IN THE COMPETITION APPEAL TRIBUNAL

Case No 1051/4/8/05

BETWEEN

SOMERFIELD PLC

Applicant

and

COMPETITION COMMISSION

Respondent

COMPETITION COMMISSION SKELETON ARGUMENT

References to [Skeleton, x], are to paragraph x of Somerfield's Skeleton argument; references to [S/x/y], are to page y behind tab x of Somerfield's bundle; references to [CC/1/x/y], are to page y behind tab x of the exhibits to the witness statement of Christopher Clarke.

1. This Skeleton covers three issues: the appropriate standard of review under section 120 of the Enterprise Act 2002; the lawfulness of the decision of the Competition Commission ("CC") to designate the stores to be divested in each of the 12 local markets in which it has found an SLC; and the lawfulness of the decision to limit the identity of approved purchasers, and to provide for qualifications to be such an approved purchaser, during the [**CONF**] of the divestment process. The CC has already set out in its Defence and in the witness statements of Mr Clarke and Mr Davies the reasoning on which it relies to support the legality of its decisions and has provided further supplementary material and argument relevant to its case.

I. THE APPROPRIATE STANDARD OF REVIEW UNDER SECTION 120

2. Parliament has provided that the standard of review under section 120 is that of judicial review and not that of an appeal. As a general principle, the CC

submits that it is difficult to better the observations of Lord Bingham in *Macdonald* [1999] 1 WLR 841 at 855 that:

> "it is important to remember always that this is judicial review of, and not an appeal against, the judge's decision. We can only intervene if persuaded that his decision was perverse, or that there was some failure to have regard to material considerations or that account was taken of immaterial considerations or that there was some material misdirection."

3. In respect of the jurisdiction of the Competition Appeal Tribunal (the "CAT") in merger cases, the case law and the text books were extensively reviewed by the Court of Appeal in *OFT* v *IBA Health* [2004]EWCA Civ 142, [2004] 4 All ER 1103. At paragraph 53 of the judgment the Vice Chancellor ruled that the principles to be applied by the CAT are the ordinary principles of judicial review and that they are mandatory requirements. Carnwath LJ, with whose observations Mance LJ agreed, addressed the principles of judicial review in an extensive passage of the judgment, at paragraphs 88-101. The CC respectfully suggests that the standard of review to be applied in the current proceedings can be deduced from those principles. To the extent that passages cited by Somerfield in its NoA from Case C-12/03P *Tetra Laval* might suggest a different or even more intensive review than that provided by those domestic principles, the CC submits that they should not be followed by the CAT.

4. More generally in respect of the judgments and reasoning of the CFI and the ECJ, in cases involving Articles 81 or 82 of the EC Treaty or the EC Merger Regulation,[1] the CC observes that the system of legal accountability of the EC Commission to those courts derives its authority from the Treaty. Where the approach taken by those courts fits with the principles of domestic administrative law, which, as the Court of Appeal held in the *OFT* case, are flexible, that is a matter which a domestic tribunal will no doubt take into account. But it is a different system. In the present case the principles

[1] EC Council Regulation 139/2004, effective May 1 2004, repealing Regulations(EEC) No 4064/89 and No 1310/97.

relevant to the standard of review are contained within the principles of UK administrative law.

5. As in the *OFT* v *IBA Health* case, the present case before the CAT is not concerned with a decision as to policy or discretion, in the sense of political judgment: see Carnwath LJ at 93-100. The role of the CC in a merger inquiry such as *Somerfield*, in making its determination both as to the likelihood of an SLC and the appropriate remedies, is one of "factual judgment" , using that expression to mean, as the Court of Appeal did in the *OFT* case, a matter of judgment as to what is likely to happen in a market based on the evidence it has available to it. The CC's duty in arriving at a factual judgment is to: consider relevant facts; evaluate them, in the sense of assessing them and attaching weight to the various components of the factual matrix; apply economic analysis in accordance with appropriate principles and, in particular, its Merger Guidelines; draw conclusions; and then reach a decision. In carrying out those functions, it has, consistent with established principles of administrative law, a wide margin of appreciation.

6. On the matter of the intensity of review, Somerfield submits [Skeleton, 3] that "the normal standard of review applies, as set out in its NoA" [19-24]. But it also claims, *ibid*, that the "lack of a political check on the CC's exercise of these powers justifies an intensive review by the Tribunal." Two points may be made.

7. First, Somerfield's argument appears to be that there is a need for the review court to change its approach to fill the void created by the fact that the Secretary of State is no longer involved in the process. That argument appears to assume that, under the previous regime, the role of the Secretary of State and the purpose of his or her involvement was similar to that of a court on an application for judicial review. But that was not the case. Under the old regime, the main purpose for the involvement of politicians in the process was to provide a way for political considerations to be taken into account, not to carry out a judicial review of the CC's report.

