# Substantial local complexity? The CMA's revised retail mergers commentary and its application in three recent cases

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## Introduction

In April 2017, the Competition and Markets Authority (CMA) published a revised 'Retail mergers commentary' (the Commentary).[2] This article reviews the Commentary and considers its practical application in three recent Phase 1 decisions.[3]

The CMA's Commentary is of broad relevance to mergers between retailers (eg supermarkets, pharmacies etc), as well as wholesalers and service providers that supply customers with goods and services locally (eg gyms, betting shops and cinemas). The CMA has deliberately not published guidelines, but instead the Commentary outlines the diverse issues that may arise and the different approaches that have been applied in various cases. In this regard, the Commentary offers a 'menu' of choices as to analytical approaches that may be tailored to the precise issues and facts available, rather than specifying a fixed 'recipe' to be applied in all retail mergers.

The publication of the updated Commentary is unsurprising and timely, given the significance of retail mergers in the CMA's workload, and the evolution of the CMA's approach to such mergers since the Office of Fair Trading and Competition Commission published their previous joint commentary on the topic.[4] From 1 April 2010 to 31 March 2017, 41 out of 104 (39%) Phase 1 mergers that were either referred to Phase 2 or were subject to undertakings in lieu of reference involved retailers, wholesalers or local service providers. The relatively high prevalence of retail mergers in cases involving undertakings or references to Phase 2 reflects the complexity of the issues raised by these mergers.

This article considers the practical application of the principles described in the Commentary, focusing on the following four areas:

- First, the challenges associated with defining local catchment areas within which the parties compete for customers, and identifying and weighting the 'competitive set' (ie the rivals that directly constrain the parties). The revised Commentary provides much more detail on the CMA's approach to assessing local competition, including how to assess catchment areas, the CMA's filtering of unproblematic areas, and the types of evidence that can be informative in relation to these points. The extent of any local competition issues will depend sensitively on the size of the catchment area, and the competitors included in the competitive set and the weight attached to these rivals.

1 AlixPartners.
2 'Retail mergers commentary', CMA62 (10 April 2017), available at https://www.gov.uk/government/publications/retail-mergers-commentary-cma62 (the Commentary).
3 The assessment of mergers involving local retailers, wholesalers and other service providers is discussed extensively in Chapters 6 and 9 of N Parr, R Finbow and M Hughes, *UK Merger Control: Law and Practice*, 3rd edn (Sweet & Maxwell, 2016). Mat Hughes, Rameet Sangha and Ben Forbes co-authored these chapters.
4 'Commentary on retail mergers', OFT1305/CC2 (March 2011) (available at https://www.gov.uk/government/publications/commentary-on-retail-mergers). This publication was withdrawn on 10 April 2017 upon publication of the revised Commentary.

- Second, the interaction between local and national retail competition. The Commentary is explicit that the CMA's 'strong starting assumption' at Phase 1 is that there is material local competition in relation to one or more aspects of firms' retail offer.[5] Accordingly, if a retail merger creates or enhances high concentration in the local catchment areas centred around one or both of the parties' outlets, then this may raise purely local competition concerns such as to give rise to a substantial lessening of competition (SLC) even when rivalry at the national level is unaffected. However, the Commentary concedes that this may not always be the case.[6] The new Commentary also identifies two theories of harm in relation to national competition: loss of national competition where prices are set uniformly and centrally across all stores; and the loss of dynamic competition (ie the parties abandoning pre-merger actual or potential plans for expansion into new locations).
- Third, how to assess the degree of competition interaction between the online and 'bricks-and-mortar' retail channels. The Commentary recognises that 'Retail markets are continually evolving and we note that online retailing is increasingly important'.[7]
- Fourth, the use of diversion ratios and surveys in retail mergers. The Commentary contains a new section on quantitative techniques, including diversion ratios and price pressure indices, as well as econometric evidence including price concentration and entry/exit analysis.

Assessing the issues outlined above is not straightforward. The Commentary describes the principles that the CMA applies when approaching these issues and refers to examples from previous cases. However, the approach that the CMA will take in each case depends very much on the facts of the specific case and the data available. This article discusses the above four topics with reference to three Phase 1 merger decisions from May 2017.[8] While all three cases raised local competition issues, the local competition analysis was carried out in markedly different contexts, and the CMA's analysis and decisions therefore varied:

- *JD Sports/Go Outdoors*[9] was cleared unconditionally, in part due to the acceptance of online competition as a constraint on local outlets. This was the first time the CMA has accepted this in a retail merger at Phase 1.[10]
- *David Lloyd Clubs/Virgin Active gyms*[11] involved the acquisition of 16 gyms. This merger was cleared subject to David Lloyd giving undertakings in lieu of reference not to acquire two gyms.
- *Euro Car Parts/Andrew Page*[12] involved a completed acquisition of a firm that was in

5 See Commentary, n 2, above, at para 1.6.

6 The Commentary identifies a number of Phase 2 cases in which the effects of the retail merger have been assessed at the national level. While the CMA usually starts from a position at Phase 1 that the local competitive offer may be flexed in response to changes in local competitive rivalry, it is willing to consider evidence that the customer offer is determined entirely or predominantly nationally.

7 Commentary, n 2, above, at p 3.

8 As noted at p 3 of the revised Commentary, the CMA applies a different threshold for clearing mergers at Phase 1 compared to Phase 2. At Phase 1 the CMA only has to find a 'realistic prospect' of an SLC, in contrast to Phase 2 where it applies a 'balance of probabilities' approach. In the sections that follow we have focused on Phase 1 decisions, where the threshold for merger clearance is higher than at Phase 2.

9 'Completed acquisition by JD Sports Fashion Plc of Go Outdoors Topco Limited – decision on relevant merger situation and substantial lessening of competition' (Case ME/6648/16) (3 May 2017, published on 7 June 2017).

10 Mat Hughes, Ben Forbes and Rameet Sangha provided competition economics advice to the merging parties, and worked with the parties' legal advisers, Addleshaw Goddard. David Branch and his team of data analytics experts assisted with the analysis of local overlaps, graphical presentation of catchment areas and mapping.

11 'Anticipated acquisition by David Lloyd Clubs of 16 Virgin Active gyms – decision on relevant merger situation and substantial lessening of competition' (Case ME/6679/17) (19 May 2017, published on 26 May 2017).

