EVERSHEDS SUTHERLAND

Sainsbury's/Asda and the CMA

A statement of intent pre-Brexit

Introduction

On 21 and 20 February 2019 respectively the Competition and Markets Authority (**CMA**) published its **Provisional Findings** and a **Notice of Possible Remedies** (**Notice**) in its phase 2 review of the anticipated merger between J Sainsbury PLC and Asda Group Ltd.

The CMA has provisionally found that the anticipated merger raises "extensive competition concerns" and that even significant divestments may not be effective at addressing these issues. Specifically, the UK regulator has found that the proposed merger could:

- increase prices for in-store and online supply of groceries and at the parties' petrol filling stations;
- lead to a poorer shopping experience; and
- reduce the range and quality of products on offer.

Although the CMA's findings are only provisional at this stage, they are a significant statement of intent by the CMA. The Provisional Findings and Notice are not only reported to possibly jeopardise the Sainsbury's Asda transaction but also potentially have repercussions for the CMA's future approach to retail and consumer deals. This briefing considers some of the key consequences of the CMA's Provisional Findings both for future deals and also for the CMA as it seeks to boost its global profile prior to Brexit.

What are the concerns that the CMA has identified?

The CMA's investigation has examined in-store groceries, online delivered groceries, general merchandise, fuel and Sainsbury's and Asda's potential combined buyer power vis-à-vis their suppliers.

At a national level the CMA has found a competition problem (a substantial lessening of competition) in relation to in-store groceries (both for supermarkets and convenience stores) and online delivered groceries.

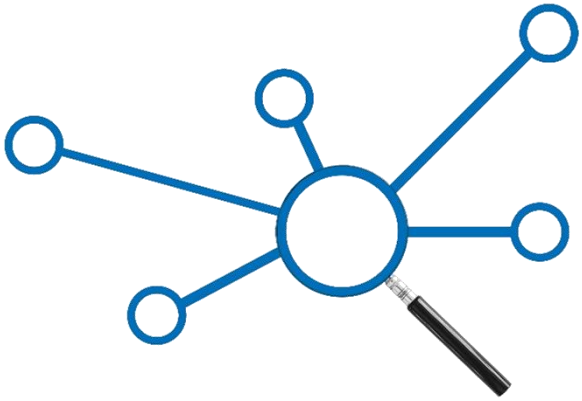
For in-store groceries the CMA has provisionally found that parties are significant national players with a combined national share of supply of 29% and with the parties competing with one another in 70-80% of Sainsbury's supermarkets and around 80-90% of Asda's supermarkets. While the CMA recognises the growth of and competitive constraint imposed by discounters Aldi and Lidl nevertheless the CMA has provisionally found that as part of the 'Big 4' supermarkets Sainsbury's and Asda do compete closely with one another.

For online delivered groceries the CMA found that only four online grocery retailers have national shares materially over 5%, and only three, Tesco, Sainsbury's and Asda have a near-national presence.

At a local level the CMA has provisionally found a competition problem in 629 local areas for the supply of groceries in supermarkets, 65 local markets for the supply of groceries in convenience stores, 290 local markets for the supply of online delivered groceries and 132 local markets for the supply of fuel.

The options proposed by the CMA to remedy their competition concerns are either an outright prohibition of the deal or a sale (divestiture) of a significant number of stores and other assets, potentially including one of the Sainsbury's or Asda brands, to create in effect a new 'Big 4' player. However the CMA states that its:

"... initial view is that divestiture carries a significant risk of being an ineffective remedy."



A statement of intent by the CMA pre-Brexit

As a merger of the second and third largest supermarkets in the UK, it was expected that the CMA would identify problems with the deal. However, the scale of the CMA's concerns and the seemingly significant disparity with the companies' expectations are more of a surprise.

Usually in a phase 2 investigation, where the CMA has longer to carry out a more in-depth rigorous assessment, the CMA would focus down on a smaller number of competition concerns than those identified during its initial preliminary phase 1 review. In this case, however, the opposite has happened. At phase 1 the CMA, for the purposes of its fast-track review, did not consider Aldi and Lidl to compete with Sainsbury's and Asda, excluded them from its analysis and found competition concerns in 463 local areas. Whereas at phase 2, the CMA has considered that Aldi and Lidl do compete to some extent with the companies, but yet provisionally identified substantially more local areas which give rise to competition concerns (629 local areas). This is highly unusual.

This combined with the CMA's strongly-worded statement that "The CMA's current view is that it is likely to be difficult for the companies to address the concerns it has identified", i.e. even a large scale disposal of stores is unlikely to resolve its concerns, sends a strong signal that the CMA is willing to intervene in and potentially block what it considers to be problematic mergers.