8. Second, the CC does not argue for any precise point on a putative scale of intensity; such an approach is artificial and unhelpful. But it does contend that Parliament has chosen to confer on the CC responsibility for carrying out the process of evaluating the evidence and reaching an informed judgement on the statutory questions set out in sections 35 and 41 of the Enterprise Act. Specifically, under sections 35 and 41 Parliament has conferred on the CC the responsibility to take determinative decisions as to the nature of remedial action to be taken in respect of a finding of an SLC; decisions which require the exercise of expert judgment. The CC is, of course, conscious of ensuring that its remedies are proportionate to the SLC; indeed, this consideration is specified in its Merger Reference Guidelines [CC/1/6/4.9]. However, that consideration does not alter the nature of the role conferred on it and, therefore, the intensity of review that should in practice be applied. Nor, contrary to Somerfield's submission [Skeleton, 5], does it alter the usual position that in an application for judicial review the applicant bears the legal burden of proof throughout and the initial evidential burden.[2]

9. The CC naturally accepts that the CAT may and should consider whether the CC applied the correct legal test and reached its conclusions taking into account all relevant considerations and disregarding all irrelevant considerations. But if the CC did that, and if its decision was within its margin of appreciation, the CAT cannot lawfully overturn that decision even if it considers that an alternative decision would have been possible or even preferable.

10. Somerfield argues that in respect of the two outstanding issues, choice of store and identity of purchaser, the CC has acted perversely. The CC would accept that if on the facts found or on the material that it had before it "the only reasonable conclusion contradicts [its] determination"[3] that would be an instance of perversity. But there is no perversity in the CC's decision in the present case.

[2] OFT v IBA, paragraphs 54 to 57.

[3] *Edwards v Bairstow* [1956] AC 14, per Lord Radcliffe, cited by the Vice Chancellor in *OFT* v *IBA Health* supra at paragraph 70.

11. Whilst Somerfield couches its case in terms of the type of serious errors that may constitute good grounds for a review, namely illogicality, inconsistency and perversity, this is an attempt to disguise the true nature of its case. The substance of Somerfield's case is that it disagrees with the weight placed by the CC on different pieces of evidence, and with the CC's assessment as to precisely where to draw the boundary line for the set of suitable purchasers. But both of these are matters of judgment for the CC and its conclusions fell well within its margin of appreciation. Somerfield's case is in reality an impermissible appeal on the merits and should be rejected.

II. THE CHOICE OF STORE ISSUE

12. The CC's reasoning on the *Choice of Store* issue is set out at paragraphs 11.9-11.23 of the Report under the heading *The Stores to be Divested.* That reasoning has been amplified in the Defence, at paragraphs 24-36, in the statement of Christopher Clarke, in particular at paragraphs 18-47 and 51-97, and in the statement of John Davies at paragraphs 6-32.

13. The finding of an SLC requires the CC to form a judgment as to how it can be remedied. The starting point for the Remedies conclusions is the CC's conclusions on the effect of the acquisition on competition in specified local markets, set out at paragraphs 8.1-8.3 of the Report, and summarised in the conclusions at paragraph 10.1. The CC concluded at paragraph 8.3 as follows:

> "As a result of any such loss of competition, the acquisition may therefore also be expected to have the adverse effects on consumers in those areas, of higher prices (including local promotional activities) to consumers, of reduced range of products available to shoppers; of loss of choice not only of products, but also of retail outlets available to shoppers; and of poorer service to shoppers."

14. The CC's approach to structural remedies in the present case is essentially simple and direct, and based on some very clear principles. The CC's starting point, set out in paragraph 11.9, and consistent with the remedies notice [S/25], was that:

> "Divestment of the acquired store to a suitable purchaser (as discussed in paragraph 11.24 et seq) would normally remedy, mitigate or prevent the SLC. We suggested in the remedies notice that the stores to be divested in the relevant local market would be those stores acquired from Morrisons unless we considered that the divestiture of alternative stores would satisfactorily restore competition in the local markets concerned (remedies notice paragraph 4(a))."

15. The proviso *"unless"* is critically important. It was tested in respect of 9 of the 12 areas where an SLC had been identified[4]. The test applied by the CC was set out in paragraph 11.12 of the Report:

> "To address the SLC, it is important first that the location of the store to be divested be such as to remedy the SLC identified, as would clearly be the case were the acquired store to be divested. If the existing store to be sold was some distance from the acquired store, it may be necessary to reassess the identity of the appropriate purchasers for the store, requiring both a re-evaluation of the extent of competition in the isochrone of the existing store, and of the diversion ratios of customers of the existing, as opposed to the acquired store. In any cases in which there is more than one existing store, divestment of a more distant store, to which diversion ratios are likely to have been lower, may also fail to remedy the SLC identified. But secondly, it is important in order to address the SLC that the store offered for sale should be attractive to purchasers able to satisfy the criteria set out in the remedies notice. They should also be able to offer a comparable degree of competition with Somerfield on PQRS to that which existed prior to the acquisition. Where an existing store is relatively unprofitable, or has a significantly smaller sales area than an acquired store or has a disadvantaged store location, then there may be a significantly greater risk of not attracting a suitable purchaser and addressing the SLC."

16. The first point made in 11.12 relates to location. It requires little elaboration. It is an obvious example of a case where the identity of the store, in terms of its location, is critical to the effectiveness of the remedy. Indeed, Somerfield now appears to admit the relevance of the point generally (and specifically in the case of Middlesbrough Linthorpe).

