

# PARTIES' STATEMENT OF FACTS

CE/9262/10

## Proposed joint purchasing co-operation agreement between Makro Self-Service Wholesalers Limited and Palmer & Harvey McLane Limited

---

Please note that square brackets indicates figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

---

### 1. THE PARTIES

1.1 Makro Self-Service Wholesalers Limited (**Makro**) is a membership only, business-to-business, cash and carry supplier with a national network of 30 store locations nationwide, and is part of the Metro Group AG, an international group in the wholesale sector. Makro is active in the supply of fresh, chilled and frozen foods, confectionery, soft drinks, crisps and snacks, grocery, alcohol, clothing, toys, furniture, and related goods. As part of its normal operations, Makro is in the process of setting up a delivery service that will deliver to foodservice customers.

1.2 Palmer & Harvey McLane Limited (**P&H**) is the largest independent wholesale supplier in the UK. It is active in the distribution and delivered wholesaling of tobacco, confectionery, soft drinks, crisps and snacks, grocery, alcohol, chilled and frozen foods and related goods, to independents, multiples retailers, forecourts and mini-multiples, delivering to customers from a national network of 13 delivery locations.

### 2. THE PROPOSED CO-OPERATION AGREEMENT

#### Creation of PalMak

2.1 Makro and P&H (**the Parties**), propose to enter into a joint purchasing co-operation agreement (**proposed co-operation agreement**) with respect to selected products in the UK.

2.2 The proposed co-operation agreement between the Parties would be implemented through a jointly-owned service company (**PalMak**) which would be supported through funding and seconded employees from the Parties.

### **Terms of the proposed co-operation agreement**

2.3 Through PalMak, the Parties would jointly negotiate purchase conditions with certain agreed suppliers, for food and other products (excluding tobacco products) including the joint negotiation of discounts and overall promotional contributions.

2.4 The proposed co-operation agreement will initially seek to improve the least favourable terms offered by a supplier to one of the Parties to match the most favourable terms offered by that supplier to the other party (**the initial target**). [ ]; this means that the benefit of the initial harmonisation of buying terms will be [ ] between the Parties.

2.5 The agreement provides for the calculation of [payment] to be made on a quarterly basis, [ ].

2.6 The calculation of the [payment] is based on the level of purchase achieved with a particular supplier in aggregate. Therefore, to the extent that [one] Party purchases multiple products from the supplier, the [other] Party will not be able to monitor the former purchasing patterns disaggregated at a single product level.<sup>1</sup>

2.7 Once the initial target is achieved in relation to a supplier, the Parties' objective would be to continue to seek an improvement to the terms of supply. [ ].

2.8 The discounts covered by the proposed co-operation agreement will include, subject to specific exceptions noted below, all discounts and rebates received by Makro or P&H as a result of their respective purchases from the supplier.

---

<sup>1</sup> Please see paragraph 7.7 to 7.9 of the Short-form Opinion regarding a modification to this aspect of the proposed co-operation agreement.

2.9 The joint negotiation of promotional contributions will be limited to the overall contribution to be made by a supplier, expressed as a percentage of the turnover achieved by the supplier with Makro or P&H (as appropriate). All other matters, other than the size of the overall promotional contribution, would be a matter for bilateral negotiation between the supplier and the individual purchaser. Accordingly, the joint negotiations would not include a detailed specification of individual promotional activities or the amounts to be devoted to promotional activities. Nor would they address the number, type or timing of any promotions.

### **Exclusions to the proposed co-operation agreement**

2.10 The proposed co-operation agreement will exclude suppliers where the Parties (taken together) have a significant presence (that is, where suppliers rely on the Parties for more than 22 per cent of their sales by value to customers in the UK, such that the suppliers could be deemed to be economically dependent on the Parties).<sup>2 3</sup> Accordingly, due to P&H's significant position in tobacco, the proposed co-operation agreement will exclude all tobacco products and suppliers.

