction in aggregate competitive pressure, and therefore no economic incentive to raise centrally-set prices (or worsen other centrally-set non-price variables) post-merger.

(29) Further, the Parties submit that there are no residual "national" theories of harm such as loss of "pipeline competition" or other theories that are discrete from local competition and that a local unilateral effects analysis would fail to capture. [✂].

(30) The CMA's Phase I fast-track decision ("**FTD**") found that there is a realistic prospect of horizontal unilateral effects in the retail supply of groceries in-store at national level. The core of this theory of harm appears to be that the Parties compete particularly closely with each other because they are said to form part of a "Big 4" of national competitors: at para. 68, the FTD states that there is "*evidence that Sainsbury's and Asda (along with Tesco and Morrison) form part of a 'Big 4' (a term frequently used in both the Parties' own internal documents and industry commentary) that compete particularly closely with each other*". The Parties consider that there is no basis for such a theory of harm, for the reasons set out below.

A. The Phase II in-depth investigation must give due weight to all competitive constraints on the Parties

(31) In the retail grocery industry, there remains widespread usage of the term "Big 4", referring collectively to the traditional supermarkets Tesco, Morrisons, Sainsbury's and Asda. It is a relic from before and after Morrisons' acquisition of Safeway, when the four largest supermarkets primarily lost sales to each other, and continues to be used as a shorthand term in industry commentary and press reports. It has also featured in press commentary about the Proposed Merger. It is not striking that the term appears in the Parties' internal documents; indeed, it would be odd if it did not (as for the weight to attach to this: see B below).

(32) However, in light of the evidence in the Merger Notice, a shorthand "Big 4" label is not an analytical shortcut, and would not be an appropriate lens through which to examine the

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[18] ibid footnote 16.

[19] Kantar, Share of groceries data, 52 weeks to 12/08/18, attached as **Annex_004_187**.

[20] See in particular Merger Notice, Chapter 7, Section V; Chapter 6, Section IV.

evidence or frame the competition analysis. Unilateral effects analysis of the type the CMA will consider at Phase II must focus on "closeness of competition" between merging parties. This does not involve a four-way analysis between the "Big 4" (or a six-way analysis if Aldi and Lidl are included); rather, it requires an assessment of the bilateral competitive constraint that Sainsbury's exerts on Asda and vice versa, and this constraint must be assessed relative to the constraint from all other rivals.

(33) A "Big 4" lens would distort this in two ways. First, it treats the excluded "non-Big 4" players as unimportant to competition – despite the weight of evidence showing that Aldi and Lidl have had the most profound impact on competition (as set out above in section II). In the last year to June, net switching losses from Asda to Aldi and Lidl combined are three times the net switching losses to all Asda's "Big 4" rivals; for Sainsbury's the equivalent Aldi/Lidl figure is over 50% higher than to all "Big 4" rivals.[21] Indeed switching data clearly shows that net switching from Sainsbury's to Aldi, and to Lidl, is higher in both cases than from Sainsbury's to Asda; equally, net switching from Asda to Aldi, and to Lidl, is higher in both cases than from Asda to Sainsbury's (see the relative switching losses noted below at C).

(34) Second, at the same time, at national level it treats all "Big 4" members as being equally close competitors to each other, although, for example, Tesco is a considerably stronger competitor to each of Sainsbury's and Asda than the Parties are to each other.[22] These are the same binary assumptions that lie behind a fascia count analysis, and are out of date for the same reasons. It would be inconsistent for the CMA to avoid an outdated fascia count at local level by applying a WSS approach (as the FTD implies will occur for Phase II) and then apply a binary assessment nationally.

(35) As to internal documentary evidence, the appropriate unilateral effects question is not about a Big 4 bias but is a bilateral question: how much weight and focus do Sainsbury's documents give to Asda, relative to rivals, and vice versa? The evidence shows that the Parties do not disproportionately focus on each other:

- In Asda's commercial and performance board reports documents over the last three years, [✂].
- In Sainsbury's Food Board and strategy documents over the last three years, [✂].

