



Supermarkets : competition inquiries into the groceries market

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Over the last two decades, the growing dominance of supermarkets has been a major theme in the nation's life, seen in eating habits and shopping trends, the architecture of the high street and the look of the countryside. It is undeniable that the vast range of goods and services that supermarkets provide, and the prices at which they supply them, have been terribly successful. However, the growth and profitability of these companies – in particular, the four major chains, Asda, Morrisons, Sainsbury's and Tesco – has been controversial. Many critics have argued that the supermarkets have exploited their dominant market position in a way that is contrary to the public interest.

The principal responsibility for enforcing competition law lies with the two independent competition authorities – the Office of Fair Trading (OFT) and the Competition Commission. In particular, the Commission has the duty to investigate and report on a market on a reference from the OFT, to assess whether competition in that market is prevented, restricted or distorted, and to take any necessary action to remedy, mitigate or prevent those effects.¹

The UK grocery market has been the subject of two major inquiries in recent years. In October 2000 the Competition Commission completed the first of these enquiries, and it led to the creation of a Code of Practice, to regulate the relationship between the largest supermarkets and their suppliers. However, the OFT received many complaints that the Code was not preventing supermarkets exploiting some of their suppliers, and putting many small shops out of business. In May 2006 the OFT referred the market to the Commission for a second time. In April 2008 the Commission completed its inquiry, concluding that in many respects UK grocery retailers were “delivering a good deal for consumers” but that action was “needed to improve competition in local markets and to address relationships between retailers and their suppliers”, including a strengthened and revised Code of Practice, to be enforced by an independent ombudsman.²

¹ Under s132 of the Enterprise Act 2002. Ministers may also make a reference but the presumption is that the OFT will consider the matter first. For more details see, Competition Commission, *General Advice and Information CC4*, March 2006 pp17-19

² Details of the Commission's inquiry, and its subsequent actions to implement its conclusions, are collated on its website at: <http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm>

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In August 2009 the Commission recommended that the Government should establish an ombudsman, having failed to reach a voluntary agreement with the supermarkets. In January 2010 the Labour Government announced a consultation exercise on taking this issue forward, “mindful of placing unnecessary costs on to business especially in a period of economic difficulty.”³ Following the 2010 General Election, the Coalition Government stated that it would introduce an ombudsman within the OFT and in August 2010 it published details of its plans to legislate to establish a ‘Groceries Code Adjudicator’.⁴ The Government published a draft Bill in May 2011 which was the subject of an inquiry by the Business, Innovation and Skills Committee.⁵ Finally on 10 May 2012 the Government published a Bill to establish an Adjudicator as one of the first Bills of the 2012/13 Session.⁶

This note discusses these two enquiries into competition in the groceries market. A second note looks at more recent developments regarding the regulation of supermarkets, and in particular the Coalition Government’s plans to set up a Groceries Code Adjudicator.⁷ Two other notes examine the wider debate about supermarkets’ power over farmers and other suppliers, and the role of the planning system in controlling their growth.⁸

Contents

A.	The 2001 Supermarket Code of Practice	2
B.	The purchase of convenience stores	7
C.	Debate on a reference to the Competition Commission	11
D.	The OFT’s reference to the Commission – May 2006	18
E.	The start of the Commission’s inquiry	22
F.	The Commission’s Final Report	28
G.	Implications of the Commission’s report	32

A. The 2001 Supermarket Code of Practice

In April 1999 the Office of Fair Trading (OFT) referred the conduct of supermarkets in their grocery business to the Competition Commission, following an eight month inquiry into their profitability.⁹ The Commission completed its report in October 2000:¹⁰ although it was

³ HC Deb 13 January 2010 cc23-4WS. The consultation was launched the next month, with responses invited by 30 April 2010 (Dept for Business, Innovation & Skills press notice, 5 February 2010).

