

# TESCO

## Overview Response to provisional remedies decision

### 1. INTRODUCTION

1.1 This market investigation has inquired into one of the most competitive, dynamic and innovative sectors in the UK. Over a period when the prices of many of life's essentials have increased above inflation - such as rail, petrol, council tax and the TV licence – the CC finds the UK grocery market has been delivering “*a good deal for consumers*”. Yet some of the proposals made by the CC on the basis of work we think flawed would actually undermine competition, reduce innovation and freeze investment. Taking into account the importance of the sector and the current uncertain financial climate, the CC's proposals will regrettably have serious ramifications for consumers and the UK economy.

1.2 We have particular concerns in relation to:

- (a) the proposal for a growth cap, which will reduce investment and expansion; and
- (b) some of the proposals for unnecessary and burdensome regulation of supermarkets' relations with their suppliers. More red tape is likely to stifle the dynamic relations between retailers and suppliers, and reduce the flexibility of the supply chain to deliver for consumers.

1.3 Although other proposals could have merit in their own right, especially if they were made less intrusive, we do not accept that the need for them has been demonstrated.

### 2. THE PROPOSED GROWTH CAP IS NOT APPROPRIATE

2.1 ***It will reduce investment and expansion in this competitive sector, and harm the wider economy.*** The competition assessment is intended to restrict expansion and may freeze local catchments, as one or more retailers already present could be reliant on new entry occurring before they could grow. Yet supermarket investment and expansion has brought tremendous benefits. Growth serves consumers by providing new, larger or more modern stores. Often, it entails regeneration of local communities. Expansion also allows the provision of increased space for non-food, a separate market in which grocery retailers' entry has benefited competition and consumers. Extensions and replacements bring unambiguous improvements to consumers – yet of the Tesco pipeline sites which the competition assessment would seek to prevent, over 80% are proposed replacements or extensions intended to modernise and enhance our consumer offer. Supermarket expansion has also contributed to the Government's housing agenda, including mixed-use schemes where hundreds of flats are brought forward alongside leisure and retail uses.

2.2 Given these achievements of UK supermarkets, this freeze on investment has serious ramifications for our economy. And by adding to the costs facing the sector at a time when the economic outlook is in any event uncertain, it is deeply concerning

that the CC proposes (and that some retailers support) a remedy whose direct annual costs of at least £150 million may filter through to consumers.

**2.3 *It fails to take account of the most important people in this Inquiry – consumers.*** By distorting the operation of normal competitive forces in all local areas across the UK the assessment is contrary to normal competition and would operate with no consideration to what consumers actually want. Retailer growth flows from consumer demand, but the assessment would override such demand and give a windfall advantage to less successful operators. Tesco is concerned by the CC's apparent belief that the only way to strengthen some competitors is by weakening others. Selecting winners and losers in this way would undermine the vigorous competition the CC has observed, without a commensurate improvement for consumers.

**2.4 *It does not reasonably address the alleged adverse effect.*** The CC appears to believe that the addition of the competition assessment to existing planning tests can be expected to alleviate the CC's apparent concerns. It is impossible to see how it can do this in a reasonable way. By constituting a further planning hurdle that has to be overcome, the competition assessment instead adds to the regulatory limits on expansion by introducing new costs, complexities, delays and risk into the development process. This will restrict growth and add to the burdens (and risks of appeal) facing local planning authorities, in direct contradiction of Government policy to streamline planning.

**2.5 *The design is misconceived.*** Any growth cap will suffer from the objections described above: they cannot be 'designed out' of the assessment. The question is not whether the competition assessment can be expected to reduce competition, but by how much. But the particular proposals put forward are misconceived. The CC has done no work to establish that the four fascia the assessment requires in every local market (even in small market towns or coastal areas with low population<sup>1</sup>) is the appropriate number to ensure optimal competition. Nor has the CC shown why (say) 70% rather than 60% is not the correct market share threshold to measure high concentration. And the CC has not demonstrated why it is appropriate to omit discounters from the market despite the wealth of evidence - including the views of the discounters themselves - that they should be included. This is an attempt to micro-regulate the whole of the UK, without the benefit of adequate analysis to support its introduction. The CC is doing so on the basis of a test that is arbitrary, in which a host of substantial (and unresolved) practical questions have already been identified.