B. The Parties' internal documents clearly demonstrate a wider competitor set in which they are not particularly close competitors

(36) At paragraph 68(a), the FTD makes reference to the Parties' internal documents, stating that "*[t]he Parties closely monitor and react to the performance and strategy of other Big 4 players (including in relation to key strategic factors that are set at the national level). Discussion and analysis of the other Big 4 players is typically given significantly more prominence in the Parties' recurring internal reporting documents*".

(37) This conclusion is not borne out by the Parties' internal reporting documents (or other internal documents). Whilst Tesco, Morrisons, Sainsbury's and Asda are important competitors to each other, as set out in Section IV above, the weight of the Parties' business documents also (1) supports the importance of at least seven third party

[21] See Merger Notice, Schedule 6.

[22] Tesco is a stronger competitor to each Party than they are to each other because: (i) it has around twice the stores and therefore overlaps to a greater degree locally; (ii) like Aldi and Lidl, it is likely to have lower costs than the Parties, due to procurement scale; and (iii) in consumer perception, its brand is positioned closer to those of each Party than the Parties' brands are to each other (see Ch. 7 of the Merger Notice, Fig. 36).

competitors common to both Parties, and (2) is not biased in favour of prominence towards the "Big 4" players.[23]

Number of competitors monitored

(38) As set out in the Merger Notice, the Parties have in common that they each centrally monitor at least seven third party competitors: [✂]. In addition, the evidence demonstrates that the Parties also monitor a wider competitor set, including Iceland and bargain store players and have specifically adjusted their methodologies for tracking competitor's pricing, range, quality and service offerings in order to do so (for example, where information cannot be readily web scraped for all of these competitors). This evidence is inconsistent with a conclusion that the Parties care only about competition between a subset of four players.

Relative prominence of competitors

(39) As noted at paragraph (35), Asda documents clearly do not suggest Sainsbury's is a particularly close rival, and the same is true vice versa. This responds directly to the pertinent unilateral effects question. Further, for the avoidance of doubt, the Parties' internal documents referred to above at paragraph (35) also demonstrate clearly that there is no "Big 4" bias or segmentation:

- In the Asda documents, [✂].
- Within the Sainsbury's documents, [✂].

(40) On a qualitative basis, if any competitors are given prominence disproportionate to their UK-wide share of supply, it is Aldi and Lidl, because of their transformational impact on the marketplace. For example:

- Sainsbury's current [✂].
- Similarly, [✂].

C. The switching data shows direct competitive losses to Aldi and Lidl

(41) At para. 68(b), the FTD further suggests that "*the switching data cited by the Parties may overstate the extent to which Aldi and Lidl should be considered close competitors to the Parties (in particular because there is some evidence to suggest that customers lost to Aldi and Lidl store openings do not affect the Parties' incentives in the same way as customers lost to other Big 4 players)".*

(42) The Parties do not recognise any evidence that would support such a reading.

(43) Kantar switching data is demand-side evidence of consumer preferences at the national aggregate level, showing greater customer switching to Aldi/Lidl than between the Parties (see Section III). It is fully consistent with the local picture of competitive impacts from Aldi and Lidl store entry. With respect to Sainsbury's [✂]. For Asda [✂].

(44) Across their estates, the Parties have lost over [✂] in sales to Aldi and Lidl in the past two years both as a function of the opening of new stores, and because of the increasing

[23] Of course, there are differences between, say, Tesco and Aldi or Tesco and Waitrose, but to the extent that some players have fewer UK stores in total than others, or fewer or indeed no large stores (OSS) at all, where these differences meaningfully play out is at the "fundamentally local" competitive level and will be captured in the WSS assessment, which in prior cases (Ladbrokes/Coral, Poundland/99p) has also been built up into a national aggregate WSS picture. See Ch. 7 of the Merger Notice.

appeal of Aldi and Lidl to customers, reflected in greater like-for-like store sales. A loss of [✂] hurts in the same way regardless to whom it is lost.

(45) Lost sales to Aldi and Lidl in particular (but not exclusively) have undoubtedly affected the Parties' incentives to react and compete. The clearest evidence of this is the huge centrally-driven efforts the Parties have made to respond to Aldi and Lidl in terms of cutting retail prices at all their local stores uniformly, and their ongoing monitoring of and benchmarking against these players.