[4] There was no need for testing in respect of Filey, Poole Bearwood and Whitburn as Somerfield agreed to the sale of the acquired store.

17. The second point in 11.12 relates to the saleability of the stores at issue: the characteristics of the stores identified in the relevant local areas have an impact on the *risk* of not attracting a suitable purchaser within an appropriate timetable and thereby remedying the SLC. In assessing saleability the CC carried out a process of evaluating the relative quality of assets, profitability and resources. Assuming that the CC correctly directed itself as to the materiality of the matters to be assessed, this is a question that is for the decision maker to determine. The CC concluded that in four markets it was not satisfied that divestment of the existing store would remedy the SLC within a reasonable timescale.

Somerfield's case on choice of store

18. Somerfield no longer maintains any 'in principle' legal argument that the CC could never be entitled to impose limitations on which store should be sold in circumstances such as these.[5] Somerfield now accepts that the CC is entitled to impose limitations on which store may be divested where there is more than one existing store within the isochrone [Skeleton, 7 and 38]. It also accepts that, as a matter of principle, the 'saleability' of a store is a relevant consideration for the CC, i.e. that in making its remedies decision it is relevant for the CC to consider how likely it is that a store could be divested to a suitable purchaser within a reasonable time frame (taking into account the 'composition' and 'purchaser' risks referred to in the CC's Guidelines on Divestiture Remedies).

19. At Skeleton 32 Somerfield suggests that rather than considering saleability, the CC was focussed upon "comparability" i.e. were the acquired and existing stores similar (and so had similar "competitive weight") *not* were they similarly saleable. This allegation is groundless: the CC was *not* working to an agenda different from that set out in paragraphs 11.18 to 11.23 of the Report (see in particular the language in paragraph 11.22, and the comments of Mr Clarke as to the CC's reasoning [55, 71-74 and 79]).

[5] The NoA [101-105] is uncompromising in this respect, although Ridyard [78] appears to accept a necessary qualification in cases where there is more than one existing store.

20. As the CC understands Somerfield's case in its Skeleton, it is that the analysis of saleability was fundamentally flawed and, therefore, unsustainable essentially on two grounds, considered in turn below:

- The *first* is that the starting position of the analysis should be to allow a choice of store unless saleability considerations suggest otherwise, and that "the circumstances of this case ... [did] not give the CC any basis upon which to preclude Somerfield from choosing whether to divest acquired or proximity stores in order to remedy the specific SLC that has been found" [Skeleton, 8] (see also Ridyard at paragraphs 77-79).

- The *second* is that the exercise on the relative saleability of the acquired and existing stores was flawed, because store characteristics "go only to the consideration for the sale, not to saleability itself" [Skeleton, 30]. If a store has characteristics that are unattractive to purchasers, the consequence is that the store will sell for a lower purchase price. Once that lower price is taken into account, those unattractive characteristics cease to have any effect on the likelihood of being able to secure a sale to a purchaser within a reasonable period of time.

First, Somerfield argument on saleability – the CC should have been indifferent between acquired and existing stores

21. The CC rejects the contention that the criteria adopted at 11.12 were unlawful or unreasonable or were not properly applied. There were good reasons for each of the decisions taken, on the facts relating to the local markets and on the prospects of achieving a timely and effective remedy for the SLC. Thus:

(a) in respect of the closed stores at Kelso and Littlehampton, the CC decided that the SLC could best be remedied by their sale and not the sale of the acquired stores;

(b) in respect of the three acquired stores at Filey, Poole Bearwood and Whitburn that Somerfield agreed should be sold, Somerfield had a full opportunity of raising arguments in the same way as it did in respect of

Johnstone, Yarm and Peebles as to why the existing store should be divested but it did not;

(c) the CC took full account of the reasons put forward by Somerfield as to why the SLC would be remedied by the sale of the existing stores at Johnstone, Yarm and Peebles, and concluded that given the likely similar saleability of existing and acquired stores, Somerfield could choose which to divest; and

(d) applying the same reasoning, the CC decided against the submissions of Somerfield in respect of the stores at Middlesbrough Linthorpe, Newark, South Shields and Pocklington.

22. There is no justification for a finding that these conclusions were beyond the bounds of reasonable judgment or that on the facts the only reasonable conclusions would have been to permit Somerfield simply to make its own decision as to which of the stores should be divested. Specifically, that is the case in relation to the conclusions in respect of the seven local markets referred to at (b) and (d) above, which are the conclusions challenged in the application.

23. Somerfield suggests [Skeleton, 29] that the CC's conclusions at 11.22 are no more than an inference based on a comparison of what is implied to be a very limited range of information relating to the characteristics of the stores, namely information relating to their financial performance, size, physical condition and amount of car parking.

24. That is not correct. As explained by Mr Clarke [32 to 36], the CC received a considerable amount of information relating to the acquired and existing stores, and on several occasions requested further information from Somerfield. By the time of reaching its remedies conclusions the CC had received and taken into account the following information relating to stores (where relevant): (i) size; (ii) tenure (i.e. freehold or lease);[6] (iii) rent and

[6] The CC did not, as is suggested by Somerfield [Skeleton, 34] "disregard ... the relative ease of disposing of freehold properties as opposed to leasehold". On the contrary, this consideration was

leasehold details; (iv) current condition; (v) car-parking (vi) refurbishment details; (vii) turnover, (viii) contribution; and (ix) acquisition cost.[7] The CC also knew whether any other bids had been received for the acquired stores when they had been marketed by Morrisons, and was well aware from its Stage 1 and Stage 2 analysis of the conditions of competition in each of the relevant local markets, including how far the acquired and existing stores were from competing stores and what the diversion ratios were from the acquired stores to their competitors.

