

**Summary of the remedies hearing with Morrisons
held on Thursday 20 December 2007**

1. Morrisons told us that the UK supermarket sector was fiercely competitive with retailers' competing nationally on price, quality, range, service (PQRS), and brand image. This competition was delivering consumers real value for money which was reflected in price decreases and increases in product range since 2000.

Planning

2. Morrisons agreed with the proposal that the needs test, in its current form and application, should be replaced. The rigid and mechanistic way in which the needs test was applied had prevented new store development and acted as a barrier to entry other than for town centre sites. However, the quantitative aspects of any development should still form an important part in the consideration of any planning application. Morrisons believed that a quantitative assessment was required so that scale and impact could be taken into consideration on an existing centre. Scale was a key part of Planning Policy Statement 6 (PPS6). The assessment of quantitative need not only served competition goals but also general public policy objectives. In the majority of cases the presence of quantitative need would most likely correlate with the presence of a viable business case for a new grocery store.
3. In Morrisons' view, the distinction between edge-of-centre and town centre should be retained. Although there were circumstances when an edge-of-centre site could have an unacceptable impact on a town centre there were other instances when edge-of-centre sites might contribute towards town centres (for example, where there were no town centre stores and the incumbents were located out-of-centre). Morrisons did not think there was any need to change the definitions of town centre, edge-of-centre and out-of-town sites but believed that consideration should be given to the tests that should be applied to each type of site.

Competition test

4. Morrisons thought that there should be an increased emphasis on competition within the planning system. Of the two proposals outlined in the Competition Commission's (CC's) remedies notice, Morrisons favoured the option of the Office of Fair Trading (OFT) acting as a statutory consultee. The principal problem with the proposed licence to operate was that it would prolong the overall store development process and might operate as a barrier to entry: if the cost of applying for a licence to operate was relatively small, grocery retailers might submit numerous and frivolous applications. If, however, it was part of a planning application, the operator or developer would be incurring costs in the region of £100,000 or £200,000 per application. A licence to operate might also impact on other issues such as the sale or leasing of a store. Morrisons believed that using a statutory consultee would ensure a more uniform approach and national consistency to applications. Far too many local planning authorities (LPAs) did not have the right resources to be able to deal with what were complex matters in terms of establishing need. In some instances LPAs could probably be bulldozed by an applicant into approving an application.
5. In Morrisons' view, the appraisal process carried out by the OFT should include a fascia test based on an assessment of the number of stores in a defined catchment area using the 1,400 sq metre threshold. The test should include stores being built and an assessment of any applications being processed in the system. This would

reduce the opportunities for 'gaming' by competitors (for example, a retailer might decide against increasing the floor space of a particular store to reduce the chances of entry by a competitor). The proposed test was simple and transparent, would increase the certainty for applications and should not slow down the planning process. The number of parties dealing with the OFT would be relatively small and these would develop a level of sophistication and an expectation of what was required. Morrisons acknowledged that the process might possibly act as a barrier to entry for those parties that were not used to it, although this would be mitigated if the OFT published its guidance.

6. Morrisons believed it was important that a single body should be responsible for the process rather than individual LPAs. Sometimes LPAs complained about being under-resourced, whereas the OFT had expertise in operating techniques such as population re-centring and isochrone flexing, and, was experienced at looking at local market issues. It would also be more efficient and cost-effective for the OFT to invest in and operate a standardized package than for every LPA up and down the country.