D. Consumers do not choose their local grocery store based on the fact that the store owner "operates a very significant number of OSS across the UK"

(46) At para. 68(c), the FTD states *"[e]vidence from the Parties and third parties shows that the Big 4 players operate similar business models, being large and well-established players that operate a very significant number of OSS across the UK*".

(47) The "national network of OSS" aspect of the FTD's "Big 4" theory is also reflected in its commentary on national shares:

> "*While [the Parties' shares of just over 30% are] below a level that would typically give rise to prima facie concerns … [they] may also not fully reflect their competitive significance, as they are calculated on the basis of a total market that all includes all retail suppliers of groceries regardless of their size or commercial focus (e.g on convenience rather than one-stop shopping) [fn and where smaller stores may not be considered good substitutes for larger stores by consumers, and where the Parties operate similar business models as opposed to other retailers]* (para 67 and fn26).

(48) Asda, Morrisons, Sainsbury's and Tesco are "similar" insofar as they are large well-established brands with large networks of OSS stores (as defined by the CMA). However, there are considerable variations between them in terms of their businesses. For example, Sainsbury's has a significant convenience store offering (which Asda does not) and a proportionately larger general merchandise offering. In any event, similarities in business models would not, in and of themselves, allow any conclusions to be drawn as regards the possible unilateral effects of the Proposed Merger for the following reasons:

(49) First, a unilateral effects analysis on closeness of competition is fundamentally about customer switching preferences: the proportion of customers that would switch from one merging party to the other if the retail offer worsened, as opposed to switching to other (third party) options. The greater this degree of customer substitution, the "closer" the two competitors are.

(50) In this respect, supply-side similarities are, at best, superficial evidence, relying on a very indirect inference that business model similarities dictate customer switching. But this cannot be treated as equally - let alone more - important evidence of customer switching than *actual* customer switching, reflected in the economic evidence summarised above. Consumers voting with their wallets reveal a very different picture of customer switching across business models, especially towards the Aldi/Lidl supermarket model, as above.

(51) Secondly, because consumers buy locally and do not procure UK-wide (as a corporate customer might source an industrial input), they do not switch locally in ways governed by the supplier's national network. In other words, "Big 4" status or national share of the

Parties,[24] alone or with Tesco, do not determine whether they are particularly close local substitutes for consumers. It is of no relevance to local consumers whether, at UK level, Tesco is #1, the Parties are #2 and #3, or whether all "form part of a Big 4". Accordingly, the "Big 4" label and/or their aggregate national shares do not make these players closer competitors to each other than to other competitors, such as Aldi and Lidl, or other non-"Big 4" rivals, such as Waitrose, Co-op and M&S.

(52) Third, as the evidence clearly shows, the one stop shop format is in significant decline. The changed nature of shopping missions and decline of the big weekly shop has manifested in declining sales across "big box stores". For example, as set out in the Merger Notice, the Parties' sales at their large stores are declining significantly relative to their sales at medium stores. Customers are increasingly doing their "main shop" at medium-sized stores, as can be seen from the fact that Aldi, which primarily operates medium-sized stores, generates an average basket size greater than the market average. The Merger Notice provides extensive evidence of this competitive impact of medium sized stores. On a per-square-foot basis, for example, medium stores exert a stronger constraint on large stores than other large stores, a result which is consistent with medium stores having a higher sales density. Accordingly, a finding that the "Big 4" players compete more closely because they operate a large number of OSS across the UK is not supported by the evidence.

V The Proposed Merger will not lead to anti-competitive buyer power or co-ordinated effects

A. Suppliers can benefit from the Proposed Merger

(53) As has been set out above, the Proposed Merger will generate substantial efficiencies that will benefit consumers, primarily through the achievement of procurement savings and, in particular, harmonisation to the better of the Parties' respective buying terms. Any reduction in supplier margins will be only to the level the supplier is *already* giving to a customer of similar size – a margin on which the supplier is profitably able to supply today. Moreover, the achievement of these procurement savings is not a "zero-sum" game whereby the Parties must "win" and suppliers "lose".

