

GROCERIES MARKET INVESTIGATION

Summary of the remedies hearing with J Sainsbury plc held on 20 December 2007

Introduction

1. J Sainsbury plc (Sainsbury's) told us it was pleased that the Competition Commission (CC) had concluded that grocery retailers were delivering a good deal for consumers. However, it considered that it could be even better if competition were stronger at a local and national level.
2. Sainsbury's said that Tesco's national strength came from an increasing number of dominant local positions, and that this increased Tesco's ability to dominate further, both locally and nationally. The CC's case, that this was not an adverse effect because competitors were expanding, was wrong, given the disproportionate increase in Tesco's share of space and sales. The expansion of competitors was the best way to constrain a dominant player, and any remedy proposed by the CC should seek to allow and encourage the growth of Tesco's competitors. If Sainsbury's proposals were implemented, Tesco's competitors would be able to grow at up to twice their current pace, in terms of floor space, in three to five years' time.
3. Unless the remedies implemented by the CC had an impact on the future accumulation of national share, it was inevitable that there would be an inquiry in the not-too-distant future and that the CC would be faced with a more entrenched situation, requiring far more disruptive (and therefore less proportionate) remedies.

Planning

4. Sainsbury's was generally in favour of streamlining the planning process, and had been engaging with the Barker review. It had considered a 'holistic' test, and believed that planning considerations should include details of how a proposal would affect the economics of an area and its impact on the town centre. This would include a competition test. A holistic test would look at the town centre as a whole and protect those which invested in the town centre, including small retailers.
5. Sainsbury's considered that the quantitative need test should be abolished. It acknowledged that the concept, and a quantitative assessment, of need should be retained for the purposes of local development plans. Sainsbury's was concerned about how the quantitative need test had been applied, and that other considerations, such as the sequential test and impact, had not been given as much weight. The need test had been given disproportionate significance and had had unintended consequences. The need test could have counterproductive effects, where one large grocery retailer could absorb all the 'need' in an area, thereby preventing further entry by competitors. It had almost become easier to justify an out-of-town development, than a development on the edge of the town centre, and once there was a store out of town it was impossible to develop edge-of-centre sites. However, the abolition of the need test would not in itself be sufficient to address dominant local positions.

6. Provided that town centres had the right protection, efforts should be made to free sites to develop larger stores on the edge of town centres, as opposed to the current process, which tended to push developments out of town.

Controlled land

7. Sainsbury's did not agree with the CC's view on restrictive covenants, exclusivity agreements or subleases. These were normal workings of the property market. Often they would lead to the development of sites that would not otherwise be developed and in many instances provided social good in the process.
8. Sainsbury's said that its controlled land holdings did not have the purpose or the effect of acting as a barrier to entry. Land holdings could be used as a barrier to entry, but there were mechanisms already in place to stop land being used for anti-competitive purposes. Sainsbury's was not aware of anybody making any complaints about controlled land.
9. Restrictive covenants and exclusivity agreements were specifically excluded from chapter 1 of the Competition Act because they ultimately benefited the consumer. The covenants and exclusivity arrangements from which Sainsbury's had benefited did not have the intent of restricting competition. Sainsbury's would be happy for those to come under scrutiny, provided that any challenge recognized the historical context in the way they came about.
10. If there were restrictive covenants and exclusivity agreements that had anti-competitive effects, those were best addressed by individual complaints rather than through *ex ante* provisions. Restrictive covenants could be lifted if a party was prepared to pay for it. The process for challenging restrictive covenants could be made more transparent. Retailers could disclose their land holdings to the Office of Fair Trading (OFT) on a regular basis. The sites that were useful for supermarket development would be clear.
11. It would be possible to have a time limit for restrictive covenants and exclusivity agreements. A reasonable time line would be the length of the lease, which would give the tenant the opportunity to negotiate with the landlord.
12. Sainsbury's did not consider that divestment of existing stores would be a proportionate remedy. Consumers would be significantly disrupted by disposals. It would be better to address concentration by encouraging new entry than by ordering disposal of existing stores. However, Sainsbury's supported the divestment of controlled land holdings in areas of high concentration, to the extent that they represented a barrier to entry and could be developed as supermarkets.

Competition test

13. Sainsbury's proposed an asymmetric competition test, which would apply more aggressively to any retailer with market power. This would achieve both better competition at a local level and prevent such a retailer from becoming so dominant that the CC would have to intervene in the future.
14. The test should be asymmetric; an appropriate approach could be that the threshold for Tesco was a [%] per cent local market share with a [%] per cent local market share for other retailers. An asymmetric test would be proportionate because it would still allow Tesco to grow in all markets where it was not currently dominant, but the company would be slowed down earlier than the competing fascias. Sainsbury's was

suggesting only a degree of separation, not a disproportionately different hurdle. A symmetric test, by contrast, would exacerbate the disproportionate growth levels between Tesco and the other grocery retailers. Asymmetry was justified by Tesco's market power.