12 'Completed acquisition by Euro Car Parts Limited of the assets of the Andrew Page business – decision on relevant merger situation and substantial lessening of competition' (Case ME/6647/16) (10 May 2017, published on 15 June 2017).

administration. The case was referred to Phase 2, with the CMA finding extensive local SLCs across 92 of the 96 local areas in which the parties overlapped and in relation to Key Accounts who procure nationally.

The three cases are introduced in the following section, before we address the four topic areas in turn.

## An overview of the three decisions

### *JD Sports/Go Outdoors*

JD Sports Fashion plc acquired Go Outdoors Topco Limited on 27 November 2016. The parties overlapped in the retail supply of outdoor clothing, outdoor footwear and outdoor equipment in the UK. JD Sports operated 180 stores in the UK: 59 Blacks, 99 Millets, 7 Ultimate Outdoors, 14 Tiso Group and 1 George Fisher fascia stores.[13] Go Outdoors operated 57 Go Outdoors retail stores and had entered into binding arrangements to open a further two stores. The CMA opened an own-initiative investigation into the completed merger in December 2016, as the merger was not previously notified to the CMA.

As many effective competitors existed at the national level, the CMA's primary concerns were at the local level, where 52 Go Outdoors stores were within 30 minutes of a JD Outdoors store and 93 JD Outdoors stores were within 30 minutes of a Go Outdoors store.

As explained below, using a filtering exercise the CMA narrowed down its areas of concern to seven local areas that the CMA considered at a Case Review Meeting (CRM). Survey and other evidence showing strong rivalry from online retailers, as well as rivalry from other local competitors in these areas, was pivotal for the CMA to clear the merger unconditionally on 3 May 2017.

### *David Lloyd/Virgin Active*

David Lloyd Clubs Limited agreed to acquire the business and assets of 16 Virgin Active gyms in the UK. The proposed merger was announced on 7 February 2017. Both parties overlapped in the supply of gyms towards the premium end of the market. The CMA identified a total of seven local overlap areas (out of 16) and considered the merger at a CRM. On 19 May 2017, it concluded that there was a realistic prospect of an SLC in two of these overlap areas.

The relatively straightforward remedy in this case, which was an anticipated merger, was for David Lloyd not to acquire the two gyms giving rise to an SLC, leaving them instead in the ownership of Virgin Active.[14] The CMA accepted undertakings to this effect on 13 June 2017.[15]

### *Euro Car Parts/Andrew Page*

Euro Car Parts Limited acquired certain assets of Andrew Page on 4 October 2016, including a licence to occupy, and an option to purchase, the leasehold of 101 Andrew Page sites. Whilst an Initial Enforcement Order was imposed on 12 October 2016, the CMA's initial merger inquiry did not begin until almost five months later, on 10 March 2017. This suggests

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13 Pentland Group plc, which owns 57% of JD Sports, owned the Speedo and Berghaus brands, which had five and four stores, respectively, in the UK.

14 David Lloyd also agreed additional conditions. In particular, David Lloyd agreed not to acquire an interest in either of the two SLC gyms while David Lloyd continued to operate the local David Lloyd gym for a maximum of 10 years.

15 'Anticipated acquisition by David Lloyd Clubs of 16 Virgin Active gyms – decision on acceptance of undertakings in lieu of reference' (Case ME/6679/17) (13 June 2017, published on 13 June 2017).

that it took several months for Euro Car Parts to provide the information required by the CMA for the merger filing to be deemed complete.

Andrew Page had entered into administration in September 2016 and was suffering from severe financial difficulties. The CMA accepted that Andrew Page would have exited the markets at issue, but concluded that there were other potential purchasers for parts of the Andrew Page business that would have been less anti-competitive. We would expect this issue to be considered in detail at Phase 2, as this provides the backdrop to assess the competitive effects of the merger.

The merging parties both supplied independent aftermarket (IAM) car parts, ie replacement car parts that are not specific to a particular vehicle manufacturer. These parts were supplied to the independent motor trade (IMT), which is made up of independent or franchised garages, car dealers and fast-fit centres.

The CMA found a realistic prospect of an SLC for Key Account (ie national) customers, as well as in 92 local areas. The CMA referred the transaction to Phase 2 on 10 May 2017.

## Catchment areas and filtering

When examining a retail merger, it is necessary to identify the local areas in which the parties both compete and where potential competition concerns arise if few other competitors remain and thus those areas that merit detailed analysis. The first step is to define a catchment area, and then assess the number and location of overlaps, ie which of the merging parties' stores are located within the catchment area of the other merging parties' stores. If there are many local overlaps identified, it may then be necessary to filter the number of overlapping areas in order to exclude those where competition issues are unlikely to arise.

A store's catchment area is the area from which most of its customers are drawn.[16] The CMA frequently defines 'most' customers as 80% of customers.[17] In cases where retailers have data on the location of their customers, perhaps from store loyalty cards or from the addresses of customers (such as for specialist outdoor retailers), it is possible to identify the geographic area from which customers are drawn, and assess which areas contain 80% or more of customers by number or (ideally) by value of custom. Defining a catchment area in this way can involve substantial data analysis, as customer data from each retail site must be analysed, and – depending on the case – drive times from the customer's home to the retail site must also be calculated. Presenting the results of the analysis also requires accurate journey time and distances, as well as mapping software to present the results graphically.

Visually representing the areas from which customers are drawn can be useful in showing where competitive overlaps are in practice limited. One way to do this is by using 'heat maps' that show the concentration of outcode areas[18] from which two competing stores attract their customers. As illustrated in Figure 1, store Alpha and store Beta obtain their customers (and hence revenues) from the same broad geographical area. However, the darker areas, indicating a higher concentration of customers, show that the customers of the two stores are concentrated in different locations. In the example below, Alpha draws its customers primarily from the south and west of the store, while Beta draws its customers