(54) There are many benefits of the Proposed Merger that can potentially create a win-win scenario for suppliers and the combined Sainsbury's/Asda (the "**Combined Entity**"). Benefits that can be expected to accrue to suppliers (whether immediately or in the medium term) include:

- Increased sales volume leading to scale efficiencies (as lower prices to consumers lead to greater sales volumes and through the opportunity to gain wider distribution through access to a larger estate).
- Reduced costs through the transactional efficiencies of working with one organisation rather than two, for example:
    - Rationalisation of common ingredients for own-brand products. By helping suppliers to maximise their purchasing volumes of ingredients, the Parties can help those suppliers to reduce their upstream costs.

[24] Whether this is closer to 25% or 30% combined (25% being the average combined share across three reputable datasets).

- A decrease in the resources and time needed to deal with retailer procurement, through increased consistency of policy and standards.
- Efficiencies in logistics, which would apply across both branded and own-brand products, for example through co-operation with respect to delivery schedules.

(55) In addition, the Combined Entity will offer the potential for farmers and growers to benefit from the best of the programmes that Asda and Sainsbury's already have in place with respect to their smaller suppliers.

B. The Proposed Merger will not result in anti-competitive buyer power

(56) The highly competitive nature of the UK grocery sector means that the Proposed Merger will not result in "anti-competitive" buyer power that harms customers.

(57) The Parties refer to the CMA's general position that "*the CMA would regard an improvement in the negotiating strength of the merging parties as beneficial to customers if enough competition remains in the downstream market, so that lower prices or quality improvements that would be negotiated are passed on to customers*".[25] As noted above, even at an aggregated level, the Parties would have no more than a 27% market share and face a variety of strong competitors across formats and channels. In these circumstances, the overall effect of the Proposed Merger will clearly be pro-competitive.

(58) Further, with respect to the effect of the Proposed Merger at the supplier level, the Parties' combined share of procurement in any relevant product category is below 30%, the threshold in European Commission guidance and often used by the CMA as an indicator of potential concern. This procurement share is also below that of the combined Tesco/Booker, which the CMA found did not raise buyer power concerns.

(59) Additionally, the majority of expected synergies derive from a small number of large multinational suppliers, national suppliers and aggregators (processors and packers), all of whom enjoy considerable bargaining strength. Any cost reduction on the part of such suppliers will directly reduce the Parties' variable costs which, in a competitive market, will benefit consumers. Given the considerable resources and margins of these large suppliers, harmonisation of terms cannot be expected to have such a negative impact on those suppliers that they would need to reduce innovation, lower quality, reduce the standards they have in their supply chains or exit the market entirely.

(60) Finally, the Parties note that they are regulated by the Groceries Supply Code of Practice (the "**Code**"). Compliance with the Code is actively monitored and enforced by the Groceries Code Adjudicator who has herself indicated that the Proposed Merger is no impediment to her ability to regulate the Parties effectively.

C. The Proposed Merger will not raise co-ordinated effects concerns

(61) A second theory of harm in CMA guidance is co-ordinated effects, where firms "*recognise that… they can reach a more profitable outcome if they co-ordinate to limit their rivalry*.[26]" The UK grocery market is highly competitive with, other than the Parties, seven significant operators (Aldi, Co-op, Lidl, M&S, Morrisons, Tesco and Waitrose); each a household name with whom UK customers spend at least approximately £5 billion every year, not including other competitors, such as Ocado, Amazon, Iceland and bargain stores, such as

[25] CMA, Poundland/99p Stores Report, 18 September 2015, para. 6.95, attached at **Annex 005_004**.

[26] OFT, Merger Assessment Guidelines, para 5.5.1.

B&M, Home Bargains and others.[27] Further, the diversity of sizes, business models and cost structures between competitors means that incentives are not aligned.

(62) With respect to the nature of competition, the fact that retail competition and overall customer satisfaction is about the retail offer as a whole (i.e. a mix of convenience, price, quality, range and service) means that a theory focused on colluding on one element in isolation (such as price) would not work.