15. The competition test should be applied to proposals for new stores and acquisitions above 1,000 sq metres. It would not be necessary to apply the competition test to extensions and on-site replacements, as these served to improve the offer for consumers. In most circumstances it would be obvious who would be precluded from entering or expanding in an area. If a council controlled the relevant site, it would know at the outset that certain parties would not be in a position to be cleared.
16. In Sainsbury's view the competition test should be administered by the OFT as a statutory consultee. The concept of statutory consultees was well established; for example, the Environment Agency was a statutory consultee for planning applications where flooding was a relevant consideration. A further benefit of the statutory consultee system was that it would work alongside the planning process, and within set timescales. The planning authority should, however, retain the right to approve a development, against the recommendation of the OFT, in extreme or unusual circumstances.
17. Custom and practice would develop quickly. The vast majority of sites would not require consultation with the OFT, because the rules would be clear. Sainsbury's did not think the statutory consultee risked being ignored. This had not been the case for other statutory consultees, and the OFT would have the recourse of having the application called in.
18. Sainsbury's saw two potential routes for planning applicants to engage with the statutory consultee. One was to go through a clearance process before submitting a planning application. The other was for an application to be referred to the statutory consultee once it had been submitted. Sainsbury's believed that the OFT should be consulted towards the end of the development process (in the last two to three years) at the point when the retailer was seeking planning permission. Whilst circumstances could change from the beginning of site assembly to the planning application being submitted, that was a commercial risk which the retailer would have to factor into its decisions. Retailers already balanced the risk of not being able to assemble all the parcels of land they needed for a development, or not receiving planning permission, and would be able to take this risk into account.
19. Sainsbury's thought it might help parties if the OFT were able to give non-binding guidance early in the process, but recognized that the OFT could not pre-clear potential applications. It was important that those parties whose applications stood no chance found out early, to avoid wasting their time and that of the planners. There would be instances that would require proper examination, and there was an element of risk involved.
20. There was always a possibility of parties 'gaming' the process, but Sainsbury's would only engage where it had honest intent. Attempts to play the system would incur actual costs and result in damage to a party's reputation. The OFT could support this by weeding out applications that it considered were mischievous.
21. The statutory consultee process would not remove anything from local democracy. The local population was likely to agree strongly that if there were already three Tescos in a town, it would be sensible if the next supermarket was a different fascia.

22. Compared with the alternatives, Sainsbury's felt strongly that a statutory consultee could achieve the desired results at the minimum level of cost, complexity and disruption and was much preferable to a licensing system. It was opposed to a licensing regime because it would, by definition, apply to everything, with all of the bureaucratic hurdles that flowed from that.
23. For the major players there would not be more than 100 applications a year, and not all of those would be referred anyway. Sainsbury's was probably looking at [X] or [X] potential development opportunities a week, but its filtering system reduced those fairly quickly. A competition test would not affect the number of stores being built. It would not discourage the market, as anything with the potential of being developed as a supermarket was very attractive, even with a further regulatory hurdle.
24. The competition test should apply both to new stores and to land holdings.

Suppliers and the Supermarket Code of Practice

25. Sainsbury's did not consider that there was an adverse effect on the supply chain and believed there was little evidence to support such a view. The evidence indicated that the supply base was growing in profitability, whilst innovation and investment were increasing and vibrant. Sainsbury's thought that the amount of evidence that the CC had identified was very small in the context of the scale of supplier/retailer relationships. Independent surveys showed that suppliers were satisfied with their relationships with retailers. The nature of any market was that there would be some who would be dissatisfied. Sainsbury's considered that the evidence pointed towards very positive trends. In aggregate the supply base had become more profitable in the last six years at a time when profitability had flattened among the supermarkets.
26. There was no evidence of consumer detriment. There was also no evidence of innovation being stifled, and no more companies were going out of business in the supplier sector than in any other industry.
27. Sainsbury's was supportive of the Supermarket Code of Practice (SCOP), which effectively governed the relationships between supermarkets and suppliers. The only change necessary was to widen the scope of the SCOP to cover other retailers. It did not consider that the question of whether intermediaries should fall under the SCOP fell within the terms of reference for the inquiry—it would require a separate market investigation. Also, extending the SCOP to intermediaries and further up the supply chain would be very difficult to manage.
28. Sainsbury's understood that the SCOP did not currently allow retrospective discounts, but felt that, if there was ambiguity in the SCOP, that should be addressed. Although there had been concerns about the use of the term 'reasonable' in the SCOP, it was difficult to find a form of words which provided both supplier and retailer with the flexibility they require in a fast-moving market. The basis for using 'reasonable' was the assumption that it would be tested, but it had not been. As long as the terms were agreed up front and that was part of the supply agreement, it was perfectly acceptable. Sainsbury's noted that risk was also transferred from the supplier to the supermarket.
29. Complaints under the SCOP should be considered by the retailer in the first instance, and it was important that both retailer and supplier exhausted the internal retailer process before resorting to arbitration. If a supplier was still dissatisfied, it could take the matter to arbitration—which the retailer would pay for—and the decision of the

arbitrator would be binding on both parties. However, the SCOP process must not become a replacement for engaging commercially with the retailer.

30. Anonymous or confidential complaints could not be accepted, but suppliers could get confidential guidance from the OFT on whether they had a case under the SCOP.
31. There was no need for an Ombudsman or any further tightening of the terms of the SCOP. In the absence of any clear evidence that there was a problem, the focus should be on making the existing SCOP and structure work better, by extending it to make sure it governed all retailers with buyer power.
32. Sainsbury's did not consider that putting an Ombudsman or any other central repository at the heart of the industry was going to make it more likely to reduce any alleged 'climate of fear'. Grocery retailing was a challenging commercial environment, and Sainsbury's did not see evidence that there was a climate of fear any more than one would expect in the normal workings of such a competitive market.