

**Summary of the remedies hearing with Tesco
held on 19 December 2007**

1. Tesco told us that it was pleased that the Competition Commission (CC) had found in its provisional findings that the groceries market was competitive. High levels of investment and innovation in the supply chain had allowed Tesco to widen its range and intense price competition had produced better value for consumers.
2. Tesco therefore expressed surprise at the nature of some of the proposed remedies. Some of the remedies proposed by the CC had merit in their own right. They would free up the competitive process by removing regulatory hurdles and would be pro-competitive. But others, particularly divestment remedies and the so-called 'competition test', would mean drastic and expropriatory intervention which was unjustified in a market that was working well. Tesco was concerned that the provisional findings tended to overestimate the extent of any problem and that there was a danger of micro-regulation in the remedies that the CC had proposed.
3. The provisional findings report suggested that concentration led to a detrimental effect on local retail offers. Tesco believed the evidence for this theory was very weak. The CC had measured retailers' margins and believed margins were higher in areas of high concentration, but Tesco said its evidence showed that this relationship was only true because some stores had higher sales than others. A proportion of store costs were fixed and therefore higher sales would lead to higher margins. In other words, the higher margins were explained by higher sales—not because there has been any deterioration of the retail offer. Tesco believed it had taken a more direct approach to exploring the CC's theories and analysed every suggested measure of its local retail offers. This had shown that there was no relationship between its customer offer and concentration.

Land and planning

4. Tesco would support more speed and transparency in the planning process,, including more resources and specific timetables for decisions. It would be happy if the need test were removed because it was an unnecessary bureaucratic hurdle. Tesco saw merit in abolishing the distinction between edge-of-centre and town centre for the purpose of the sequential test. This would allow more stores to be built and support 'town centre first', because edge-of-centre development could often benefit town centres. Tesco had put forward additional proposals to simplify the planning process, including having a higher hurdle for call-ins.
5. Tesco considered that the CC had overestimated the degree of persistent high concentration, that the effect of a limited number of concentrated local areas was relatively small and there was little to justify proposals to remedy areas of high concentration. Tesco disagreed that the existence of high concentration in an area was evidence of barriers to entry. It was instead due to other factors including low population, the strategic decisions of some of Tesco's rivals, and the presence of mid-sized and discounter stores. Over time natural development, along with a liberalized planning system, would cure any persistent concentration, and local planning authorities already had the power to promote genuine choice.
6. Tesco was very concerned about the proposed competition test remedy, which it considered to be an anti-competitive local growth cap, and considered there were numerous in-principle objections. Tesco thought that a competition test would result

in less competition. It might prevent certain stores being built, even though consumers wanted them, and might result in retailers choosing not to expand. It would harm customers: for example, where a Tesco store was prohibited, customers would be permitted only a more expensive rival or no store at all. Such a remedy would benefit Tesco's competitors but not competition, and would be disproportionate in a market that was working well and where the CC had not demonstrated any incumbency advantage. Moreover, a growth cap could not address the feature of the market the CC had provisionally identified—ie planning acting as a barrier to entry.

7. Tesco's view was that by imposing a test prior to planning permission, the discretion of the democratically elected local planning officers and bodies to take planning decisions and to balance and prioritize relevant considerations would be curtailed. It would prevent regeneration and mixed-use schemes which had delivered important community benefits, revitalising rundown centres and delivering housing and amenities. The Office of Fair Trading (OFT) lacked local knowledge and could not evaluate whether a scheme would benefit the local community. The reference to 'competition' in the planning guidance already allowed the planning authority to take account of competition between different stores. Tesco said that there should be no regulatory control other than planning over the organic growth in the retail industry, and that any more draconian remedy would be disproportionate given the scale of the CC's concern.
8. A competition test would penalize the successful—notably Tesco. Penalizing investment in innovation and regeneration would send a perverse signal to other firms that investing to generate a successful customer offer might result in regulatory intervention.
9. Tesco believed that a competition test would be contrary to Government policy. The Barker report referred to the need to avoid multiple consent regimes and to simplify and streamline planning. A competition test would add considerable complexity, cost and delay, and would not be workable. If a competition test were implemented by means of a licensing regime, a company like Tesco would probably have to submit hundreds of precautionary applications for licences each year to reduce the risk of site assembly being hampered by lack of licence. Legal challenges by applicants and third parties would be common practice and lead to regulatory gridlock.
10. Careful thought needed to be given to any remedies in relation to restrictive covenants and exclusivity arrangements, and blanket bans would be inappropriate.
11. In many cases exclusivity agreements were objectively justified and pro-competitive. Exclusivity agreements were often used to give a party some reassurance at the beginning of a major development, during a process of high risk. While believing them to be pro-competitive and objectively justified, Tesco said it might be reasonable for some exclusivity agreements to be time limited so that, after a period when Tesco had had the opportunity to recoup some of its investment, the exclusivity agreement could cease.
12. Tesco made very little use of restrictive covenants. It believed they could be justified in certain circumstances. This included covenants which ensured that a block of flats above a store would remain as flats, thereby preserving the amenity of the block, for the benefit of residents. Tesco would be prepared to look at specific covenants and discuss whether they were in fact necessary.
13. Tesco said that, because of the constraints and complexities of assembling a site and getting planning permission, there should be no limit on the time a retailer was allowed to hold land before developing it. Tesco noted that complex schemes, such

as its own regeneration scheme at Streatham, very frequently took a long time to bring to fruition for reasons outside the retailers' or developers' control. However, Government policy was strongly in favour of site assembly and encouraged retailers to take the long view.