25. Furthermore, the CC developed its understanding of the supermarket business and the way in which market participants might operate throughout the course of the inquiry. Indeed, two of the individuals involved in this inquiry (Mr Goodall, a member of the Inquiry Group, and Mr Roberts, the CC's Chief Business Advisor and Director of Remedies) already had prior experience of the supermarket sector that the CC was able to draw on in this regard [Clarke, 11-12].

26. Although it is not entirely clear, Somerfield also appears to suggest [Skeleton 27 and 33] that at least in relation to certain pieces of information, the CC could not know whether they increased or decreased the saleability of stores. Assessing the impact upon saleability of different characteristics of stores was a matter which the CC assessed in the light of all the information it had and the understanding of the grocery sector that it had developed through the course of the inquiry. The assessment reached by the CC was well within the margin of appreciation which must properly be afforded to it in these circumstances. For example, in the hypothetical illustration set out in paragraph 35, it is obvious that in the light of their different characteristics, Store A will be more attractive to potential supermarket operator purchasers

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taken into account. [

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[7] Much of this information can be located in Somerfield paper 223 [CC/1/3], and Somerfield's 'Note from Somerfield on the Remedies Notice' [S/29/515-542] and written submissions of 19 August 2005 [CC/1/4]. Somerfield also provided information relating to the acquired and existing stores in the store-by-store discussion in the second half of the remedies hearing [S/40/1019-1049].

than Store B. Somerfield is plainly wrong to suggest that these characteristics "do not go to saleability" [Skeleton, 34].

27. Somerfield further argues [Skeleton, 27] that if all the information before the CC relating to an issue has been supplied by it, then the CC is obliged to adopt Somerfield's conclusions in respect of that issue. That is a remarkable proposition. It is without foundation and should be rejected by the CAT without hesitation. Under its statutory and public law obligations, the CC must consider issues carefully and objectively. The CC cannot simply accept uncritically the conclusions of another person, particularly where that person is a party to a merger and has a commercial interest in the CC's decision.

28. In the circumstances, it was clearly open to the CC to specify that it was the acquired stores at Middlesbrough Linthorpe, Newark, South Shields and Pocklington that should be divested in order to remedy the findings of SLC made in relation to those local markets.

Second, Somerfield argument re: saleability – store characteristics only go to price

29. Somerfield's second argument, on saleability, which is linked to the first, as set out above, is, or appears to be, that the exercise of assessing *saleability* was irrelevant, because the store characteristics considered by the CC "go only to the consideration for the sale, not to saleability itself." [Skeleton, 30]. Somerfield also maintains [Skeleton, 35] that the CC could have granted Somerfield a choice of which store to divest within the initial divestment period, but that if, at the end of that period, the existing store had not been sold to an approved purchaser, a divestment trustee could be appointed to sell the acquired store at whatever price the market would bear, [

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[8] Somerfield's position appears ambivalent in relation to the powers of the divestment trustee. [

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30. But that course of action would be inconsistent with the CC's duty under ss.35 and 41 of the Enterprise Act to achieve as comprehensive a solution as is reasonable and practicable. Where the likelihood of finding a suitable purchaser within a reasonable timetable is materially higher for one store than for another store, the CC must have the right to require the divestment of the store in respect of which the likelihood is materially higher. All the time that a remedy is not implemented, consumers and the market are suffering the detrimental effects of the SLC.

31. A very important aspect of remedying an SLC (once found) satisfactorily is to remedy it quickly[9]. In the CC Guidelines on Merger References CC 2 [CC/1/7], it is emphasised at paragraph 4.16:

> "Clearly, given the need to protect customers from an SLC or any other resulting adverse effects of a merger, the Commission will tend to favour a remedy that can be expected to show results in a relatively short time period – so long as it is satisfied that the remedy is both reasonable and practicable and has no adverse long-run consequences."

32. Somerfield agreed the merger transaction on 25 October 2004 and it was referred to the CC on 23 March 2005. The CC's Report was published on 2 September 2005. Even if final undertakings had been agreed by [**CONF**], the initial divestiture period of [**CONF**], that is to say, the period within which Somerfield was required to sell the stores, would not have expired until the beginning of [**CONF**], [**CONF**] after the merger. From October 2004, as found by the CC and no longer challenged by Somerfield, consumers in 12 local markets have been suffering the detriment of the SLC. From the perspective of those consumers, it is highly desirable that a sale be achieved within the initial divestiture period [**CONF**] and, ideally, as quickly as possible. The possibility of a divestment trustee having

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[9] This basic point was accepted by Somerfield during the inquiry when it repeatedly made the point that divestment of freehold stores would remedy the SLC more effectively than sale of leasehold stores because it would allow sales to be achieved more quickly ([**CONF**]; [S/40/1036/line 5]; [S/40/1040/line 1-22]; [S/40/1045/lline 23]).

to be appointed is very much a worst case scenario. Somerfield's arguments entirely ignore this consideration.