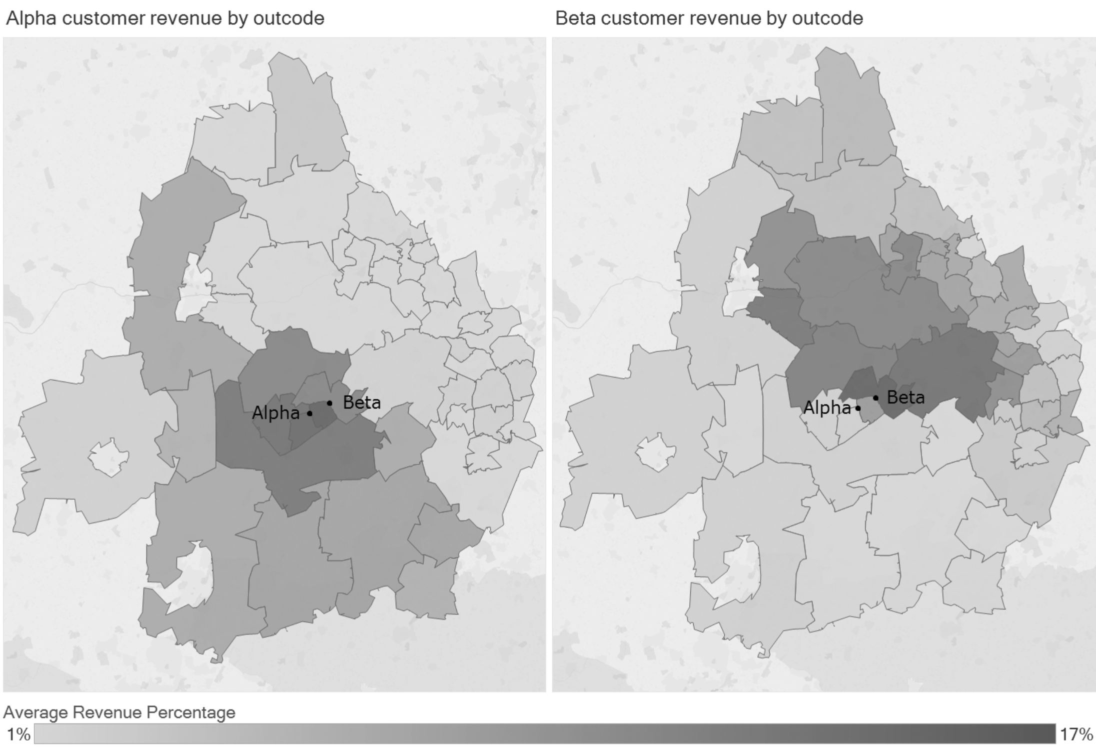
16 Commentary, n 2, above, at para 2.1.

17 Commentary, n 2, above, at para 2.20. As discussed further in section 9–065 of Parr, Finbow and Hughes, n 3 above, the 80% catchment area may understate geographic markets as competition from more distant outlets may still be a competitive constraint and customers may respond to a deterioration in the offering of local outlets by purchasing from further afield.

18 An outcode is the first part of a postcode. So, for example, postcode EC4A 3BF falls within outcode EC4A.

primarily from the north and east of the store. Competition between these stores for local customers is thus likely to be more limited than an analysis of store proximity or a count of overlapping outcodes would suggest.

**Figure 1 – 'Heat maps' illustrating relative concentration of customers for two different stores**




*Source:* AlixPartners analysis (data is illustrative and not from an actual merger).

In *JD Sports/Go Outdoors*, the merging parties used 'heat maps' to highlight two features of local competition: first, that the relative concentration of the stores' customers in some local areas were different, despite a high number of overlapping outcodes (as illustrated in Figure 1); and, second, that catchment areas were wider than the CMA's initial 30-minute drive time filter had suggested (ie customers in one particular area were willing to travel to a nearby town where several effective competitors operated).[19]

19 *JD Sports/Go Outdoors*, n 9, above, at para 158.

### *Defining catchment areas*

In *JD Sports/Go Outdoors*, the CMA examined 30-minute drive time catchment areas (or isochrones). It was estimated by the merging parties and two competitors that this would capture 80% of a store's customers.[20]

The parties held data on the addresses of a proportion of their customers and contended that a revenue-weighted outcode approach was a better approach to determining individual stores' catchment areas than average drive times across all stores. This was because individual store catchment areas would best capture the actual location of the customer base of any particular store.[21]

However, the CMA instead concluded that applying a standard 30-minute drive time, rather than individual store analysis, was the right starting point for assessing local catchment areas. Their reasons included:

- The parties' internal documents and other competitors suggested a 30-minute drive time was an appropriate catchment area. While this might suggest that 30 minutes is right on average, it does not necessarily mean that 30 minutes is always right in all areas.
- The CMA's analysis found that some outcodes where the parties' or competitors' stores were located could be missed under this approach if very few people lived at these locations (eg if the stores were located in the central business district or retail parks). This specific criticism is somewhat harsh as the parties' approach included local nearby competitors. The CMA was also concerned by JD Sports' small survey samples for some of its stores, with this survey data being used to obtain data on customer locations and hence define catchment areas.
- Data from individual stores suggests a wide variation in defined catchment areas. The CMA's decision does not explicitly address why this would be problematic. However, stores' catchment areas are likely to vary depending on local population densities, local transport networks and differences in the local appeal of the parties' stores and those of rivals. This point is discussed further below.
- The CMA's sensitivity analysis found the overlaps raising prima facie concerns would not be identified using revenue-weighted 80% catchment areas, but would be identified using a 30-minute drive time approach. Sensitivity testing is reasonable. However, in any assessment of competitive effects, it is clearly relevant to have regard to whether the merging parties predominantly attract the bulk of their customers from the same or different geographical areas.[22]

The CMA found that 52 (out of 57) Go Outdoors stores were within a 30-minute drive of a JD Outdoor store, and 93 (out of 180) JD Outdoor stores were within a 30-minute drive of a Go Outdoors store.[23]

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20 The parties used two sources of data to determine where their customers came from. For Go Outdoors customers, information on customer was collected through their loyalty card scheme, which captures customer information on revenue and postcodes. For the JD Sports brands, the parties captured data through a mix of loyalty card data and customer surveys at point of sale (conducted periodically). See *JD Sports/Go Outdoors*, n 9, above, at para 61, for further detail.

21 As the CMA notes in its decision in *JD Sports/Go Outdoors*, n 9, above: 'The Parties used customers' postcodes, aggregated to outcode level (eg so that "EC4A 3BF" would become "EC4A"), so that catchment areas did not capture individual customers and areas would not be presented with spurious accuracy' (footnote 14). A revenue weighted outcode approach assigns a proportion of the stores revenue to each outcode and ranks them from the highest (eg EC4A has 5%) down to the lowest (eg EC3A has only 0.5%).

22 The impact of using a 30-minute catchment area compared with say a 20-minute catchment area is not straightforward. Increasing the reach of each store will likely mean a larger number of overlaps, but the same larger area also captures more competitors, thereby reducing the number of areas with three or fewer competitors post-merger.

23 *JD Sports/Go Outdoors*, n 9, above, at para 93.