**2.6 *The CC has not proven an adverse effect on competition (AEC).*** We do not believe the CC has proven its provisional finding that there is an AEC resulting from local concentration. We have seen no evidence that major retailers vary their offer

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<sup>1</sup> In relation to small market towns and coastal areas, the CC's approach to population does not reflect reality. Take, for example, the small market town of Brigg in North Lincolnshire. The CC's approach implies that the existence of a large population of 133,000 within 20 minutes' drive of Brigg – primarily because of nearby Scunthorpe – means that Brigg itself can support four stores. Yet Brigg only has 19,000 people within 10 minutes, and Scunthorpe already has an Asda, a Morrisons, a Sainsbury and a Tesco.

based on concentration levels, and we have demonstrated that no such relationship exists for Tesco. The CC stated in January 2007 that “*Our starting point is that in a competitive market, commercial success should not be penalized unless there is clear evidence of an abuse of market power and harm to consumers*”. The CC has found no such evidence of wrongdoing in the UK groceries market, which the CC believes benefits from “*vigorous competition*”; the commercial success of the sector should not be penalised.

### **3. SOME SUPPLY CHAIN REMEDIES WILL HARM SUPERMARKETS AND CONSUMERS**

3.1 We attach a lot of importance to having good relationships with our suppliers, and we therefore believe that the CC has overstated its concerns. It is by working flexibly with our supply base that Tesco has been able to deliver prices which have fallen by almost 30 per cent in real terms over the period 1997-2007. In response, other retailers have raised their game – and consumers have benefited again. However, we recognise that some of the proposed supply chain remedies may help reduce misconceptions about retailer-supplier relationships, and are welcome on their own merits. Others could be helpful if made less intrusive.

3.2 ***The ombudsman proposal is misguided.*** The CC’s major proposed supply chain remedy is for an ombudsman. While perhaps superficially an appealing solution to apparent concerns in the supply chain, the proposal is misguided and would not be in consumers’ interests. An ombudsman charged with protecting suppliers’ interests would create only unnecessary bureaucracy and may lead to increased prices to consumers, whose interests supermarkets serve in our competitive market.

3.3 ***The costs of supply chain remedies may lead to a worse deal for consumers.*** If retailers are less able to work flexibly with suppliers in the way they have in the past to keep prices down, consumers may get a worse deal. The cost of the remedies proposed would be high. The ombudsman; the compliance officer; the uncertainty of the one-sided ‘*fair dealing*’ obligation; putting even the slightest agreement in writing; committing to arbitration and additional internal and external audits; being subject to anonymous complaints against the principles of natural justice; the complete ban on retrospectively agreeing amendments to contracts – all these can be expected to result in the perverse outcome that the dynamism and innovation which has characterised the UK groceries sector is jeopardised.

### **4. THE CONTROLLED LAND REMEDIES GO TOO FAR AND REQUIRE CLARIFYING**

4.1 The limitation of exclusivity agreements to five years may mean developers find it more difficult to attract retail anchors to shopping centres. Supermarkets may be less able to take on risky and difficult regeneration schemes in future. And the CC’s current proposals are retrospective – agreements dating from before 2003 will expire instantly. In this regard, the CC seems to have gone further than perhaps is necessary, which is why we have proposed that existing exclusivity agreements

should remain valid for five years on a forward-looking basis (as is proposed for new agreements).

4.2 The complete ban on restrictive covenants also risks having unwanted spillover effects, in particular for the housing agenda. The breadth of language used means that agreements in leases to protect the amenity of residential tenants of flats or houses built by a supermarket developer (but not by any other developer) will not be possible. This has a real impact on retailers' ability to deliver mixed-use schemes, and we hope the CC will include a carve-out for these important developments<sup>2</sup>.

## 5. CONCLUSION

5.1 While the CC has not demonstrated the need for any remedy, certain of the proposals advanced are sensible in their own terms. For example, some of the supply chain remedies may help reduce misconceptions about retailer-supplier relationships.

5.2 However, with the competition assessment and the ombudsman proposal the CC is proposing remedies which threaten the “*good deal for consumers*” it has found to result from “*the benefits of vigorous competition*” in one of the UK's most dynamic, consumer-focused and innovative sectors. In the short-term, the direct costs of these interventions may be passed back to consumers. In the longer term, the CC risks freezing investment, limiting expansion and having a detrimental effect not just on the grocery sector as a whole, but in the wider economy beyond its remit. We urge the CC to reconsider.

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<sup>2</sup> We have proposed the following carve-out:

*“The prohibition on the use of restrictive covenants will not apply to existing or new restrictive covenants restricting use to residential only. These residential restrictive covenants should continue to be allowable on freehold or leasehold land and buildings, in the case of residential houses or flats intended to benefit and protect the amenity of the residents and/or the value of the residents' interests.”*