

11/08/08

Mr T J Oyler
Groceries Market Inquiry Secretary
Competition Commission
Victoria House
Southampton Row
London WC1B 4AD

Dear Mr Oyler

Re: Recent developments bearing on the UK groceries market.

Pareto Retail understand that there is an opportunity to submit further potentially relevant comment argument for publication, inter alia, as a main party response to the final CC groceries market report. In the first instance Pareto would wish to note recent press articles relating to the Co-op's proposed acquisition of the Somerfield Group. Perhaps a better banner headline might have been, **“5 firms soon to control 85% of UK groceries market – SHOCK!”**

As you are aware, Pareto Retail have indicated many times that we feel that the UK competition authorities' understanding of the dynamics of the 'C-store' and 'top up' sectors is less than complete, and that this remains the case even after the recent groceries market inquiry. One recalls for instance the CC's main hearing with the Association of Convenience Stores, when there took place a somewhat uninformed debate as to the degree of concentration of the UK c-store sector, consolidation by Tesco and the Co-op, and whether any of this mattered. Of course it matters! NB: Pareto suggest in the light of the proposed Co-op / Somerfield merger that the combined Tesco / Co-op dominance of the core economic 'managed' store segment of the UK C-store market could soon reach 80% + market share. A considerably higher degree of concentration than any other UK groceries market segment.

Whilst Pareto are strong supporters of the OFT's recent crack-down on “coordination” in key segments of the UK groceries market, there is of course a fundamental design limitation to the degree in which such intervention is feasible (a recent article in The Independent clearly indicated how retail prices of Key Value Items remain highly correlated). The ideal structural remedy is of course to ensure a level playing field such that the ‘invisible hand’ of the market works its magic through ‘de novo’ entry and through expansion of smaller players. The C-store sector is key to this. Our back-of-envelope perspective is that a 5% buying advantage gap yields an ability for a large prospective C-store buyer to outbid small rivals by a factor of about 100%. So a ca. 13% buying advantage for Tesco seems to Pareto a clear anti-competitive effect (AEC).

It is understood that the strongest independent sector wholesalers had approximate pricing parity with the Co-op back in 2003, but this was effectively undermined when the OFT allowed Tesco and Sainsbury to buy the larger independent sector members without a referral – undermining, in particular, the relative chilled category competitiveness for SME independents using symbol suppliers – (whilst the actual quantum effect is commercially confidential Pareto have consistently argued to the authorities that this is an absolutely clear example of the *dynamic water bed effect*, for the existence of which the CC said it could find no evidence!). Until these matters are resolved (including related anticompetitive Article 81 supplier discrimination in favour of the parties with buyer power) –Pareto believe it is logical for SMEs generally to place on hold any long term store expansion plans .

Similarly, Pareto remains very much of the view that the CC made a cardinal error in not allowing for the effect of the bursting of the credit bubble in its recent analysis of corner shop vitality (we argued for a multiple regression analysis over the credit cycle, since 1990, to fully evaluate the effect on C-store numbers) and was entirely vague on the vitally important subject of SME C-store net exit rates and barriers to entry. We remain of the view, if the current strong trend towards consolidation is allowed to continue, despite parliaments apparent reservations given the 2015 report findings, (driven largely by market power at the segment level), that other litigation based solutions may be viable in the longer term, including class action against “regulatory negligence”, and/or complaints to the EU as in the Equitable Life case.

In conclusion, following the above litigation thread, Pareto understand that Tesco is currently appealing certain of the Competition Commission's findings and recommendations. From a counter-balancing perspective, Pareto would wish to highlight our original submission letter comments, identifying the possibility of long term SME regulatory entrepreneurial activity in order to influence the regulatory attitude toward consolidation/coordination trends in a manner that helps to secure SME's potentially vital contribution to the long term efficiency and effectiveness of the UK economy (indeed we see this DIVERSITY force as a significant potential driver of growth in the next economic cycle). Thus, having had the opportunity to read both the CLG PPS6 proposal and BERR government response to the final CC report our concluding comments would focus on the perceived 'bottom line' need for government to ensure its actions comply with their various legal 'diversity' obligations.

So far as PPS6 and other related Sustainability planning initiatives are concerned, we would strongly urge the Secretary of State that the propose initiatives will remain defective until effective measures are implemented to measure retail 'diversity' including SME activity levels and this is the single most effective way to ensure balance and 'fair play' in planning and development terms, whilst minimizing the potential for conflicts of interest to emerge amongst the various parties. Indeed, Pareto would repeat our previous suggestions that the application of the HHI type of indices of diversity at the LPA level would be a good starting point in this respect (including an LPA obligation to publish these statistics and related diversity targets on their respective planning web sites) . Finally, whilst Pareto fear that BERR may have somewhat misunderstood some of the finer nuanced arguments and findings in the CC report; once the Tesco appeal is satisfactorily resolved, we remain confident that providing that the department are committed to intervening as necessary to drive through the appointment of an effective proactive Ombudsman, it is likely that they will be seen to be fulfilling their general duty under the Enterprise Act to act in the best long term interests of 'customers' and 'consumers' alike.

Yours sincerely,

Adrian Costain, MD Pareto Retail Ltd.