2.11 The proposed co-operation agreement will specify that each party will be free to conduct additional negotiations with the selected suppliers as to matters outside the scope of the agreement, or to conduct purchase negotiations with any other supplier, independently of PalMak. The outcomes of any such negotiations will be kept confidential from the other party.

2.12 Further, matters relating to sales conditions, selling prices, strategy and competitive behaviour, and any other business decisions outside the specified scope of the collaboration will be conducted independently, and no such information will be exchanged between the Parties.

2.13 Finally, the proposed co-operation agreement excludes any information in relation to specific promotional activity, international discounts that result

---

<sup>2</sup> The Parties state that that they have chosen this figure as it is based upon the European Commission's evaluation of dependency in past merger control cases (See Rewe/Meinl, Case M.1221, decision of 3 February 1999).

<sup>3</sup> Please see paragraph 7.2 to 7.4 of the Short-form Opinion regarding a modification to this aspect of the proposed co-operation agreement.

from agreements established with other companies within the Parties' groups, and/or credit insurance arrangements.

2.14 Accordingly, PalMak will not be included in negotiations with suppliers any of the above activities.

### **Exchange of information**

2.15 The proposed co-operation agreement provides that any information shared between the parties will be the minimum required for effective operation of the arrangement.<sup>4</sup> No forward-looking information or information regarding downstream commercial parameters will be exchanged. Information will only be disaggregated to the extent required for the effective operation of the agreement.<sup>5</sup> The Parties' purchasing patterns tend to be stable historically. Although the principal deal negotiations take place annually, it is likely that supplementary negotiations will take place during the year (for example, in response to a supplier's demand for increased prices on some or all of its product lines). Nonetheless, the Parties would seek to ensure, so far as practical, that information is only exchanged annually.

## **3. MARKET DEFINITION**

3.1 The Parties operate within the wholesale grocery market. The grocery retailing industry has been examined extensively in recent years by both the OFT and the Competition Commission (CC).<sup>6</sup>

3.2 The Parties submit that the supermarket multiples are the major players in procurement and distribution in the grocery sector. Joint purchasing operations provide a means by which other operators can improve their purchasing terms through combining the scale of their purchases.

3.3 The Parties refer to a survey prepared for the CC's market investigation on the supply of groceries in the UK (Groceries Report) which indicates that:

---

<sup>4</sup> All the following information will be provided on an aggregated prior year annual discount basis: [ ].

<sup>5</sup> For example, [ ].

<sup>6</sup> For recent OFT examples, see Anticipated acquisition by Co-operative Group Limited of Somerfield, 20 October 2008. For CC examples, see 'The supply of groceries in the UK market investigation', April 2008 (Groceries Report).

## Upstream

- 45 per cent of suppliers claimed that the four main supermarkets accounted for more than 50 per cent of their revenue
- fewer than 5 per cent of suppliers claimed that wholesalers and symbol groups accounted for more than 50 per cent of their revenue, and
- over 75 per cent of suppliers claimed that wholesalers and symbol groups accounted for less than 20 per cent of their revenue.

## Downstream

- Large grocery retailers accounted for 75 per cent of all grocery retailers' turnover, and
- independent, non-aligned retailers and forecourts accounted for 14 per cent of all grocery retailers' turnover.

3.4 The Parties state that in addition to the Parties' proposed co-operation agreement there are several joint purchasing operations aggregating the purchases of independent wholesalers and/or retailers, including Spar, Landmark, NISA, and Musgrave Budgens Londis (MBL).

## 4. THE PARTIES' REQUEST AND SELF ASSESSMENT

4.1 On 4 February 2010 the OFT received a request from the Parties to provide guidance on the application of the European Commission's Guidelines on Horizontal Co-operation Agreements (**the Horizontal Guidelines**)<sup>7</sup> to a joint purchasing cooperation agreement between the Parties.