33. The characteristics of an unattractive store that reduce saleability will not be eliminated simply by reducing the sale price (whether during or following the initial divestiture period). Unattractive characteristics may deter all potential purchasers for a number of reasons. In the light of its business model, a supermarket operator may want only certain types of store and may not be interested in purchasing a store outside that profile even if it is offered at a very low price.

34. It is not simply a question of whether it would, after a period of time (which may be considerable), be possible to find one willing purchaser for a store at a low price. The issue for the CC was to weigh up the consequences of allowing Somerfield to choose or specifying which store should be divested. The SLC had to be remedied: the question was whether there was a significantly greater risk of *not* attracting a suitable purchaser within a reasonable time frame for the existing store than for the acquired store.

35. It may be helpful to illustrate this by taking an example: Store A is large, highly profitable, is in excellent current condition having been recently renovated, and has a reasonable rent, good car parking facilities, room for expansion and no competitors located nearby. Store B, on the other hand, is small, loss making, in very poor condition as a result of having received no investment for some time, and has an unfavourable rent, no or limited car parking facilities, no room for expansion and is situated next to a large one-stop-shop owned by a competitor. It is likely that Store A will attract more interest from more potential purchasers and is likely to be divested more quickly and efficiently. The prices offered for the two stores are likely to be very different, but that does not mean that their respective characteristics are irrelevant to the assessment by the CC of their comparative saleability.

36. Somerfield itself stated that certain stores are extremely difficult if not impossible to sell to other supermarket operators as a result of their

characteristics. Of the 115 stores purchased from Morrisons, Somerfield commented that, had it not purchased them all as a package, [

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In relation to the acquired store in Johnstone, one of the three local markets in which the CC concluded that Somerfield should have the choice of divesting the acquired or the existing store, [

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37. Somerfield itself appears to acknowledge that the CC had discretion to treat acquired and existing stores differently for the purpose of divestment on the grounds of divestment potential which they described as "speed and achievability" [NoA, paragraph 103, footnote 32]. Furthermore, it is notable that many of Somerfield's own comments during the course of the inquiry appeared to recognise that it was likely to take longer to sell unattractive stores, even if they were sold at a low price [**CONF**]. The clearest example is its arguments in the remedies hearing in relation to [**CONF**], mentioned above [**CONF**], but there are numerous other examples (for example, [**CONF**]; [S/40/1013-1014]; [**CONF**]; [**CONF**]; [S/40/1040/line 1-22]; and [S/40/1046/line 14-19]).

38. Taking all the above factors into account, Somerfield's case that store characteristics only go to price is clearly unsustainable. The CC was correct in its decision to consider and evaluate the relevant characteristics in deciding how to discharge its remedial functions under the Enterprise Act.

[10] Further, in two instances, Somerfield suggested that it would be possible to sell a store but that a sale would only be possible or would be more likely to an independent operator or a discounter (i.e. because it was unclear or unlikely that operators within the competitor set would be interested) [S/40/1035/line 4; S/40/1046/line 11;].

III. The LADs issue

39. In relation to the issue of the LADs, there are only two main points of dispute between the parties. These relate to whether the CC's decision to exclude the LADs from the set of suitable purchasers for the first [**CONF**] of the initial divestiture period [**CONF**] was unreasonable or otherwise unlawful:

   - as a result of the CC's approach of taking into account all five pieces of evidence referred to in paragraph 6.43 of the Report; or

   - in the light of the results of the competitor impact analysis.

The CC's approach of taking into account all 5 pieces of evidence referred to in paragraph 6.43 of the Report

40. Somerfield challenges the CC's decision to exclude the LADs from the set of suitable purchasers during the first [**CONF**] of the initial divestiture period on the basis of the five pieces of evidence referred to in paragraph 6.43 of the Report. Somerfield argues that "only the competitive impact is persuasive but it does not support the conclusions which the CC seeks to draw" [Skeleton, 71].

41. The CC notes at the outset that Somerfield's challenge is to the weight placed by the CC on different pieces of evidence, some of which were in the nature of technical economic evidence. Such a challenge is generally impermissible in a review application. The courts have repeatedly stated that while it is for the review court to determine whether a consideration is or is not relevant, unlike in an appeal, in a review it is generally for the decision maker to attribute to the relevant considerations such weight as it thinks fit (*Tesco Stores Ltd v Secretary of State for the Environment* (HL) [1995] 1 WLR 759, 764G-H; *City of Edinburgh Council v Secretary of State for Scotland* [1997] 1 WLR 1447, 1458G-H; *R v Director General of Telecommunications, ex p Cellcom Ltd* [1999] COD 105, 27).

42. In any event, Somerfield's criticism of the CC's approach is misguided.

43. Somerfield's essential argument is that the competitor impact analysis was "the only one serious piece of quantitative evidence", and the remaining "pieces of evidence were "weak, devoid of real content, and/or inconclusive... and it was perverse of the CC...to attach more weight to them collectively than to the competitor impact assessment" [Skeleton, 45]. Before the CC addresses those harsh, and in the CC's submission, wholly unwarranted criticisms – the CC can confirm that there was no question of attaching a collective weight to four pieces and balancing them against one, the reasoning in the Report is clear on the point - it may be helpful to refer to recent case law of the CAT.