⁴ Dept for Business, Innovation & Skills press notice, 3 August 2010

⁵ HC Deb 24 May 2011 c47WS; Business, Innovation & Skills Committee, *Ninth report : Time to bring on the referee?*, 28 July 2011, HC 1224 2010-12

⁶ Full details of the Bill and its Parliamentary scrutiny to date are given on the Parliament Bill page at: <http://services.parliament.uk/bills/2012-13/groceriescodeadjudicator.html>

⁷ *Supermarkets : the Groceries Code Adjudicator*, SN06124, 2 August 2012

⁸ *Supermarkets : controls over buyer power*, SN01187, 18 October 2010; *Town centres, planning and supermarkets*, SN01106, 29 July 2011.

⁹ OFT press notice PN 33/98, 30 July 1998 & OFT press notice PN 11/99, 8 April 1999. At this time the provisions regarding the OFT’s powers to make a reference for the Commission to investigate a possible monopoly situation were contained in the *Fair Trading Act 1973*.

basically favourable to supermarkets, it expressed some concerns about their relationship with suppliers. The Commission recommended the establishment of a code of practice to put relations between supermarkets and their suppliers on a clearer and more predictable basis. The Government concurred with this judgement¹¹ and the Code was agreed in October 2001.¹²

In its report the Commission had found that any supermarket that had shares of more than eight per cent of grocery purchases for resale from their stores “are, for the most part, able to control their relationships with suppliers to their own advantage, whilst the smaller multiples are not able to do so to anywhere near the same extent.” As a consequence those retailers who met this eight per cent criterion should be required to give undertakings to comply with the Code.¹³ The four companies which passed this test – Asda, Safeway, Sainsbury and Tesco – did so.¹⁴

The Policy Commission – appointed by the Government in August 2001 to examine the farming and food sector – raised concerns about whether the Code would work effectively in their report published in January 2002.¹⁵ In its response the Government committed the OFT to preparing an annual report on how the Code was working, particularly in relation to dispute resolution.¹⁶ In February 2003 the OFT announced that it was undertaking the first such report,¹⁷ which it completed in February 2004.¹⁸ The OFT found considerable resentment against the major companies but were unable to find objective evidence of abuse of the Code, and proposed that it would commission further work on the issue:

Despite anecdotal evidence that the Code is not working, no cases have gone to mediation under the Code ... Nor has the OFT received any detailed information from suppliers or trade associations about alleged breaches of the Code. This has made it impossible to draw any firm conclusions as to how individual supermarkets are operating under the Code, though it is clear that widespread dissatisfaction amongst suppliers continues. Fear of complaining was the main reason identified for the Code's perceived lack of effectiveness ...

The concept of 'reasonableness' ... used in many of the Code's terms was also seen by suppliers to allow the supermarkets to interpret the Code to the detriment of suppliers, leading to uncertainty about some of Code's key provisions and increasing reluctance to complain. The four supermarkets themselves [ASDA, Safeway, Sainsbury's and Tesco] each express a commitment to the Code and believe that relations with suppliers are generally good. However, the OFT has no evidence from the supermarkets that their relationships with suppliers had changed significantly since the introduction of the Code.

¹⁰ Competition Commission, *Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom* Cm 4842 October 2000

¹¹ DTI press notice P/2000/64, *Byers publishes Competition Commission report on supermarkets*, 10 October 2000

¹² DTI press notice 2001/606, *Hewitt backs good behaviour code for supermarket suppliers*, 31 October 2001

¹³ Cm 4842 October 2000 paras 2.458, 2.590

¹⁴ OFT press notice 52/05, 22 March 2005

¹⁵ Report of the Policy Commission on the Future of Farming and Food, *Farming and food: a sustainable future*, January 2002 p33

¹⁶ Cm 5709 December 2002 p 6

¹⁷ OFT press notice PN 16/03, *OFT to conduct supermarkets code review*, 17 February 2003

¹⁸ [The supermarkets code of practice OFT697](#), February 2004

Given the reluctance of suppliers to provide specific evidence of alleged breaches of the Code, the OFT intends to obtain information from the supermarkets by conducting a focused compliance audit ... of each of the four supermarkets' dealings with suppliers. The audit will involve a sample examination of the supermarkets' records of dealings with their grocery suppliers, focusing particularly on the clauses of the Code where claims of breaches were more frequently identified by suppliers.¹⁹

In March 2005 the OFT completed this 'compliance audit' of the four major supermarkets, concluding that they were, by and large, complying with the Code, although the Code was not being used to settle disputes between them and their suppliers.²⁰ A summary of this report was given in a press notice, in part reproduced below:

The compliance audit of supermarkets ... looked at a sample of 500 grocery supplier relationships with the big four supermarkets. The audit found relatively little evidence of breaches of the Code. However there was evidence of some breaches consisting of supermarket requests that suppliers make lump sum payments in relation to loyalty and continued supply (Clause 9 of the Code). Suppliers appear not to have complained to the supermarkets about having to make the payments and the payments in question, which mostly concerned Safeway before its acquisition by Morrisons, appear to have ceased. Without the use of mediation to resolve disputes as envisaged by the Code, it has been difficult to assess the Code's effectiveness. The Code's success depends on it being used. The OFT believes that suppliers should overcome the fear of complaining and use the Code's dispute resolution procedure when they have concerns about their dealings with supermarkets.

The OFT considers that it is legitimate for supermarkets to compete vigorously for supplies on quality and price allowing consumers to benefit from value and choice through effective competition. The OFT considers supply relationships work best when there is a combination of competition and straight dealing. It is not fair or legitimate for supermarkets to negotiate contracts with suppliers and then change or cancel them without reasonable notice or compensation. What is reasonable depends on the facts and can, if necessary, be established through mediation under the disputes resolution procedure. However, supermarkets and suppliers should ensure that their terms of business are in writing to help avoid misunderstandings and to ensure that bargains struck are kept.

The audit found that while standard terms were available to suppliers (on such matters as title of goods, delivery terms, etc) they did not ask for details in writing of the additional particular terms to which they were often subject (such as those recording trading agreements, promotions, etc). This is surprising and the OFT urges suppliers to ensure that they obtain and understand these additional particular terms...

The OFT believes that varying the Code would be unlikely to tackle its perceived ineffectiveness and would have legal and practical difficulties. No code can be successful in dealing with allegations of breaches unless there is evidence of those alleged breaches. In addition, the Competition Commission's 2000 report found that most relationships between supermarkets and suppliers were good. The Code has to

¹⁹ OFT press notice 28/04, *OFT publishes supermarkets code review*, 20 February 2004

²⁰ [Supermarkets: the code of practice and other competition issues](#) OFT783, March 2005

apply to a vast range of commercial dealings and making it more rigid and prescriptive may stop mutually beneficial arrangements between suppliers and supermarkets, in turn damaging competition and ultimately consumers.

The OFT is aware of proposals for a voluntary Buyers' Charter which ensures that supplier-supermarket relations are conducted on a clear and predictable basis: these are welcomed by the OFT (provided that the Charter complies with competition legislation).²¹

The report gave a little more detail on how this proposal for a voluntary Buyer's Charter, supported by the National Farmers Union, would have worked:

The objectives are similar to those of the statutory Code, although the intended scope of the Charter is broader. The Charter would be owned and administered by representatives of all major parties in the food supply chain, and would cover all key aspects of trading relations between them, including the principles to be applied to day-to-day relationships between suppliers and their customers. Participating companies would be independently audited, and there would be a procedure for the resolution of complaints and disputes, together with an independent panel to consider those complaints and disputes which could not be resolved at company level.²²

Concerns about the effectiveness of the Code continued to be raised during 2005;²³ the Labour Government's position on the issue was given in answer to a PQ in April that year:

Mr. Drew: To ask the Secretary of State for Environment, Food and Rural Affairs what discussions she has had with the Department for Trade and Industry on the recent Office of Fair Trading findings on supermarkets.

Alun Michael: Officials from the Department discussed the Office of Fair Trading's paper on the audit of the supermarket Code of Practice and related competition issues with colleagues in the Department of Trade and Industry at the time of its publication. The paper gives the Office of Fair Trading's preliminary views on the audit and on wider concerns that have been raised about competition in the grocery market and invites comments and evidence on both. We encourage all those who have views on these issues to respond to this invitation.