In *David Lloyd/Virgin Active*, the CMA used drive time catchment areas that captured at least 80% of the parties' gym members.[24] In most cases, this resulted in a 20-minute drive time catchment area. In two local areas (Northwood and Surrey), the resulting catchment area was slightly wider.[25] Using these individual outlet catchment areas, the CMA identified seven local areas where a David Lloyd gym and a Virgin Active target gym overlapped.

At this juncture, it should be noted that what the CMA has effectively done is to reject individual store assessments of catchment area in *JD Sports/Go Outdoors* and applied such an individualised approach in *David Lloyd/Virgin Active*. The Commentary states that the CMA usually considers average catchment areas, but it has considered individual stores as a sensitivity or as the basis of its analysis. It adds that individual stores' catchment areas may be informative where customers' willingness to travel varies, and the differences in travel patterns are not related to observable factors, such as whether an area is rural or urban. However, the Commentary cautions that customers may not need to travel far if there are many stores in a local area, and thus individual stores' catchment areas might not reflect willingness to travel, such that average catchment areas might be more appropriate to identify overlaps.[26]

At one level, it does not matter whether actual individual catchment areas are considered at the stage of assessing potentially overlapping overlaps or subsequently (or in addition) as part of the assessment of competitive effects. For example, in assessing competitive effects in both *JD Sports/Go Outdoors* and *David Lloyd/Virgin Active* the CMA had specific regard to the actual geographical overlaps in the areas from which the parties drew customers and, where these were limited, this was a relevant factor for concluding that there would not be an SLC.

However, it is important to be clear that average catchment areas cannot and do not measure customers' willingness to travel in specific local areas. They simply measure how far customers currently travel on average, which will inherently vary due to a combination of local geographic and demographic factors (such as transport links and population locations and densities) and the number and appeal of local outlets. In an area well served by many competing outlets, customers may not need to travel far and there may be little actual rivalry between outlets that are further apart. The converse may apply in areas that have few outlets and, if the appeal of a local outlet deteriorates, customers may respond by purchasing from further afield. These considerations may mean that catchment areas vary markedly according to whether an outlet is located in a large city or a rural area, and the Commentary highlights that the CMA may find that catchment areas vary on this basis.[27]

In *Euro Car Parts/Andrew Page*, Euro Car Parts initially submitted that catchment areas were about five miles around Andrew Page sites, as this was the distance implied by minimum delivery times agreed in Service Level Agreements between Euro Car Parts and its customers. However, the CMA found significant differences in the 80% catchment area by site. Accordingly, the CMA followed a more complex approach than the merging parties to determine catchment areas. First, using Office of National Statistics (ONS) area categorisations, it categorised Andrew Page sites into: (i) conurbation/city; (ii) city/town; and (iii) rural. Second, it calculated individual catchment areas for a sample of each of these three ONS categories. On the basis of this methodology, the CMA determined catchment areas of four, six and nine miles, respectively, for the Andrew Page sites falling into categories (i), (ii) and (iii).

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24 Each local gym would have had records of its customer names and addresses from which to map customer locations and calculate drive times.
25 *David Lloyd/Virgin Active*, n 11, above, at para 30.
26 Commentary, n 2, above, at paras 2.21–2.22.
27 Ibid, at para 2.25.

Applying these catchment areas showed that local overlaps arose in 94 of the 101 acquired Andrew Page sites. The CMA then included two (out of the seven) remaining sites in its local assessment because it received evidence from customers and competitors that the merging parties were close competitors in these two additional areas (Andover and Malton). It thus examined local competition in 96 out of the 101 acquired sites. The CMA did not find a local overlap in the remaining five sites given the substantial distance between the parties' sites, their geographic location, and the absence of other evidence of competitive interaction.

### *Filtering to identify non-problematic overlaps*

If the merging parties have very few stores or retail outlets, it may be practical to examine all overlaps. This was the case in *David Lloyd/Virgin Active*, where the CMA identified only seven overlaps and was able to examine each area without further filtering.[28]

Where a transaction gives rise to a relatively large number of local overlaps, then the CMA generally conducts a filtering exercise to exclude those local areas where competition concerns are unlikely to arise post merger. To do this, the CMA generally defines the effective competitor set, and then applies a rule (eg in relation to the number of competitive fascias in the catchment area) to see if sufficient competitors to the parties' stores will remain post merger.[29]

This raises three obvious challenges. This first is identifying the relevant competitor set. To determine the effective competitor set, the Commentary explains that the CMA may have regard to: the parties' internal documents (eg which rivals do they identify as important competitors); evidence on store characteristics (eg which rivals have similar offerings and prices); evidence from competitors and customers, surveys; and, potentially, econometric analysis.[30]

In *JD Sports/Go Outdoors,* the CMA used an effective competitor set comprised of outdoor specialist retailers.[31] It did not include online-only retailers in the effective competitor set for filtering purposes and only included independent retailers on a case-by-case basis.[32] However, it did have regard to rivalry from online retailers across all areas in assessing competitive effects as discussed below.

The CMA's process in *Euro Car Parts/Andrew Page* was different from the process described above, as identifying the effective competitor set (the first step in the filtering process) proved problematic. The merging parties put forward a large list of competitors, totalling over 3,800. The decision notes that the parties did not provide evidence to support whether and to what extent these suppliers actually competed with the parties, nor their relative strength. The CMA carried out research and came up with a list of 150 competitors, drawing on evidence from Euro Car Parts' submissions, references to suppliers in the parties' internal documents, initial customer and competitor views, and public information. The CMA was, however, 'unable to conclude at that stage of the investigation, to the required standard, that each of these suppliers was an effective competitor to the Parties'.[33]

28 *David Lloyd/Virgin Active*, n 11, above, at para 35.
29 Commentary, n 2, above, at para 3.1.
30 Ibid, at para 3.11.
31 To determine the effective competitor set, the CMA considered third party evidence (including comments made during the investigation and other market reports/commentary), the parties' internal documents, and the CMA's own desk research. *JD Sports/Go Outdoors*, n 9, above, at para 99.
32 *JD Sports/Go Outdoors*, n 9, above, at paras 96–100.
33 *Euro Car Parts/Andrew Page*, n 12, above, at para 152.

The CMA narrowed its list of 150 competitors down to 121 following responses to its merger investigation. It included competitors in its competitive assessment only if they were named by at least one customer or competitor.[34]

As the CMA did not believe that it had sufficiently robust information on the effectiveness of competitors, the CMA did not apply fascia counts to filter out areas that were unlikely to raise competition concerns. Instead, the CMA used fascia counts to inform its market testing, and in particular to prioritise and test more substantively those areas that seemed more likely to give rise to competition concerns.