4.2 In particular, so that the Parties may be able to self-assess whether the proposed co-operation agreement could have the object of preventing, restricting or distorting competition, they have requested clarification from the OFT regarding the following three aspects of the Horizontal Guidelines:

- the identification of a downstream safe harbour for buying co-operations

---

<sup>7</sup> Commission Notice on the applicability of Article 101 to horizontal co-operation agreements [2001] OJ C3/2.

- the degree of transparency as to input costs at which a buying co-operation may give rise to adverse effects on downstream competition, and
- whether, in principle, the OFT considers that a joint negotiation of promotional contributions may give rise to competition issues.

4.3 The Parties consider that the proposed co-operation agreement has no appreciable effect on competition, and indeed, will be pro-competitive to the benefit of the Parties' customers and consumers.

4.4 In relation to the upstream (purchasing) markets the UK competition authorities have not previously defined the boundaries of the procurement market for groceries. However, the European Commission has considered this market and held that the product market comprised the sale of daily consumer goods by producers to customers such as wholesalers, retailers and other firms purchasing directly from the industry. In *Rewe/Meinl*<sup>8</sup> the Commission considered that the market could be broken down into groups of products as set out in the table below.<sup>9</sup> While the parties do not consider it necessary to define the relevant product and geographic market and would like to leave the question open, they will subsequently benchmark their procurement volume against the total sales volume available in the UK (production **minus** exports **plus** imports) in the categories given hereinafter.

<b>Relevant markets</b>
Meat, sausages + poultry
Bread and Pastries
Dairy products (+ eggs)
Fresh fruit and vegetables*
Beer, wines, spirits & soft drinks
<b>Soft drinks</b>
<b>Beer</b>
<b>Wine and spirits</b>
Hot Beverages§
Confectionary
Basic foodstuffs + preserved food
<b>Basic foodstuffs</b>

<sup>8</sup> M.1221

<sup>9</sup> Note that in this case the Commission considered poultry and eggs as a separate category, but in the above table, these products are included in the meat and dairy categories respectively.

<b>Preserved Food</b>
Frozen food (incl. ice cream)
Baby food
Pet foods
Body care products*
Detergents, polishes, cleaning products
Other drugstore products*
Other non-food products normally found in supermarkets

- 4.5 Accordingly, on this basis the Parties state that there is no effect on upstream (purchasing) markets because their combined share on all such markets is below [ $< 10$ ] per cent, and in most cases substantially below that figure, and therefore well within the 15 per cent safe harbour market share set out in paragraph 130 of the Horizontal Guidelines.
- 4.6 With respect to downstream (selling) markets, the Parties state that the relevant product market should not be limited either on the supply side to independent wholesalers or on the demand side to independent convenience retailers. Rather, they consider that the supply side should include other companies performing a wholesale function and competing with independent wholesalers at customer level (including subsidiaries performing a wholesale function) and that the demand side should include other types of customer (such as foodservice companies) supplied as part of the same business activity.
- 4.7 The Parties state that, on any view, there are no adverse structural indicators on such markets. If one refers to the IGD Report,<sup>10</sup> their overall combined share of independent wholesale grocery sales is [10-15] per cent (and should sales by subsidiaries of suppliers fulfilling wholesale functions be included, then this share would be lower). In addition, the combined sales share of the activities that will be subject to the proposed co-operation agreement is lower still (under [ $< 10$ ] per cent of wholesale grocery sales as defined by the IGD Report). On the basis of the narrowest possible downstream frame of reference - the wholesale supply by independent wholesalers to independent and convenience retailers - the Parties' combined share, as stated in the IGD Report, is [15-20] per cent. For the reasons stated above, the Parties consider that the relevant market is much broader and, on that basis, their shares would be much lower.

---

<sup>10</sup> IGD's report on 'UK Grocery and Foodservice Wholesaling Outlook 2009', April 2009.

4.8 The Parties have not provided any market share information at a regional or local level. This is because the Parties consider that the relevant geographic market should be national, as grocery wholesalers have a broader reach and that local markets often overlap, meaning local markets are of less relevance.

