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## Back to the future

### FINDINGS OF THE COMPETITION COMMISSION'S GROCERIES INQUIRY

*In May 2006, the UK Office of Fair Trading (OFT) referred the groceries sector to the Competition Commission, highlighting concerns that included pricing, the effect of buyer power on the viability of wholesalers, and the linked issues of supermarkets' land holdings and the planning system. In April 2008, the Competition Commission rejected most of the OFT's concerns. Instead, it largely re-addressed issues it had focused on in its 2000 supermarkets inquiry, where its recommended remedies had either not been imposed, or had not been as effective as it had hoped.*

The Competition Commission's Inquiry into Groceries, finalised in April 2008, was one of the most extensive (and expensive) ever carried out in the UK. The Commission investigated more than 15 main parties, received over 700 submissions, and held 81 meetings. Yet the final results bore only limited connection to the concerns that had prompted the OFT to trigger the investigation. The Commission instead proposed remedies which appeared to be inspired by unfinished business from the 2000 supermarkets inquiry.



Even the origins of this inquiry were fraught with controversy. In 2005, the OFT decided not to make a reference; but the Association of Convenience Stores (ACS) appealed. Late that year, the OFT began a new investigation based on the ACS's concerns, and in May 2006 announced that it had reasonable grounds to suspect that there were several features of the market that prevented, restricted or distorted competition. These features were:

- the planning system, which the OFT considered might limit the scope for new entry;
- retailers' land holdings (which the OFT thought might reinforce their position in certain areas), together with practices – such as restrictive covenants – which might have an anti-competitive effect;
- retailers' buyer power, which might undermine the viability of alternative business models, including wholesale distribution to convenience stores; and
- aspects of retailers' pricing behaviour, including below-cost selling and local price variations.

In the event, the Commission was broadly positive about the degree of competition in, and the overall consumer benefits provided by, the groceries sector. It only found substance in the above concerns in relation to the interplay between planning and land holdings, and proposed specific remedial action with respect to a group of land practices. However, the major thrust of the Commission's remedies and recommendations related to issues not raised by the ACS.

## AFTER YOU

The planning regime provides a mechanism by which competing claims on land use can be balanced. Its operation can be costly and complex. The “sequential test” states that a new retail site must be located in the town centre, unless no such site is available, in which case edge-of-centre and ultimately out-of-centre sites can be considered. The “need test” asks whether there is a lack of provision in the local area of the class of goods to which the planning application relates. This regime, the Commission found, constrains entry by larger retailers for which suitable sites are often scarce, and lengthens the time taken to develop stores.

The Department for Communities and Local Government had said that it would wait for the Commission's recommendations before proceeding with its own, wider consultation on the planning regime (which has now been published). So far as the planning regime is concerned, however, the Commission did not suggest relaxing the existing tests, despite finding that planning acted as a barrier to entry. On the contrary, it proposed the introduction of a further “competition test” to be passed by new supermarket developments based on local fascia and market share, to be monitored by the OFT. A similar recommendation was made by the Commission in the 2000 supermarkets inquiry, but the Government did not act on that proposal. It remains to be seen whether it is more keen to do so today.

### HALF FULL OR HALF EMPTY?

Before the inquiry, there had been heated public debate about the grocery retailers' so-called "land banks". The retailers argued that the length of the planning process necessitated a pipeline of development opportunities. Their critics alleged that the retailers had built up land banks to block rivals' development. Beyond isolated instances, the Commission did not agree with these criticisms. It was more concerned about restrictions on land use that made it difficult for rivals to develop other sites.

The two practices that gave the Commission most concern in this context were restrictive covenants and exclusivity arrangements. By placing a covenant on a piece of land that prevents its use for grocery development, the retailer might block a rival without even having to own the land. The Commission found 30 restrictive covenants that it considered prevented rival entry, and proposed that such covenants should be abandoned. Future restrictive covenants should be banned, with an exception to protect the residential amenity of flats built as part of a mixed-use development.

The Commission recognised that exclusivity arrangements – whereby a certain retailer is granted sole rights to operate a grocery store on a certain piece of land – might have pro-competitive benefits, by allowing developments to be built that otherwise would not have occurred. However, it proposed limiting the duration of future arrangements to five years, where custom and practice amongst property lawyers has previously been for exclusivity agreements to run for perpetuity.

### WATERBEDS, VICIOUS CIRCLES AND PREDATORS

Most of the items on the OFT's query list were dismissed by the Commission. The ACS had argued that supermarket buyer power has a detrimental effect on the convenience sector, in two ways. Firstly, through the "waterbed" effect. The argument was that wholesalers and suppliers, whose prices are forced down by supermarkets, respond by charging convenience stores more, weakening their competitive position and even driving them out of business (and so reducing customer choice). This cut no ice with the Commission. It found that key empirical requirements of the waterbed theory did not occur in the groceries sector and that its survey of suppliers did not support the existence of the theory.

In practice, the Commission was more interested in exploring the direct effects of supermarket buyer power on suppliers, rather than the indirect effects on convenience stores. It revisited one of its main concerns from the 2000 inquiry, proposing measures designed to extend and strengthen the existing Supermarket Code of Practice (SCOP) for dealing with suppliers. After the earlier supermarkets inquiry, SCOP was developed through negotiations between supermarkets and the OFT. The Commission seems to have taken the view – supported by comments from suppliers, farmers, and third parties such as Banana Link – that the SCOP has not been as strong a constraint on retailers as it had originally hoped.

The second strand of the ACS’s argument portrayed a vicious circle: lower convenience store sales weakened independent wholesalers by reducing their ability to access economies of scale, so that their prices to the convenience stores would increase, and so on. The Commission rejected this hypothesis. It found that wholesalers’ revenues were steadily increasing; and took the view that any future decline they may suffer was likely to be accompanied by consolidation, maintaining access to economies of scale. For good measure, the Commission stated explicitly that the development of Tesco and Sainsbury convenience stores had enhanced competition in the convenience sector rather than diminished it.

The ACS got no further with two challenges on supermarket pricing practices, both variants of predation allegations. First, it argued that large supermarkets sold some products below cost as a way of driving out smaller stores. Second, it argued that local “vouchering” (the distribution of money-off coupons to customers) was used as a means of targeting predatory price reductions at customers of specific small competitors.

The Commission did not support either argument. It found some below-cost selling, but did not think this was predatory. Since it considered convenience stores to be in a different product market, the Commission thought it unlikely that large stores would have any incentive to predate, and it did not find any evidence that below-cost selling had resulted in a reduction in the number of convenience stores. Moreover, the Commission found local vouchering to be driven not by predation against small competitors but by competition between large ones.

### NEVER SAY DIE

It is too soon to say what the full consequences of the latest inquiry will be. But two conclusions can already be drawn. First, the wide gap between the OFT’s initial list of issues for investigation and the remedies eventually proposed by the Commission may be a sobering lesson to those, in any market, urging the OFT to make a referral. And second, which may be equally sobering for those referred, is that old competition issues never die – they just get recycled.

*Frontier advises Tesco on competition matters.*

<b>CONTACT</b>	<b>David Parker</b> david.parker@frontier-economics.com
	<b>Simon Gaysford</b> simon.gaysford@frontier-economics.com
	Frontier Economics Ltd
	<b>FRONTIER ECONOMICS EUROPE</b> BRUSSELS   COLOGNE   LONDON   MADRID
	<a href="http://www.frontier-economics.com">www.frontier-economics.com</a>