The second challenge is the appropriate concentration measure. The Commentary indicates that the CMA applied various alternative approaches, including counting the number of independent fascias, counting the number of stores, revenue-based market share, and potentially applying different competitive weights to specific retailers due to differences in their offering or based on their proximity to the parties' stores. The Commentary indicates that the CMA usually uses a fascia or store count.[35] In short, the CMA's practice has evolved since 2011 when the previous version of the Commentary indicated that the Authorities usually applied a fascia count.[36]

Before proceeding further it is perhaps helpful to be clear about why mergers between rivals may lead to anti-competitive unilateral effects. As set out by Parr, Finbow and Hughes, the intuition for why such effects may arise is straightforward:

> '… when a firm increases its prices or reduces output (or otherwise worsens its competitive offering in terms of reducing quality, range, service or innovation), some of its customers will respond to the deterioration in its offer by wholly or partially switching to rivals or reducing their purchases. This diversion disincentives the firm from engaging in such conduct pre-merger, because the fall in sales volumes would reduce its profits. Post-merger this constraint is relaxed.'[37]

Accordingly, the substantive issue is how this competitive constraint is relaxed. In a differentiated product or geographic market (eg branded consumer goods or in local retail mergers), following a merger with a rival, a proportion of the sales that would have been lost to a rival may no longer be lost by the merged entity. It is this recapture of valuable lost sales that may create a unilateral incentive for the merged entity to increase prices or otherwise worsen its offer. The value of these diverted sales depends on: (i) the proportion of sales volumes that are diverted between the parties (which is referred to as the diversion ratio between the parties), rather than to other competitors or lost due to customers buying less; and (ii) the level of gross profits.

Accordingly, the appropriate concentration measure is the one that best captures the relative diversion (ie switching) between various competitors' outlets should one of the merger parties increase its prices or otherwise worse its offer. As a result:

- Fascia counts are normally used when the fascia brand matters to consumers, and there is little variation between the offerings in each of the fascia's sites. If a retailer has two stores with the same fascia in a catchment area, it will be counted once if it is considered most likely that rival fascias are similarly close rivals even if they operate only one store.

34 Ibid, at para 158.
35 Commentary, n 2, above, at paras 3.20–3.32.
36 Commentary on retail mergers, n 4, above, at para 2.7(ii).
37 Parr, Finbow and Hughes, n 3, above, at sections 9–077–9–078.

- If retailers' brands and outlet offerings vary locally it may be more appropriate to apply a measure based on outlet count (ie market share by number of outlets) or market share by revenue, as these will be better measures of relative diversion between local outlets.[38]
- Similarly, more complex filters involving weighting of measures (such as where not all fascia are of the same competitive significance due to their offering being differentiated or the outlets being further apart) could be employed, but are typically not used at Phase 1.[39]

The third challenge is the relevant concentration threshold to be applied to identify areas that potentially raise competition concerns. The Merger Assessment Guidelines indicate that 'previous OFT decisions in mergers involving retailers suggest that the OFT has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above)'.[40] The Commentary thus suggests that the CMA is now applying a more conservative approach as, whilst a 'four to three' fascia count threshold is still applied in the grocery sector to identify potentially problematic overlaps, the Commentary states that it has often used a 'five to four' fascia count in other sectors.[41]

A relevant issue in considering any such thresholds is the relative proximity of the parties' outlets and those of competitors, together with the extent to which included and excluded rivals compete with the parties. In particular, if the parties' outlets are very close to one another and other rivals' outlets are at the edge of the catchment area, it is possible that diversion between the parties' outlets may be high. For example, in *JD Sports/Go Outdoors* the CMA considered in more detail the competitive effects in some areas that still had four independent fascia post-merger, where the parties were particularly close competitors and other rivals were further away.

Similar issues arise in relation to the setting of market share based thresholds to identify potentially problematic local overlaps. The Commentary refers to various cases in which a store count market share threshold of 35% or 40% was applied.[42]

A combination of fascia and store count criteria may also be applied. For example, in *Euro Car Parts/Andrew Page*, of the 96 local areas examined, the CMA found that the exiting firm counterfactual applied in two areas, leaving local competition to be assessed in 94 areas. In those 94 areas, the CMA calculated shares of supply using data on the merging parties' turnover per site. For competitors, the CMA used competitor revenue data where it was available, and assumptions based on average revenues where data was unavailable.[43] The

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38 Commentary, n 2, above, at para 3.22.

39 Commentary, n 2, above, at para 3.26. A description of how the CMA assessed the relevant competitive set and the different weights that should be applied to differentiated types of pub in *Green King/Spirit Pub Company* ('Anticipated acquisition by Greene King plc of Spirit Pub Company plc' (Case ME/6501/14) (11 May 2015, decision published 29 May 2015)) is set out in sections 9–099 to 9–100 of Parr, Finbow and Hughes, n 3, above.

40 Competition Commission and Office of Fair Trading, 'Merger Assessment Guidelines', CC2/OFT1254 (September 2010).

41 Commentary, n 2, above, at para 3.35. The Commentary cites three retail mergers that applied a fascia count to identify potentially problematic local overlaps. In one of these cases involving cinemas, the Competition Commission used a 'four to three' fascia count that excluded independent cinemas to identify potentially problematic overlaps. In *Rank/Gala* (2013), the Competition Commission used more conservative filters considering local overlaps in detail where the parties faced three or fewer additional casino fascia within a 30-minute drive time or, regardless of the number of local competitors, where their casinos were within a 10-minute drive time of one another. However, the CMA only reached an SLC finding in four of the 17 areas identified by its filter rules, and only where the merger effectively created a duopoly, even allowing for likely entry. This case is discussed further in sections 9–101 to 9–102 of Parr, Finbow and Hughes, n 3, above. The Commentary also cites, at para 103, *Saint-Gobain/Build Center* (2012) as a case where the OFT used a 'five to four' fascia count to screen out non-problematic areas, but it omits to mention that it only applied this additional filter only where there was a 'two to one' within five miles.

42 Commentary, n 2, above, at paras 3.36–3.37. These cases are discussed further in sections 9–101 to 9–104 of Parr, Finbow and Hughes, n 3, above.

43 *Euro Car Parts/Andrew Page*, n 12, above, at para 162.