The paper also welcomes the National Farmers Union's proposal for a voluntary Buyer's Charter that would cover all key aspects of trading relationships between suppliers and their customers throughout the food chain. We support this initiative and have encouraged all sections of the food chain, whether they be retailers, processors or manufacturers, to work positively with the National Farmers Union to develop the proposal.²⁴

When the OFT published its report, it asked for evidence from supermarkets, suppliers and stakeholders "regarding the issues identified by the compliance audit, and wider competition

²¹ OFT press notice 52/05, *OFT publishes supermarkets compliance audit*, 22 March 2005

²² *Supermarkets ... OFT783*, March 2005 para 3.31

²³ For example, EDM 495 of 2005-06, 4 July 2005 & EDM 882 of 2005-06, 27 October 2005. These motions attracted 59 and 56 signatures respectively.

²⁴ HC Deb 7 April 2005 c 1674W. The issue was also raised in Trade & Industry Questions on 23 June 2005 (HC Deb cc 934-6).

concerns.” Following receipt of this, in August 2005 the OFT published its conclusions that the Code “should remain unchanged but be used more effectively”:

The OFT received 29 responses to its invitation for comments on the findings of the Supermarkets Code compliance audit report ... the OFT says that evidence has not been provided to show that the Supermarkets Code should be replaced or that the market for the supply of groceries and other goods is not working well for consumers. Without clear evidence that the Code is not working, or that competition in the market is being restricted or distorted, the OFT does not have grounds to refer the market to the Competition Commission or to launch a new market study.

The OFT will continue to encourage the use of the Code and work with supermarkets and suppliers to improve its practical usefulness. This initiative will include:

- working with supermarkets to ensure written records of supermarket-supplier dealings are kept, allowing for greater transparency in the terms of business
- regularly monitoring supermarkets' Code compliance procedures
- confirming that trade associations can take group actions on behalf of their members under the Code with sufficient evidence.²⁵

The *Financial Times* reported some of the reaction to these conclusions:

The [OFT] yesterday rejected calls to strengthen regulation of supermarkets' treatment of their suppliers and said there were no grounds for a new anti-trust inquiry into the growth of the sector ... Its findings were criticised by groups representing farmers, environmentalists, small businesses and others ...

The Liberal Democrats described the report as a disgrace. Norman Baker, environment spokesman, called for a National Audit Office investigation of the OFT's work on the code. Friends of the Earth, the environmental group, said: "This decision beggars belief. How many UK farmers need to go out of business before the OFT recognises that the Supermarket Code of Practice protects no-one but the supermarkets?" ... Which?, the consumer watchdog, welcomed the OFT's decision not to increase regulation. "Using regulation to turn back the clock to a mythical world of jolly butchers and attentive corner shops will involve a forced reversal of these demographic trends," said the organisation.²⁶

The outcome of the OFT's report was discussed in a written answer in March 2006:

Mr. Stewart Jackson: To ask the Secretary of State for Trade and Industry what steps the Office of Fair Trading takes to ensure local suppliers are able to provide evidence on possible breaches of the Supermarket Code of Practice without affecting their future contracts with the supermarket. [58422]

Mr. Sutcliffe: Competition in the supermarket and grocery sectors is a matter for the independent competition authorities, in this instance the Office of Fair Trading (OFT).

²⁵ OFT press notice 146/05, 3 August 2005. See also, [Supermarkets: the code of practice and other competition issues – conclusions OFT807](#), August 2005

²⁶ “OFT rejects supermarket suppliers inquiry”, *Financial Times*, 4 August 2005

In August 2005 the OFT announced its intention to monitor the code more proactively, and as part of this it will:

- Check regularly with supermarkets their procedures for complying with the code and how often and why their dispute procedures have been used; eg it will want to understand what kinds of dispute arise and how they are dealt with;
- follow up complaints made to it under the code where those are put to the supermarket concerned to find out what the outcome is and what happens to that supplier post-complaint; and
- take appropriate enforcement action against code breaches.