44. Somerfield's observations have some similarity with those of Aberdeen Journals in *Aberdeen Journals Limited v OFT* ([2003] CAT 11, 126f), in which Aberdeen Journals argued that there was a strict hierarchy of evidence under which 'objective' economic evidence should be accorded greater weight than other types of evidence. The CAT rejected that proposal, and instead suggested that decisions will often best be taken by making effective use of all available information and looking at the different pieces of evidence 'in the round'. *Aberdeen Journals* was an appeal under the Competition Act in which the CAT was required to form its own view as to the weight to be placed on different pieces of evidence, rather than a judicial review where weight is a matter for the original decision maker. But the CC's approach in this inquiry was similar to that of the CAT in *Aberdeen Journals*, and with good reason.

45. Where several pieces of evidence are available, it is generally unwise to take a decision on the basis of one piece of evidence only: a single piece of evidence is very rarely a perfectly precise and reliable indicator of reality. Indeed, if a decision maker adopted that approach, it could potentially be criticised for ignoring relevant evidence. That is true as much for economic evidence as for other types of evidence. Indeed, in its challenge (now abandoned) to the CC's conclusions at Stage 2, Somerfield argued strongly that the CC's economic evidence should have been 'sense checked' against other pieces of evidence (which had in fact been done by the CC).

46. The CC regarded the competitor impact analysis as a valuable piece of evidence, and placed appropriate weight on it. But this single piece of evidence was not regarded as being perfect, particularly in the light of the fact that the sample size was small in respect of some operators. It was entirely reasonable for the CC to have regard to those other pieces of evidence, and to assess the position in the round: conclusions are generally soundest when supported by several pieces of evidence. The CC considered that, when looked at in the round, and individually, all the evidence pointed towards the same conclusion [Clarke, 112].

47. Somerfield attempts to argue that the other four pieces of evidence were all so flawed that it was wrong for the CC to place any weight on them. But while it is true that, just like the competitor impact analysis, none of the other four pieces of evidence are perfect, Somerfield's criticisms are significantly overstated.

The LADs' range of products

48. Somerfield argues that "having chosen to include or exclude operators in an approved competitor or divestee set on the basis of the competitive constraint that they offer to Somerfield, it was *wholly illogical* for the CC then to differentiate between competitors on the basis of their business model or consumer proposition" (emphasis added).

49. Paragraph 6.43 of the Report refers to the fact that the LADs offer less than 20 per cent of the range of most other retailers, and that two of the LADs sell predominantly own-brand items. Mr Clarke elaborates [115-116] on the other significant differences between the LADs' business model and competitive offering and those of operators within the competitor set. Those differences were highlighted by Somerfield itself during the inquiry.

50. Generally, the degree of competitive constraint between two undertakings with very similar offerings is likely to be higher than that between two undertakings with offerings that are significantly different from one another. It was entirely uncontroversial for the CC to have regard to the differences between the

offerings of the LADs and those of other operators in assessing the degree of competitive constraint between them.

51. Further, the degree of competitive constraint exerted by different product offerings is the basis on which product markets are defined. In the section concerned with product market definition, the CC's guidelines state that one piece of information that can be useful for defining markets is "product characteristics such as physical properties and intended use" [CC/1/6/2.16]. Other competition authorities also have regard to qualitative evidence of this type, as well as quantitative evidence. It is wrong for Somerfield to suggest that qualitative evidence should be ignored wherever quantitative evidence is available: the two types of evidence are each useful in their own right. The CC's approach was therefore entirely consistent with its own guidelines and the approach of other competition authorities.

<u>The views of supermarket operators</u>

52. The CC accepts that the views of supermarket operators as to the identity of their competitors are to be treated with some caution (and also took this view during the inquiry). Nonetheless, Somerfield is wrong to suggest that the CC should have entirely ignored them.

53. The CC's guidelines suggest that responses from competitors to questions about customer behaviour and the hypothetical monopolist ("SSNIP") test are relevant in determining the scope of a product market [CC/1/6/2.16]. In the context of Competition Act appeals, the CAT has also recognised that the views of undertakings in the market are capable of being of significance (*Aberdeen Journals,* paragraphs 103 to 104). Had the CC entirely ignored the views of supermarket operators, it would have been disregarding a relevant consideration.

54. Further, the points made by Somerfield in paragraphs 62 and 63 of its Skeleton are without merit. In relation to paragraph 62, it should be noted that the questionnaire expressly asked supermarket operators who they regarded as competitors *for different sizes of store* (and not only in respect of one-stop-shops). In relation to paragraph 63, the CC regarded an observation that the

LADs did not consider Somerfield to be a competitor to be, at least, a factor to be considered as part of its overall assessment. The impact of the LADs on Somerfield was, indeed, fully considered as part of that assessment.

The NOP survey results

55. Somerfield argues that "the CC ought not to have had any regard to the NOP survey when determining the range of potential divestees" [Skeleton, 69] because the NOP survey results have a "fundamental flaw ... [because they] are not adjusted for matters such as store size and distance" [Skeleton, 65].