Merger Assessment Guidelines note that the CMA does not typically raise concerns where the merging parties have a combined share of supply below 40%, albeit this threshold is referred to as applying in undifferentiated markets,[44] but in some cases the UK authorities have applied a lower market share threshold of 35%.[45] The CMA divided the 94 areas into several categories:

- First, 38 'high concentration' areas in which a fascia count indicated that there would be fewer than three independent competitors post-merger. The CMA also examined price matching data and found that Andrew Page was in the top three competitors of Euro Car Parts' closest site price matches.[46] Unsurprisingly, the CMA found a realistic prospect of an SLC in all 38 areas.
- Second, 54 'high combined share' areas in which a fascia count indicated that there would be more than three local competitors post-merger, but the parties had combined shares of over 40% and increments in share were material (greater than 5%, and in 34 areas greater than 10%). The CMA found a realistic prospect of an SLC in 52 of these 54 areas. The two areas in which the CMA did not find an SLC were Great Yarmouth and Ellesmere Port. In Great Yarmouth the parties' combined share was 30–40%, so seemingly less than 40%, the increment in share from the merger was 10–20% and four competitors each had a share greater than that of Andrew Page. In Ellesmere Port, the parties' combined share was above 40%, but the increment was less than 5–10% and the closest Euro Car Parts site did not price match Andrew Page, suggesting that it was not a close competitor to Andrew Page.
- Third, two areas with 'other basis for concern'. Customers and competitors had indicated that the merging parties were close competitors in two areas (Andover and Malton) where the CMA's catchment area analysis had not suggested an overlap. These concerns appear to have been raised relatively late in the Phase 1 investigation. The parties did not produce data or information on these concerns like those areas set out in its Issues Letter, and so the CMA found a realistic prospect of an SLC in these two areas.[47]
- The CMA thus found a realistic prospect of an SLC in 92 out of 94 local areas. In this regard, it should be noted that the key driver of this outcome was the CMA's decision to exclude the bulk of the rivals identified by the parties from the effective competitor set, and at Phase 2 the CMA will need to re-consider this issue.

It should also be noted that in some highly regulated markets local competition concerns have only been identified where higher concentration thresholds apply, notably in relation to NHS dentistry and regulated pharmacy retailing. These cases turn on their specific facts, namely the extensive nature of regulation and the limited scope for competition.[48]

## *Conclusions on catchment areas and filtering*

It is important to appreciate that the purpose of considering catchment areas and any filtering rules is to highlight those locations where the parties are sufficiently close competitors such that local adverse effects on competition may arise. This suggests that conservatism is appropriate in identifying potentially problematic overlaps, and the CMA also routinely applies sensitivity testing to consider whether it should include or exclude marginal overlaps.

44 Ibid, at para 161.
45 See, eg, *Greene King/Spirit Pub Company*, n 39, above.
46 *Euro Car Parts/Andrew Page*, n 12, above, at paras 169–172.
47 Ibid, at paras 182–184.
48 See further section 9–102 of Parr, Finbow and Hughes, n 3, above.

Nevertheless, whatever catchment areas and filtering rules are applied, it is important that the assessment of local competitive effects has regard to the combined impact of the merged undertaking losing sales to rivals outside the defined catchment area and competitive set.[49]

## National vs local competition

The previous section proceeded on the basis that retailers routinely flex their competitive offer based on local rivalry, but this may not be the case. However, the Commentary rightly emphasises that, even if retailers set aspects of their offer centrally and uniformly, local competition can still occur if: (a) certain aspects of the competitive offer are determined or vary locally (eg store opening hours or product ranges stocked); and (b) the parties would have an incentive to vary their offer locally even if they do not do so pre-merger.[50] Even if there appears to be limited local flexing of competitive parameters (such as price, quality, range and service), such flexing can be subtle (eg with respect to staffing levels or product mix).

The Commentary also indicates that the loss of local rivalry post-merger could be sufficient to cause the retailer to worsen its competitive offer nationally.[51] In addition, the Commentary notes that a merger of retailers could have an impact on national competition that is not related to the extent of local competition, including a loss of dynamic competition (eg in relation to expansion into new geographic areas).[52]

Many retail mergers do not raise national competition issues. For example, the *David Lloyd/Virgin Active* transaction raised no national issues as the transaction related to the acquisition of only 16 Virgin Active gyms in the UK and Virgin Active remains a significant national competitor post-merger with 45 gyms.[53] The CMA focused on local issues only.

Similarly, in *JD Sports/Go Outdoors* the CMA found that the parties had relatively modest share of supply (varying from 10–20% in outdoor clothing to 20–40% in outdoor equipment) and faced a range of credible competitors in each product category in both brick-and-mortar and online channels. The evidence did not suggest that the parties are uniquely close competitors in any product category. Accordingly, the CMA concluded that there was no SLC at the national level, leaving only local issues for further investigation.[54]

In *Euro Car Parts/Andrew Page*, the CMA examined the impact of the merger on Key Account customers, who purchase IAM car parts on a national basis. It found that for these Key Account customers the merging parties competed closely with each other on price, quality, product range and delivery capability. It found just one other significant competitor (Parts Alliance) with national coverage capable of constraining the merged entity. It therefore found a realistic prospect of an SLC in relation to the supply of IAM car parts to Key Accounts.[55]

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49 Ibid.

50 Commentary, n 2, above, at para 1.4.

51 Ibid, at paras 1.13–1.17. The Commentary also considers the possibility that a merger may have an adverse effect on competition nationally, even where the element of the national offer in question is not based on the aggregate of local competition (see para 1.19).

52 Ibid, at para 1.18. See further the CMA's Phase 2 report in *Poundland/99p* ('A report on the anticipated acquisition by Poundland Group plc of 99p Stores Limited', 18 September 2016)) and the CMA's Phase 1 decision in *Pure Gym/The Gym* ('Anticipated combination of Pure Gym Limited and The Gym Limited' (26 June 2014)), which are discussed at section 9–112 of Parr, Finbow and Hughes, n 3, above.

53 *David Lloyd/Virgin Active*, n 11, above, at para 28 and footnote 12.

54 *JD Sports/Go Outdoors*, n 9, above, at para 6.

55 *Euro Car Parts/Andrew Page*, n 12, above, at paras 8–9. This is thus a case where regional/national customers wish to purchase primarily from suppliers with regional/local networks of outlets. See further section 9–068 of Parr, Finbow and Hughes, n 3, above.

## Competition from online retail

The CMA's new focus on competition from online retailers is unsurprising. In May 2017, online retail spending accounted for 15.9% as a proportion of total retail spending – up from 14.3% a year earlier, and from just 9.6% in May 2012.[56] The year-on-year growth (as at May 2017) is now 14.4%. This has wide-ranging consequences for traditional bricks and mortar retailers.

