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The CMA's Retail Mergers Commentary: Practical Application and Recent Developments

Speakers: Colin Raftery, Director of Mergers, CMA
Mat Hughes, Managing Director, AlixPartners
Bruce Kilpatrick, Partner, Addleshaw Goddard LLP

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Venue: Addleshaw Goddard LLP, Milton Gate

The purpose of the seminar was to learn more about the CMA's approach towards retail mergers, with a particular focus on recent developments and their practical application.

Colin Raftery, 'The CMA's Retail Mergers Commentary: Practical Application and Recent Developments'

Colin gave his perspective on retail mergers, subject to the usual caveats that he was speaking in a personal capacity and that all mergers are judged on their specific facts. As a first principle, he highlighted that because the UK has a voluntary system, the CMA must aim to provide parties with the necessary clarity to enable them to self-assess. The CMA must also be flexible to accommodate the kinds of data that businesses hold in practice and understands that different businesses have different approaches; it must be ready to adapt to the businesses, where necessary.

Colin also noted the importance of recognising that investigations should be proportionate for both the parties and the CMA (this involves an appreciation that Phases 1 and 2 are different beasts) and of investigations inspiring consumer confidence by being pursued for the benefit of the customers of the parties. He noted certain instances where media reports had been based on an inaccurate understanding of the CMA's approach to mergers, and explained that it's important for the CMA to explain the outcome of its cases and the approach that it has taken in analysis in a way that can be clearly understood.

Six years since first publication, in 2017 the CMA updated its Joint Commentary on Retail Mergers (Commentary) following a wide consultation. The Commentary does not set out binding rules about what cases it will be relevant to.

Colin considered the example of how the CMA assessed JD Sports/Go Outdoors. Both parties were principally bricks and mortar retailers. In its local overlap analysis the CMA focused on five problematic areas; the main question was how to assess competitive constraint imposed by online-only retailers. The CMA noted that while the products sold by these retailers are widely available online, there was also evidence that highlighted the importance of physically trying on products and getting expert assistance from people in store. The CMA distinguished diversion from migration: to assess diversion, the question is whether an increase in price in bricks and mortar lead to consumers going online, meaning that the increase in the bricks and mortar channel would not be profitable?



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Colin explained that the evidence in that case – comprising the merging parties' commercial strategies, internal documents, third party views, and survey evidence – was mixed in relation to the constraint that online retailers exerted on bricks and mortar retailers. Accordingly, in JD Sports/ Go Outdoors, the CMA found:

1. The evidence did not sufficiently support a single relevant market for bricks and mortar and online sales; but
2. Online sales were treated as a constraint on the parties when considering merger effects at a local level.

Colin then considered the example of Heineken/Punch. This case showed the circumstances in which a change in approach from a relatively recent case in the same sector, in this case Greene King/Spirit Pub Company, might be justified, and also provided useful guidance on approach of in-depth investigations of local concerns. On consistency between the two cases, there was a key difference between the facts in each: Greene King was mainly about dry-led pubs (which make most of their money from food), Heineken was about wet-led pubs (which make most of their money from alcoholic drinks); customers tend not to drive to the latter, and the evidence showed on balance that there was a smaller catchment area for wet-led pubs (compared to the catchment area used for the mainly dry-led pubs in the Greene King case).

As an example of how the CMA will take the characteristics of the parties and potential competitors into account, he observed that, where a large number of local areas is involved, further analysis (after filtering) would typically be based on factors, supported by relevant evidence, that could be systematically analysed, rather than conducting a detailed area-by-area investigation. For example, it might be argued that certain categories of pub – such as a 'football pub' and 'bridge pub' might attract a different type of customer. On this basis, it might be argued that these types of pub are unlikely to compete closely, assuming that this could be supported by internal documents and other evidence. A finding that these pubs are not close competitors could then be systematically applied across all local areas (rather than individually assessing the closeness of competition between individual pubs within each and every local area). Colin further explained that after the filtering process is complete, there is a high bar that must be reached if another competitor is to be included in the assessment in any specific local area. In addition, in considering any adjustments that might be made post-filtering, it is also necessary to consider whether and how this should be reflected in the initial filtering rules, which might identify other problematic overlaps if changed to reflect these new adjustments.