56. In any individual market, factors such as store size and distance will have an effect on the diversion ratio results, but one of the advantages of taking an average result from a number of different markets is that it tends to reduce the impact of such local factors [Davies, 69-70].[11]

57. Somerfield argues, however, that the *average* results remain biased because "there are fewer LADs than other stores in the areas surveyed (nationally, Tesco has more stores than all the LADs put together) and thus on average, there are fewer of them close to a surveyed store" [Skeleton, 65].

58. The CC is aware, and was aware during the inquiry, that the survey results are unadjusted for factors such as size and distance, and should be viewed accordingly. However, there is no reason to suppose that the survey results are so biased against the LADs (or otherwise generally unrepresentative) that they should have been entirely disregarded.

59. For example, in its Skeleton (footnote 33) Somerfield has set out calculations suggesting that, within certain markets, [**CONF**] stores are more likely than LADs stores to be situated within 1 and 5 minute drivetimes from the surveyed acquired store (although the results, particularly in relation to 1 minute, are not hugely different). However, the *average* drivetime to the nearest LADs store (across all the isochrones in which a LAD was present) is

[11] Contrary to the suggestion at paragraph 67 of Somerfield's Skeleton, Mr Davies did not 'turn a blind eye' to the evidence from the three markets in which the diversion ratio to a LAD was high. Rather, he noted [66] that the CC did not disregard the evidence from those markets and the Report set out the average results taking them into account.

approximately [**CONF**] minutes, only slightly longer than the average drivetime of [**CONF**] minutes to the nearest [**CONF**] store (across all the isochrones in which a [**CONF**] was present).[12]

60. Furthermore, the distance of an 'alternative' store from a surveyed store is only one of the factors that affect the diversion ratio. Another is the size of the alternative store: other things being equal, larger stores are likely to exert a greater level of competitive constraint (and therefore have a higher diversion ratio) than smaller stores. Returning to Somerfield's comparison between [**CONF**] and LADs, on average, the nearest LADs store (across all the isochrones in which a LAD was present) was, at [**CONF**] square feet, more than double the size of the nearest [**CONF**] store (across all the isochrones in which a [**CONF**] was present), at [**CONF**] square feet. This difference in size might reasonably be expected to tend to counteract any bias produced by [**CONF**] stores being on average slightly closer than LADs stores to the surveyed store.

61. This is not to suggest that, across all the markets surveyed, and in respect of all operators, the different variables perfectly counterbalance one another; indeed, this is highly unlikely. However, it does suggest that there is no reason to suppose, as suggested by Somerfield, that the results were hugely biased against the LADs and in favour of [**CONF**], and fundamentally flawed for that reason.

62. The CC was conscious that the NOP survey results were unadjusted, and were intimately familiar from its experience during the inquiry of how different considerations tended to affect diversion ratios. In those circumstances, it was not unreasonable for the CC to have had regard to the NOP survey results when looking at all the evidence in the round. As noted in paragraph 6.43 of the Report, the results showed that nearly twice as many shoppers ([**CONF**]) would switch to a [**CONF**] store than would switch to a LADs store ([**CONF**]), should an acquired store cease to be available.

[12] Calculated using the drivetime data supplied by Somerfield to the CC.

The Mintel report

63. In relation to the Mintel report, Somerfield may well be correct that one of the explanations for the results in the Mintel report is that there are more stores operated by the major chains than are operated by the LADs. However, another reason is also likely to be part of the explanation, namely that, as a result of their different offering, the nature of the shopping mission of a typical customer of a LAD is different from that of a typical customer of one of the operators within the set of suitable purchasers. Somerfield itself made this point to the CC during the inquiry [S/37/727], and the evidence from the Mintel report is entirely consistent with this being the case, and it was in no sense unreasonable for the CC to have regard to it.

The results of the competitor impact analysis

64. In reaching its conclusions relating to the set of suitable divestees during the first [**CONF**] of the initial divestiture period [**CONF**] the CC took into account the competitor impact analysis results and regarded it as a valuable piece of evidence, but also took into account the four other pieces of evidence discussed above. Somerfield argues that the CC should have had regard only to the competitor impact analysis results. However, very significantly, at no point in either the NoA or its Skeleton argument does Somerfield argue that the competitor impact analysis supports the conclusion that the LADs exert a significant degree of competitive constraint on Somerfield or Kwik Save.

65. The results in fact show the opposite. The competitor impact results set out in Appendix B show that the LADs exert a relatively weak degree of competitive constraint on Somerfield and Kwik Save.[13] They also show that the degree of competitive constraint exerted by the LADs is significantly less than that exerted by many of the other operators included within the set of suitable purchasers for the [**CONF**] of the divestment process.

[13] As is evident from the Report, the CC took into account both the Somerfield and Kwik Save results. As to the different competitive impacts *of* (as opposed to *on*) Somerfield and Kwik Save [Skeleton, 59], in particular *vis-à-vis* the LADs, the CC's position is set out in paragraph 6.45 of the Report.