Competition authorities have begun to take notice, with the European Commission completing its sector inquiry into e-commerce in May 2017. The Final Report confirms the significance of online retailing noting that '[t]he percentage of people aged between 16 and 74 that have ordered goods or services over the internet has grown year-on-year from 30% in 2007 to 55% in 2016'. Furthermore, the Commission concluded that: 'the ability to compare prices of products across several online retailers leads to increased price competition affecting both online and offline sales'.[57]

An increasingly important issue for mergers is whether online retailers constrain bricks-and-mortar retailers. However, the Commentary cautions that evidence of customer *migration* to the online channel must be distinguished from customer *diversion* to the online channel,[58] and the CMA cites no Phase 1 cases where online competition has been given weight in the assessment of local competitive effects. In this regard, the CMA's Phase 1 clearance decision in *JD Sports/Go Outdoors* merger is particularly noteworthy, given the weight it attached to online competition.[59]

The UK market for outdoor clothing, footwear and equipment is highly fragmented, with the parties facing numerous credible competitors from both online and bricks-and-mortar stores. At the national level, the parties had a combined share of supply of 10–20% in clothing, 20–30% for footwear and 20–40% for equipment. The parties' internal documents, price tracking and matching data, survey data, and feedback to the CMA's investigation, all suggested that the parties faced significant competition from a diverse range of competitors at the national level.

While the CMA did not include online retailing within the product frame of reference, it did take account of the constraint from online retailers on bricks-and-mortar stores in its competitive assessment of competition in local areas. *JD Sports/Go Outdoors* is the first Phase 1 case in which the CMA has accepted that online retailers constrain bricks-and-mortar stores at the local level. This was down to three key factors, which are discussed in turn below.

### *Internal documents*

A consistent theme in the new Commentary is how the CMA is increasingly relying on internal documents as key pieces of evidence. In fact, the CMA referred to the term 'internal

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56 This excludes automotive fuel. See 'ONS Statistical Bulletin: Retail sales in Great Britain: May 2017' https://www.ons.gov.uk/businessindustryandtrade/retailindustry/bulletins/retailsales/may2017.

57 'Report from the Commission to the Court and the European Parliament: Final report on the E-commerce Sector Inquiry', at para 12 (available at http://ec.europa.eu/competition/antitrust/sector_inquiry_final_report_en.pdf).

58 Commentary, n 2, above, at para 4.14.

59 Online competition was not relevant in *David Lloyds/Virgin Active*, n 11, above (as gym facilities cannot be provided online), nor in *Euro Car Parts/Andrew Page*, n 12, above, where the delivery speed of car parts (of within one hour) was important.

documents' 17 times in the *JD Sports/Go Outdoors* merger decision, notably more than earlier mergers in the sector. For example, the *Sports Direct/JJB Sports* decision contained no mention of internal documents.[60]

In *JD Sports/Go Outdoors*, several pre-merger internal documents and presentations showed the parties' competitive position relative to online retailers, emphasising the 'competitive threat' posed by online retailers.[61]

### *Customer surveys*

The customer survey evidence in *JD Sports/Go Outdoors* was two-fold. First, the parties submitted a survey of Go Outdoors' customers that showed between 60–70% of customers browsed the internet prior to visiting the store.[62] Importantly, this demonstrated competitive interaction between online and bricks-and-mortar, and more importantly that online offers and discounts can drive local competition.

Second, as mentioned above, the CMA and the parties conducted their own online survey of the seven areas subject to detailed analysis. One question specifically asked whether customers would switch to online retailers if their usual store was closed. The results suggested that if their usual store were closed, 20–30% of JD Sports customers would switch to an online retailer, and 30–40% of Go Outdoors' customers would switch to an online retailer. Notwithstanding that this survey was conducted online (which may increase online diversion), the CMA considered that this supported the existence of important competition from online distributors.[63]

### *Evidence of online prices constraining in-store prices*

In addition, Go Outdoors tracked online prices as well as prices of its bricks-and-mortar competitors via its 'Price Match Plus' scheme.

Go Outdoors also provided discounts at local stores where a customer can show that a product is available cheaper at another retailer (including online retailers). Approximately 40–50% of Go Outdoors' price matches were made against online-only retailers in the period February 2014 to January 2017.[64]

The CMA's decision makes clear that when assessing competitive constraints from outside each local area, evidence that Go Outdoors price matched online competitors contributed to its finding that online competitors were a constraint to be factored into the competitive analysis. In its analysis of Southend-on-Sea, for example, the CMA notes that '[t]he Go Outdoors price matching data also confirms the extent to which online retailers constrain the Parties within this local area: three of the top five competitors price-matched by Go Outdoors are online competitors'.[65]

## Surveys and diversion ratios

Diversion ratios measure the proportion of a store's customers who would switch to a rival store in a particular scenario. The CMA can therefore use diversion ratios to approximate the

60 'Anticipated acquisition by Sports Direct International plc of 19 Stores from JJB Sports plc (in administration) – decision on relevant merger situation and substantial lessening of competition' (Case ME/5765/12) (21 December 2012, published on 25 January 2013).
61 *JD Sports/Go Outdoors*, n 9, above, at para 41.
62 The survey was over the first 10 weeks of 2017. See *JD Sports/Go Outdoors*, n 9, above, at para 45.
63 Ibid, at para 47.
64 Ibid, at para 42.
65 Ibid, at para 119. Similar points are made in relation to other local areas in which Go Outdoors had an existing store – see paras 130 (Llanelli), 141 (Colchester), 152 (Derby), 163 (Basingstoke) and 172 (Lincoln).

closeness of competition between firms or products: ie the higher the diversion from one store to a competitor store, the more closely they compete with each other. The Commentary notes that in retail mergers the CMA has most often calculated diversion ratios from consumer surveys.[66]

In competition analysis, one wants the diversion ratio to measure what customers would do in response to changes in relative prices. In practice, in retailer mergers and consumer surveys, the diversion ratios measure what customers would do if a store was closed.[67]

The CMA carried out surveys in both *JD Sports/Go Outdoors* and *David Lloyd/Virgin Active* in order to estimate diversion ratios between the local stores of the merging parties. No such survey was carried out in *Euro Car Parts/Andrew Page*.