The OFT strongly recommends that suppliers seek written terms with the supermarkets, not least because this will help suppliers complain and help supermarkets demonstrate compliance more easily. The OFT would encourage suppliers who believe they have evidence of a breach of the code to bring their concerns in the first instance to the supermarkets in question, either individually or with the backing of their trade association.²⁷

B. The purchase of convenience stores

One related concern to the use, or abuse, of the Supermarkets Code of Practice, was the determined expansion by the major supermarkets into the associated sector of convenience stores.²⁸ Acquisitions during 2004 – including the purchase of Jacksons Stores by Sainsburys – lead to critics arguing that the OFT's criteria for measuring the degree of monopoly power in this sector were flawed, allowing the major stores to increase their dominance across the grocery trade – as the *Sunday Telegraph* reported in summer 2004:

Convenience stores used to be family-run businesses - a combination of newsagent, off licence and grocer selling a limited and often pricey range of goods. But the humble local shop is now the battleground for Britain's supermarket giants which are controversially expanding into the sector. Last week, J Sainsbury bought Jacksons Stores, a 114-strong chain in Yorkshire and the Midlands, for an undisclosed price ... It is just the latest acquisition by a major supermarket of a convenience store chain ... Tesco, the UK's largest grocer, with a 28 per cent share of the total market, has led the shopping spree. In 2002, it bought the 1,200-strong chain T&S Stores and earlier this year it took over Adminstore, a London-based group with 45 stores trading under the Cullens, Europa and Harts brands ...

[One of the] attractions for the supermarkets is that buying convenience stores has so far not raised competition issues. The Office of Fair Trading argues that the sector is effectively a separate market to supermarket retailing, because it offers a different shopping experience. This is deeply controversial. Trade bodies and senior industry figures, including Bill Grimsey, the chief executive of Big Food Group, owner of Iceland, and John Bridgeman, the former director general of the OFT, are calling for competition authorities to alter their definition of the grocery market.

²⁷ HC Deb 13 March 2006 cc 2008-9W

²⁸ In spring 2004, 79 Members signed an EDM raising concerns about this trend (EDM 1248 of 2003-04, *Concentration of grocery retailing*, 20 May 2004).

The current definition is based on an exhaustive Competition Commission investigation into supermarkets in 2000. The report distinguished between the large "weekly shop", typically in superstores, and the more spontaneous "top-up shop" in convenience stores. However, critics argue that customers don't distinguish between the types of shopping, and that the OFT's distinction is meaningless ... David Rae, the chief executive of the Association of Convenience Stores, which represents 30,000 shops, is lobbying the OFT to rethink its market definition. "With every acquisition in the convenience sector the definition becomes less relevant," he says. But that looks like wishful thinking - the OFT says there are no plans to review the guidelines unless a deal is referred to the competition authorities. And Sainsbury's acquisition of Jacksons is unlikely to be the trigger.²⁹

In November 2004 the Association of Convenience Stores contributed to a joint submission to the OFT to open a new investigation into the supermarket sector:

Friends of the Earth (FOE), The Association of Convenience Stores (ACS), the National Federation of Women's Institutes (NFWI) and FARM have put together an application ... for a full OFT market review into the grocery sector setting out how:

- Market consolidation is having damaging impacts on the local economy of communities across the UK
- Market concentration by the big four supermarkets has accelerated rapidly since the most recent investigation in 2000
- How new trends such as the huge rise of acquisitions of convenience stores by big supermarkets are reducing consumer choice
- Supermarkets have an armlock on their suppliers

The application says that changes in the market since the last review of supermarkets in 2000, and the lack of action from the competition authorities, make a new review of the market essential. Under the Enterprise Act (2002) interested parties are entitled to raise concerns about particular markets and request a Market Study.³⁰ ... The submission also highlights the failure of existing measures, including the supermarket code of practice which make the need for a market review even more urgent.³¹

An extract from this submission on how the grocery market should be classified is reproduced below:

Recent developments in the market show that the grocery market is incorrectly defined by using the model set out in the Competition Commission report 2000 which assumed there were two distinct market categories: "one stop" and "top-up". Although the OFT has recently denied that it segments the grocery market into two distinct sectors,³² in its assessment of the Tesco acquisition of T&S Stores³³ it specifically considered the case in terms of 'convenience retailing' and used Tesco's own

²⁹ "Supermarkets shop for convenience", *Sunday Telegraph*, 22 August 2004. In November 2004 104 Members signed a second EDM critical of the supermarkets' acquisition policy (EDM 187 of 2004-05, *Supermarket code of practice*, 25 November 2004).