Controlled land

7. In a lot of cases restrictive covenants were used to safeguard the value of land (sold for a particular purpose) for shareholders rather than restricting competition: changes in local environment or planning policy might result in a higher-value use in the future (eg consent for a residential development). Morrisons did not believe that any of its controlled land sites were restricting access to sites because of their size, the basis on which they were held or the likelihood of securing planning consent. In many instances Morrisons was an intermediate landlord so was bound by another party. When Morrisons sublet a site to a third party it was often for a significant number of years (almost freehold). Generally the sublease reflected the terms of the main lease.
8. Before contemplating the forced release of restrictive covenants the CC would need to consider the tenure under which land was held. In terms of freehold disposals the key issue would be whether or not planning consent could be obtained for a change of use to retail. In Morrisons' case, a lot of its controlled land sites were not zoned or allocated, did not have a consent for retail and were allocated for another use. It was debatable as to whether the compelled disposal of that sort of land would enhance retailing because planning consent for retail use would need to be sought from the LPA. Morrisons thought that exclusive arrangements should be limited to between 10 and 20 years.
9. Morrisons did not believe that the amendment of the Land Agreements Exclusion Order would, should the CC recommend it, result in a large number of court hearings; most of the cases would be relatively clear-cut. Morrisons did not think that many of its restrictive covenants would generate competition or restriction of competition issues.
10. If the CC required the divestment of land sites the grocery retailers concerned would need a reasonable timescale to arrange the necessary disposals and a regime to protect the value of the sites concerned. Morrisons believed, however, that opening up the planning process would solve the problem of areas in which there was a high concentration of stores of one particular fascia. Any divestiture remedy considered by the CC should be site specific and not based on simple mechanical rules.
11. In order to justify the divestment of stores the CC would need to show consumer detriment in each case and specifically that PQRS was deficient as a consequence of only one operator owning the stores. However, the CCs own study by GfK had found no significant local variations and the econometric study of gross margins that the CC

relied upon did not address PQRS, or capture the impact of any limited vouchering and excluded the costs associated with local marketing and the fixed costs associated with store quality. The econometric analysis was founded on an array of assumptions, some dubious data, had only limited aspects of store characteristics and relied on proxies for such important factors as local cost and demand conditions. The only real data in the CC's model were suppliers' gross margins but these were all measured on an inconsistent basis and would be affected by non-grocery sales such as low margin petrol and actual labour costs (the CC had no facts as to how these varied locally). Morrisons said that the CC also had only a single year's data and many stores were excluded. In this regard a significant number of Morrisons stores had margin fluctuations of between three and six percentage points either side of the average 2005/06 margin used in the CC's analysis. Morrisons' own analysis suggested that the CC's finding that the small effect of gross margins was higher where there were fewer competitors was simply the result of spreading fixed labour costs over greater sales where there were fewer competitors and was not due to any deterioration of PQRS.

12. Morrisons also had concerns about the CC's CACI local concentration study. In Morrisons' view, the analysis was materially inaccurate and did not contain the safeguards (such as population re-centring and isochrone flexing) employed by the CC in the Safeway (2003) and Somerfield (2005) merger inquiries. It also contained a number of errors, for example Morrisons' analysis of market share based on net floor space differed from the CC's in the majority of areas.
13. Morrisons did not believe that choice of fascia alone was sufficient to justify the divestment of stores that were operating economically and satisfying customers. Morrisons could not see how the CC could contemplate, let alone require, divestments unless each local area had been considered individually by reference to the facts on the ground and local adverse effects on competition had been very clearly identified.

Supermarket Code of Practice

14. Morrisons felt that the scope of the Supermarket Code of Practice (SCOP) should be widened to include all grocery retailers, together with wholesalers and processors. The OFT, which had been involved in developing the SCOP following the 2000 investigation, was well practised in dealing with it generally and should be responsible for its monitoring and enforcement. With regard to the wording of the SCOP, Morrisons said that the definition of 'reasonable' was something that would be arrived at by each party.
15. The CC's concerns that certain practices might have a detrimental effect on supplier innovation in the future was based purely on anecdotal evidence from suppliers with vested interests and appeared to contradict actual evidence of supplier innovation and investment. It was in Morrisons' interests to ensure it retained the competitiveness of the range of products it could offer in competing with its larger rivals. If Morrisons acquired a reputation for not treating its suppliers fairly this would impact on a supplier's willingness to invest in its relationship with Morrisons.

Concluding comments

16. Morrisons had serious concerns about the CCs provisional findings and potential remedies. Any action taken by the CC must remedy the actual adverse effects identified and must be proportionate. It would be extremely perverse if the smallest national competitor should be obliged to sell stores or controlled land to its larger competitors, including Tesco.