In *JD Sports/Go Outdoors*, the CMA carried out an online survey of customers to determine what they would have done if, on the last time they went to the named store, they had learned it was closed for a year (ie to understand 'forced diversion').[68] Customers were then asked further questions about which location or website they would have visited. While the CMA surveyed customers of both JD Sports and Go Outdoors, due to low response rates from JD Sports customers the CMA placed no weight on those results.[69]

The response from Go Outdoors' customers led the CMA to conclude that 'overall, the survey confirms the constraint exercised by online retailers on bricks-and-mortar retailers within each of the seven areas that were subject to in-depth assessment'.[70] The CMA's survey evidence was thus central to its decision to include online retailers in the local competitive assessment of the seven areas subject to in-depth review.

In *David Lloyd/Virgin Active,* the CMA carried out surveys in three areas (Brighton, Clearview and Northwood) to estimate the likely diversion of Virgin Active members to David Lloyd (and vice versa) in the event that their gym was closed.[71] The relatively high diversion between the parties in Brighton and Clearview contributed to the CMA's finding of a realistic prospect of an SLC in those two areas. The CMA also noted that the results of the diversion ratio analysis were consistent with David Lloyd's internal documents in Brighton and Clearview, once again highlighting the importance of evidence from internal documents in the CMA's competition assessment.[72]

However, the CMA's reliance on its surveys in Brighton and Clearview is particularly noteworthy as the CMA attached considerable weight to the survey, despite the presence of at least four gyms offering the same core facilities that were nearer than the parties' gyms. For example, in the Brighton area the CMA emphasised that the survey evidence indicated that the parties are each other's closest competitor:

- In the event of the closure of Virgin Active Brighton, 20% of members would divert to David Lloyd and 20% to Withdean Sports Complex.

66 Commentary, n 2, above, at para 5.7.
67 Ibid, at para 5.8.
68 In Annex 2 to its decision in *JD Sports/Go Outdoors*, n 9, above, the CMA acknowledges that the 'forced diversion' question (ie responses to outlet closure) is, at least in theory, not equivalent to a question on a small but significant price increase. However, in some previous cases the Competition Commission has found broadly similar diversion from both approaches, such as in *Cineworld/City Screen* (see 'A report on the completed acquisition by Cineworld Group plc of City Screen Limited', 8 October 2013). Therefore, in this case the CMA concludes that the 'forced diversion' results provide a meaningful basis to assess diversion.
69 *JD Sports/Go Outdoors*, n 9, above, Annex 2, at para 6.
70 *JD Sports/Go Outdoors*, n 9, above, at para 109.
71 *David Lloyd/Virgin Active*, n 11, above, at paras 36 and 38.
72 Ibid, at paras 65 and 76.

- In the event of the closure of David Lloyd Active Brighton, 36% of members would divert to Virgin Active Brighton and 11% to The Gym.[73]

These outcomes may be attributable to the differentiated nature of rivals' gyms, even where their offerings are ostensibly similar. The parties criticised the survey on a number of bases, particularly as members were likely to focus on the 11 gyms listed in the survey questionnaire and high awareness of the parties' brands. However, the CMA rejected these criticisms. In particular, the CMA noted that these issues had been mitigated by adopting the parties' lists of alternative competitors and placing them in order based on distance, which placed the parties' gyms further down the lists as they were generally more distant competitors.[74] The CMA's observations seem legitimate. However, it is puzzling why the survey questions did not randomly rotate the order in which alternatives are presented, particularly as there is a natural tendency for survey respondents to choose options based on the order in which they are presented.

In an ideal world, the CMA would have looked at actual switching patterns in recent years, which might have been different that those based on survey questions based on hypothetical switching. Indeed, the parties cited research that indicated that only 1–5% of the members lost by David Lloyd Brighton switched to Virgin Active Brighton between May 2015 and December 2016. However, the CMA attached only limited weight to this as the parties had no data on the extent to which this switching was due to local competition between gyms (as opposed to other factors) and diversion to other gyms.[75]

## Conclusions

There are three key conclusions that may be drawn from our review of the Commentary and three recent Phase 1 merger decisions.

First, the CMA is placing increasing weight on internal documents and is ensuring consistency of its analysis and evidence with those documents. In *JD Sports/Go Outdoors,* the CMA relied heavily on internal documents to define the catchment area for the filtering exercise, and internal documents proved pivotal in showing online retailers as a local competitive constraint. In *Euro Car Parts/Andrew Page*, the CMA used internal documents (as well as customer and competitor feedback) to define an initial set of 150 effective competitors, despite the parties submitting that there were 3,800 competitors in total.

Second, in *JD Sports/Go Outdoors*, for the first time at Phase 1, the CMA has shown its willingness to consider online retailers as a local competitive constraint in retailer mergers. However, merging parties should proceed with caution, as in this particular merger there were two pieces of particularly persuasive evidence that online competition constrained bricks-and-mortar retailers: first, one of the merging parties (Go Outdoors) was price matching and monitoring online prices; and, second, a customer survey showed significant diversion to online retailers in each of the seven local areas subject to in-depth investigation. The survey evidence demonstrating that a significant proportion of customers would be willing to use online retailers as a substitute for bricks-and-mortar proved particularly persuasive.

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73 This may beg the question of what level of diversion is required to materially change the merged entity's pricing incentives. Given the high level of gross margins made by gyms, even relatively low diversion ratios may suggest that a merger would appreciably change their pricing incentives. See further section 9–084 and footnote 326 of Parr, Finbow and Hughes, n 3, above.

74 *David Lloyd/Virgin Active*, n 11, above, at paras 40–42.

75 Ibid, at paras 40–41.

Finally, obtaining a Phase 1 clearance in cases involving very large numbers of local overlaps remains challenging (as in *Euro Car Parts/Andrew Page*, which involved over 90 local overlaps).[76] To narrow down the areas of concern, robust evidence on the effective competitor set is essential. In addition, parties will have more success if they can visually demonstrate how the parties' stores are not particularly close competitors or that many other effective competitors exist. In *JD Sports/Go Outdoors*, the merging parties, through local area maps and revenue weighted 'heat maps' showing limited geographic overlap in catchment areas, were able to demonstrate that there was no realistic prospect of an SLC in each of the seven local areas subject to an in-depth review.

76 This is not to say that mergers with a large number of local overlaps cannot be cleared in Phase 1. For example, *Greene King/Spirit Pub Company*, n 39, above, involved around 1,000 local overlaps, yet the CMA accepted undertakings in lieu to divest just 16 pubs (out of approximately 1,200 pubs acquired). For a fuller discussion of this merger see Parr, Finbow and Hughes, n 3, above, at pp 554–560.