66. Somerfield's argument is in fact a narrow one based on the alleged inconsistency of treating the LADs differently from two other supermarket operators. Specifically, Somerfield argues that there "is a clear inconsistency in treatment because "the LADs are shown by the CC's analysis to exert a similar constraint" on Somerfield to that of [**CONF**] and [**CONF**]" [Skeleton, 50].

67. But this allegation of inconsistency is flawed.

68. The competitor impact analysis provided results for different operators across a spectrum. The nature of the reasoning under challenge is a decision as to where to draw a line within that spectrum which is a matter of judgment. When carrying out this type of line-drawing exercise, it will often by the case that the results immediately above and below the line will be relatively close. However, a line must be drawn somewhere and an approach that extended the line to include the next result whenever it was close to the previous result may result in the line being drawn in an inappropriate place.

69. Further, as already noted above, the competitor impact analysis results were not regarded as being perfect or capable of providing a firm basis on their own for the CC's conclusions: the CC looked at all the evidence in the round. That approach was particularly appropriate in relation to the results on which Somerfield focuses, which were based on a small sample.

70. In respect of [**CONF**], there were no Kwik Save data points available and only two Somerfield data points available. In respect of [**CONF**] there were only two Kwik Save data points available and five Somerfield data points.[14] The results for these operators are therefore far less statistically reliable than those for other operators in respect of which more data points were available. Consequently, it would not have been appropriate for the CC to base its assessment in relation to **[CONF]** and **[CONF]** solely on the basis of their limited competitor impact analysis results, and the CC did not do so. It is even more inappropriate for Somerfield to argue that the LADs should be

[14] These five results, when adjusted, were [**CONF**] higher than the results for Lidl, and [**CONF**] higher than the results for Aldi.

included within the set of suitable purchasers for [**CONF**] solely because their competitor impact analysis results were similar to the limited results available for [**CONF**] and [**CONF**].

71. In general, the absence of evidence of a difference is not evidence of absence of difference. The absence of a statistically significant difference, particularly in a relatively small sample, suggests that one should have regard to alternative sources of evidence to see whether the things under consideration are really the same or whether it is simply the case that one piece of evidence is inadequate to distinguish between them. The CC did exactly this, and the other evidence suggested that the LADs had a business model that was significantly different from [**CONF**] and [**CONF**] and were regarded as different by customers.

72. In paragraph 55 of its Skeleton, Somerfield argues that "it is obvious that the competitive impact of the LADs ought to have been considered collectively, and the Netto data included in that analysis". This argument is made in response to the comment of Mr Davies that, in respect of the Somerfield results there was only one data point available in respect of Netto, it is not possible on the basis of that single data point to form any reliable view of the impact of a new opening by Netto (he did not state that it should be 'disregarded').[15]

73. This is the first time that Somerfield has proposed a *collective* assessment of the impact of the LADs on Somerfield stores, incorporating the single Netto data point. The implication appears to be that such an assessment would support Somerfield's case. In the light of Somerfield's proposal, the results of a collective assessment for the LADs are set out below (using the figures in and underlying data from table 1 of Appendix B).

[15] Contrary to the suggestion by Somerfield [53]. Nor was the single Netto data point disregarded in the Report: it was set out in Appendix B alongside all the other results and was expressly referred to in paragraph 6.43(a) of the Report.

Competitor fascia	*No. openings*	*Adjusted average for LADs treated individually (as set out in Table 1 in Appendix B)*	*Adjusted average for LADs treated collectively*[16]
Safeway			
Morrisons			
Tesco			
Asda			
Sainsbury's		CONF	
Waitrose			
Co-Op			
Budgens			
LADs			
Marks & Spencer			

74. As may be seen, only [**CONF**] has a lower result that the LADs collectively, and it too was not included in the set of suitable purchasers for the [**CONF**] period. Further, in comparison with the collective result for the LADs, the result for [**CONF**] is [**CONF**] higher and for [**CONF**] higher. The collective assessment proposed by Somerfield does not therefore support its case: rather, it goes against it.

IV. CONCLUSION

75. In the CC's submission, the remedies decided on by the CC follow from its most careful analysis of conditions of competition in the relevant local markets. They are directed to securing for the benefit of consumers in those markets a timely and effective remedy of the SLC resulting from the present merger. The Report is fully reasoned. Somerfield's criticisms of the CC's methodology have been rebutted. The CAT is respectfully asked to conclude that in respect of each of the two issues, choice of store and identity of

[16] All the adjusted figures in the fourth column change when treating the LADs collectively because this involves re-estimating the econometric model (Table 14 in the Annex to Appendix B to the Report) upon which the adjusted-impact calculations in Table 1 of Appendix B are based (the formula for calculating these adjusted impacts is described in the footnote to Table 3 of Appendix B). In addition to treating the LADs collectively (and therefore as a single fascia rather than as 3) a single size of store variable for the LADs is used (whereas previously there was 1 for each LAD) in the revised econometric estimation and adjusted-impact calculation. The alternative approach would have been to devise a weighted-average of the adjusted impacts for the LADs in Table 1 of Appendix B but this would produce a less reliable estimate of the collective impact of the LADs.

purchaser, the CC's decision is lawful, is not perverse and has taken into account all relevant and material considerations.

2 December 2005

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