4.9 In addition, the Parties submit that there is no reason to anticipate that any transaction between them would give rise to adverse unilateral effects, as they are not close competitors and do not benchmark against each other.

4.10 Further, the Parties state that the proposed co-operation agreement will not lead to a level of cost commonality or transparency between them that may distort downstream competition because:

- the degree of commonality and transparency is limited as a proportion of total costs (as the costs affected by the proposed co-operation account for less than [45-55] per cent of total costs incurred by both Parties)
- margins are variable across products and over time, and
- there is limited customer price transparency, as neither Party's pricing structures are rigid, but both operate arrangements in which some pricing offers are public and others are confidential.

4.11 Finally, the Parties state that they will be constrained by other competitors who do not form part of the arrangement, and will therefore ensure that downstream customers and consumers will benefit from the commercial advantages secured through the proposed co-operation agreement.

## **5. REQUEST FOR CLARIFICATION – UNRESOLVED ISSUES**

### **Downstream safe harbour**

5.1 The Parties state that the Horizontal Guidelines refer to a safe harbour market share on both the upstream (purchasing) and downstream (selling) markets of 15 per cent for buying co-operations. The Parties note that a report by RBB Economics<sup>11</sup> prepared for the OFT considered that there is

---

<sup>11</sup> OFT863 'The competitive effect of buying groups', RBB Economics (January 2007).

scope to increase the safe harbour employed for the share on the downstream (selling) market to 25 per cent. This view was reached on the basis that a buying co-operation should not be expected to have greater effects on competition than a full merger and that a merger creating a market share of less than 25 per cent would ordinarily be regarded as unobjectionable – and so there should be no grounds for objecting to a buying co-operation between parties with a combined market share on the downstream market lower than 25 per cent.

5.2 The Parties note that the OFT has to date neither endorsed nor rejected RBB's conclusions. However, although they consider the relevant market to be much broader (and their shares consequently to be lower), given the fact that on the basis of the narrowest possible downstream frame of reference, the IGD Report indicates that the Parties would have a combined share of [15-20] per cent, they have requested clarification from the OFT regarding the assessment of the proposed purchasing agreement.

### **Cost transparency**

5.3 The Parties have requested further clarification as to under what conditions the issues of cost commonality or cost transparency adversely affect competition. In particular, the Parties cite two scenarios:

- in situations where the Parties' market shares are within the safe harbours. In such cases, the Parties submit that even a high degree of cost commonality/transparency should not adversely affect the assessment because the market structure itself is sufficient to exclude any adverse effects. The Parties consider that this is consistent with the Horizontal Guidelines and the RBB Report, and
- in situations where the parties' market shares are outside the safe harbours. In such cases, the Parties state that the question of cost commonality should be considered in light of the operation's impact on the parties' pricing behaviour. Where cost commonality is high, this would indicate a likelihood of price co-ordination. However, the Parties submit that where factors exist which exclude this risk, then cost commonality/transparency should not be problematic. Factors which the Parties submit would indicate that cost commonality/transparency will not lead to an adverse effect on downstream pricing, include: lack of competitive proximity between the parties, limited scope of the co-

operation, variability in product margins both across products and over time, limited pricing transparency and the importance of promotional activity determined by the parties independently.

#### **Inclusion of promotional contribution into the proposed co-operation agreement**

- 5.4 The Parties have requested clarification on whether, as a matter of principle, the OFT considers that joint negotiation of promotional contributions of the sort contemplated by the Parties may raise competition issues.
- 5.5 PalMak will negotiate annually a contribution to promotional activities on behalf of both Parties in the form of a percentage discount [ ]. The Parties will then individually decide how this contribution is to be used for their own promotions, that is, the number, type or timing of any promotions. All matters, other than the overall size of the contribution would thus be discussed bilaterally between the supplier and the individual purchaser.