(63) Finally, it is worth noting that hypothetical co-ordination within a subset of the market (such as the "Big 4") would not be feasible. Even if the Parties could align incentives sufficiently with Tesco and Morrisons, any hypothetical co-ordination between them would make their offering comparatively less attractive than the offering of the other retail operators and result in yet more migration of shopping baskets and customers to Aldi, Lidl, Waitrose, M&S and Co-op and others.

VI Other overlaps between the Parties

(64) Aside from their core grocery offerings, the Parties overlap in the retailing of general merchandise and road fuels.

(65) With respect to other non-consumable, non-food items, such as electricals, toys and clothing (referred to collectively as "General Merchandise" ("**GM**")), the Parties have relatively low national shares across all categories, which captures the aggregate picture at the local store level. In relation to GM products, an array of online retailers beyond the leader, Amazon, provide a particular constraint on the Parties and account for a significant proportion of UK sales. Aside from the significant constraint from online, the Parties face a wide variety of competitors, including a broad range of general and specialist competitors with large networks of physical stores. Significant competitors across GM include Amazon, Smyths, John Lewis, Tesco and ELC (toys); Primark, Next, Marks & Spencer, Debenhams, Matalan, Tesco and New Look (clothing); and Amazon, Dixons Carphone, AO.com, John Lewis, Tesco and Shop Direct (electricals), among many others. Further, the Parties are not close competitors in relation to their GM offerings, particularly as Sainsbury's primarily offers GM through Argos.

(66) Fuel retailing is a small part of the business of both Parties and was not a driver of the Proposed Merger. There are significant differences in the Parties' fuel estates and their customer propositions (with Asda focusing on (often via automated sites) speed, convenience and value, and Sainsbury's focusing on additional non-fuel food and other items and amenities, as well as loyalty card points that Asda does not offer). The Parties also face a variety of competitors (comprising supermarket operators, fuel "majors" and independents), that each offer customers a choice of proposition that balances fuel pump price and site location/convenience, as well as a range of other factors such as food and other amenities, fuel quality and loyalty card points.

(67) As with grocery, competition in fuel retailing is fundamentally local, with prices set locally and varying from site to site for all operators. The Parties fully recognise that, although not a deal driver, the Proposed Merger creates a number of local retail fuel overlaps which the CMA will want to consider in detail, as it has in other cases including the recent Motor Fuel Group/MRH inquiry. The Parties consider that the filter-based precedent to assessing competition at a local level would be both workable and sufficient. In each local overlap

[27] Global Data, UK Food & Grocery Market 2013-2023 (February 2018), attached as **Annex_004B_109**, also cited in response to RFI1, Q.5.

area, the Parties will face a large number of fuel competitors within a short drive time of the Parties' fuel stations. As is the case for grocery retailing, should the CMA have concerns in a subset of local overlap areas, the Parties will work constructively to resolve them.

(68) At the UK-wide level, the Parties are smaller players than they are in their core grocery business: Sainsbury's is the fifth-largest player with a 10.2% share, and Asda is the seventh-largest with a 7.7% share (by volume, with lower shares in terms of site numbers). With a combined share of no more than 17.9%, this is well below the levels at which concerns would normally arise.[28]

(69) Finally, it was suggested in response to the CMA's initial invitation to comment that there was overlap between the Parties in the supply of online groceries, a channel accounting for around 6% of total UK grocery sales. The Parties do not consider that the online grocery channel can properly be treated as a "separate" product market, insulated from competition from in-store sales – given that "bricks and mortar" based competition (accounting for the remaining 94% of sales) acts as a powerful constraint on online grocery sales in every local area, with survey data showing that virtually all online grocery shoppers also bought groceries in store. In-store and online grocery channels offer the same types of product (there are no "online only" product offerings) for the same price and baskets purchased online and in store have a similar product category mix. In any event, even within the narrow confines of the online channel, the Parties are not particularly close competitors. In summary, therefore, no credible competition concerns arise in relation to the online channel as a result of the Proposed Merger.

(70) The Parties look forward to engaging constructively with the CMA during Phase II.

[28] See Table 30, Chapter 11 of the Merger Notice.