Mat Hughes, 'Retailer Mergers: Substantial local complexity? The CMA's revised retail mergers commentary and its application to JD Sports/Go Outdoors'

Mat began with a quiz which revealed:

1. 39% of mergers referred to Phase 2 or undertakings in lieu of reference involved retailers/wholesalers/service providers;



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2. In Groceries, 4-3 local competitors is sufficient; elsewhere, the figure may be 5-4. However, other filter rules may be applied in certain markets, and 5-4 mergers will typically only raise issues if the parties' outlets are particularly close competitors or rivals are more distant. In addition, the CMA will not filter in every single case; if there are a small number of overlaps, the CMA will look straight at the facts of the case;
3. In only 1-2 cases the CMA has, at Phase 1, considered that internet retailers constrain local retail outlets. Internet rivalry is very important, but Mat highlighted that physical shopping trips may be different to buying on the internet: for example, if you need something immediately, you may be more likely to physically shop.

Mat considered the changes made by the CMA in its updated Commentary. He noted that the weight attached to competitors may vary (for example, in pharma and betting shops, different weight will be applied depending on proximity).

Mat also noted that the CMA has a strong presumption at Phase 1 that retailers can flex price, quality, range or service (PQRS) in local areas where there is less competition, whereas in a number of Phase 2 cases it has been accepted that such local flexing would not occur. He said that this can be difficult to assess, and he gave the example of the Groceries market investigation report. This report found that large grocers charge the same price nationally, a survey of stores found no evidence of local flexing; however, econometrics found variations in profit margins due to differences in local concentration. Tesco criticised this on basis of it not appropriately allowing for the differences between large and small stores, and its advisors did some econometrics that suggested this explained the variation in profit margins, not local concentration. This illustrates the complexity of reaching an agreed approach in this area at Phase 1.

Mat noted the new section on quantitative techniques (which basically depend on the diversion ratio x gross margin). He observed the importance of appreciating that it is the value – not the volume – of the diversion that matters.

Mat considered the case of JD/Go Outdoors. In that case, there was no need to manually assess the catchment area: the parties knew where their customers were because they had store cards and till data captured customers' postcodes. The parties did not argue that the likes of Marks & Spencer were rivals; they narrowed rivals to outdoor specialists – following what their internal documents said. Mat highlighted that there are different fundamental behaviours in relation to different businesses: customers go to a pharmacy based on proximity; customers do not choose a pub based on a fascia. Mat also highlighted that "heat maps" showing the differences in stores' customer locations may be much more informative as to local rivalry than simply counting the number of local rivals.

Mat concluded with three key takeaway points:

- The CMA is placing increasing weight on internal documents. For example, which competitors do internal documents reference?



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- The CMA is willing to consider online retailers at the local level, but this must be backed up with persuasive evidence. In JD Sports/Go, this included internet price matching by local stores and monitoring of online prices, and a survey showing significant diversion to online; and
- Phase 1 clearances with many overlaps remain challenging, but not impossible. It is important to engage early with CMA, and to automate the assessment of local overlaps to capture the effects of varying filter rules.

Bruce Kilpatrick, 'CMA's retail mergers commentary – key issues for practitioners'

Bruce began by highlighting the difficulty in rebutting the CMA's 'strong starting position' at Phase 1 that there is material local competition on one or more PQRS aspects. When examining national competition, an advisor will face the difficult call of empirically working out the degrees to which the parties face each other at a local level. It is important to remember that a loss of national competition is not always related to the aggregation of local overlap areas.

Advisors should make sure the parties' effective competitor set is as concrete as possible in the way the bar has been set. At the local level, Bruce observed that data and internal documents must be considered in relation to drive times in order to assess the catchment area adequately. Independents must be taken into account and not underestimated. When filtering, the importance of brand determines whether to count fascia or stores (if distance is more important); if a brand is well known, question whether this will lead to a higher diversion ratio than expected. Ultimately, the role of the advisor is to make sure their client knows what they will acquire at the end of the transaction – this involves minimising the surprises the CMA will cause for the parties, and vice versa.