This is a timely reminder from the CMA's perspective. The CMA will after the UK leaves the EU be able to investigate a number of the larger cross-border merger and enforcement cases which are currently reviewed only by the European Commission. The CMA estimates that its merger workload will increase by a further 30 to 50 cases per year. However, the CMA is concerned that post-Brexit companies engaged in larger cross-border deals will look to "game" the system and will not voluntarily seek the CMA's blessing for those deals (the CMA has even suggested adding a mandatory element to the UK's merger control regime to remedy this)[1]. In this context, the Sainsbury's / Asda Provisional Findings send a strong broader and more global message to companies pre-Brexit that it is an active and where necessary interventionist authority.

[1] As set out in a **letter of 21 February 2019** from the CMA's Chair, Lord Andrew Tyrie.

What do the Provisional Findings mean for the CMA's approach to future deals?

Has the CMA radically lowered its threshold for identifying competition concerns in retail markets?

The CMA rightly highlights that it considers each case on its facts meaning that its approach in one case does not necessarily follow for a different case with different facts. However, what is striking about the Provisional Findings is the CMA's threshold for identifying competition concerns.

The key focus for the CMA in the Provisional Findings has been to measure whether, and the extent to which, post-merger Sainsbury's and Asda will have the incentive to raise prices. And the CMA has adopted a methodology (gross upward pricing pressure) which it has used in other high profile retail mergers, such as Tesco/Booker and Ladbrokes/Coral, to do this.

However, as Sainsbury's Chief Executive has highlighted, the CMA's approach in this case does depart – arguably radically – from what it has done before. In Tesco / Booker the CMA identified competition concerns in those local areas where Tesco's incentive to raise prices (the gross upward price pressure) was determined to be more than 5%. In Ladbrokes/Coral the equivalent threshold was between 10 and 20%.

In this case the threshold the CMA has adopted has been 2.5% for in-store and online groceries and 1.5% for fuel. The CMA argues that in this case – unlike other previous cases – given the scale of the parties' businesses (and their importance to consumers) it has been able to come to a view that low levels of upward pricing pressure are likely to lead to consumer harm.

Nevertheless, this is a materially lower threshold than previously adopted. Crucially from a commercial perspective it means that Sainsbury's and Asda would need to dispose of many more stores to obtain CMA clearance.

It is understandable why the CMA would be particularly cautious about this deal given the scope of the parties' business and the potential impact on consumers. However, if the CMA does adopt this approach to other transactions, for example to mergers of other large consumer-facing companies which compete closely with one another, then this is likely to mean a higher bar to obtain CMA clearance and more store disposals.

Consumer-facing and digital markets will continue to be in the spotlight

Under Chair Andrew Tyrie the CMA is seeking to be more "relevant" and "to become a good deal more visible in protecting consumer interests". The CMA's **Annual Plan** for 2019/2020 (the Plan) reflects this highlighting the CMA's determination to protect and empower consumers, especially vulnerable consumers and to ensure fairness including fairness of pricing.

The Provisional Findings and Notice are a clear statement of this: the CMA states that "even a small price increase in this market would give [them] cause for concern". The CMA has acted upon this.

The CMA is also focussed on digital markets and in this case it has assessed online delivered groceries in detail and separately from in-store groceries.

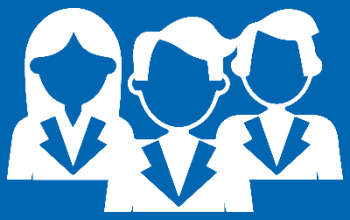
This places retail, consumer-facing and digital markets squarely in the CMA's cross-hairs.

Evidence is key

The CMA's Provisional Findings reinforce the increasing intensity and level of detail of a CMA investigation. For example, the CMA reviewed over 136,000 of the parties emails and "thousands of pages" of other internal documents. This is a reminder to companies considering future transactions that the CMA, like other authorities such as the European Commission, view internal documents and emails as key pieces of evidence. Care must be taken therefore to avoid unnecessary and unhelpful statements.

The Provisional Findings are also a reminder that the CMA places significant weight on customer views. In consumer markets the CMA often relies on surveys and in this case it has carried out three large surveys of approximately 60,000 shoppers and motorists, including face-to-face in-store surveys of over 20,000 customers. This is the largest such exercise conducted by the CMA to-date and the CMA sets great store in the findings from these surveys.

Understanding the CMA process and the likely reactions of customers, being prepared and gathering the types of evidence that carry weight with the CMA are therefore key to any engagement with the CMA.



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