14. Tesco did not think divestment of sites or stores could be an appropriate remedy to the CC's concerns about controlled land or concentration. Controlled land was not having the effect claimed by the CC, as entry had occurred even in areas where incumbent retailers owned sites they had not yet developed. The CC had overestimated the persistence of concentration and incorrectly, in Tesco's view, equated current concentration with competition concerns. Divestment, in the context of a market which was functioning well, would be unnecessarily draconian and disproportionate.

Suppliers and the Supermarkets Code of Practice

15. Tesco considered that the number of complaints from suppliers that the CC had identified was very small in relation to the large number of supplier/retailer interactions each year, and thought that many of the complaints were likely to be unjustified. As Tesco had not seen any of the specific allegations, it was difficult to respond.
16. Making the Supermarkets Code of Practice (SCOP) more restrictive or introducing an ombudsman or adjudicator could be justified only if there were clear evidence of widespread practices likely to harm innovation and ultimately customers, which Tesco said there was not. Tesco considered that an ombudsman would increase regulation and bureaucracy without providing any benefit. Tesco was not sure what proposals for a 'proactive ombudsman' would entail, but disagreed that such a measure could be a proportionate response to concerns about suppliers' perceived willingness to complain. In this regard, Tesco proposed additional measures to improve the effectiveness of the SCOP.
17. The various practices identified by the CC as potentially harming innovation, had allegedly existed for several years, over which time investment and innovation levels had risen. There was no reason to think that this would not continue. Retailers continued to have a strong incentive to ensure investment and innovation in the supply chain. The retailer must be able to retain flexibility that allowed it to negotiate the best deal for consumers. Any remedy which curtailed this flexibility would harm consumers.
18. Tesco felt the SCOP provided clear guidance on the behaviour expected from the four multiple grocery retailers, and that it had helped formalize Tesco's internal process. Tesco was comfortable to use the same principles when dealing with suppliers abroad as in the UK.
19. Tesco welcomed an extension of the SCOP to other retailers and intermediaries. Extending the SCOP to these parties would benefit the supply base. Tesco did not have a view on what the threshold for inclusion in the code should be, but did not envisage that the SCOP would need to apply to corner shops. There had been instances in the past, not specific to Tesco, where behaviour by weak buyers had given the industry a bad name, and a common code would help address this.
20. Charges imposed on a supplier for customer complaints should be proportionate to the effect of the complaint. Tesco's policy was to cover the cost of handling the administration of the complaint. Tesco did not see complaints as a revenue source.

Only a very small proportion of complaints received in Tesco's stores were charged back to suppliers.

21. There could be justification for retrospective charges. There was a misapprehension that this meant renegeing on an agreement with a supplier. If retailers did not have the flexibility to negotiate with suppliers, this would limit competition and have unintended consequences, including reducing the ability of retailers to lower retail prices to the benefit of consumers. Tesco's relationship with suppliers was fluid and based on trust, and contracts could not anticipate every possible eventuality. There were ebbs and flows in every relationship, and retrospective negotiations allowed both parties to have a dialogue in difficult circumstances.
22. Tesco said that there might be cases where, for example, a promotion had not performed as well as expected, and it might be appropriate to discuss the terms and how the promotion could be made to work with the supplier. Suppliers approached Tesco for retrospective changes and there were examples of when suppliers had suffered a problem and Tesco had shared that risk, even though it was not compelled to.
23. It might be possible to be clear up front about the circumstances when retrospective payments might be appropriate. It would not be right to ban retrospective payments as a concept, but Tesco said there might be particular retrospective practices which were inappropriate and should be prohibited. To put suppliers under unnecessary pressure would not be behaviour that Tesco would find acceptable.
24. Tesco had adopted protocols to improve transparency and allay the concerns of suppliers. It had appointed a SCOP compliance officer, reporting directly to an executive director who was not responsible for a commercial function and therefore more independent from the pressures of margin and price. This worked well and provided additional clarity to the process of resolving supplier complaints. Tesco had adopted a protocol to govern the process for de-listing or substantially reducing the amount of business done with suppliers. It believed the incorporation into the SCOP of similar measures for all retailers would be proportionate to the concerns the CC had expressed. Tesco also proposed additional measures to improve the effectiveness of the SCOP.
25. Tesco undertook an annual independent anonymous review of suppliers, and that information was collected by the compliance officer. Tesco had also held constructive supplier forums, where it gathered groups of smaller suppliers and asked them what could be done to improve the process.
26. Compliance should be an internal process residing with the retailers and suppliers, with recourse, if the internal process failed, to mediation by a professional organization like the Centre for Effective Dispute Resolution (CEDR). The mediator would sit between the retailers' internal compliance systems and the OFT. Independent mediation could improve confidence in the process.