³⁰ If the OFT decides to conduct a study the issues it will look into include; impacts on consumers; barriers to entry into the market and lack of innovation in the market. It may suggest solutions or it may refer the issues to the Competition Commission for a fuller investigation.

³¹ ACS press notice, *Call for new investigation into big four supermarkets*, 26 November 2004

³² *The Grocer* (2004). OFT says market is not segmented for mergers, 11/09/04

³³ OFT (2002). Proposed acquisition by Tesco PLC of T&S Stores PLC: Assessment

estimates of how much of its supermarkets' sales are 'convenience-related' to calculate what share of this section of the market would be accounted for by the merged operation. By making this distinction the overall buyer power of Tesco was not considered in this case and it was approved without reference to the Competition Commission.

This study is therefore necessary not least to ensure that the market is analysed in a way that better reflects the reality of the large supermarkets' market power, sitting as they do at the bottleneck between thousands of suppliers upstream and millions of consumers downstream.³⁴ At the downstream (retail) level, the market may sometimes need to be divided into different segments; in grocery retailing this may include, for example, supermarkets over 1,400 square metres (the measure used by the Competition Commission in the Supermarkets report), smaller grocery/convenience outlets, cash and carry, etc.

Retail markets may also need to be analysed by reference to geographic region, as was done in the Supermarkets report, in order to assess local dominance. At the upstream (procurement) level, the market clearly includes all types of grocery outlet, as the products sold in a small convenience store are the same as (though fewer in number) those sold in supermarkets and generally supplied by the same suppliers. The competition authorities' focus to date on large format retail has hidden the extent to which the major supermarkets dominate the "top up" or "convenience" spend in the UK. This is illustrated by the following facts:

- Top-up shopping accounts for £26bn in superstores – a higher figure than the total sales through convenience store outlets at £21.5bn.³⁵
- Harris International Marketing tracked over 1,000 shoppers and confirmed that convenience shopping now takes place at both large supermarkets and small stores³⁶
- The Grocer magazine also concluded that "shoppers do not differentiate between the two types of stores choosing to top up wherever it is convenient at a given time"³⁷

This fact was not accurately or sufficiently emphasised in the Competition Commission report of 2000. Since then the distinction has been further undermined by the rapid expansion of the major multiples' presence in convenience format outlets ... While the concerns are concentrated on the big four supermarkets, the study (and subsequent investigation) should examine the grocery sector as a whole, as many of the practices are generic to the grocery retailing industry. Certainly, so far as suppliers are concerned, the issues arising from the big supermarkets' massive buying power apply to all the products they sell, whether they are destined for a superstore or a convenience shop.³⁸

The OFT discussed this submission for a new investigation in their compliance audit of the Code of Practice published in March 2005, inviting evidence and comment on the wider

³⁴ IIED (2003). Food, Inc. Corporate Concentration from farm to consumer; figure 3.1

³⁵ Association of Convenience Stores (2004). Market consolidation, www.thelocalshop.com

³⁶ The Grocer (2004). Convenience? A superstore will do nicely – shoppers define convenience by needs not format, 17/04/2004

³⁷ *ibid*

³⁸ Association of Convenience Stores and others, *Proposal for a market study for OFT consideration*, November 2004 pp 3-4

issues that it raised.³⁹ It noted a number of structural changes to the market since the Competition Commission's report in 2000 which might have affected the major supermarkets' buying power, and asked for views on their 'practical effect':

Tesco and Asda particularly have broadened their product offer to consumers.⁴⁰ Tesco's share of supply of groceries in the UK has increased while that of Sainsbury's has fallen.⁴¹ Morrisons has acquired Safeway but the share of the combined operation has fallen to about the level of Safeway's alone before the acquisition. Tesco and Sainsbury's have also been increasing their presence in the convenience store sector. These developments may, cumulatively, have had an effect on the exercise of buyer power, with consequences for competition for suppliers and/or retailers. In particular, it has been suggested to us that convenience store acquisitions by large supermarkets have had an effect on buyer power. These have been permitted because, individually, they have not been found to give rise to a substantial lessening of competition.

In this context, we note that the balance of responses to surveys conducted by the CC for its 2003 report [into the bids for Safeway, which led to Morrison's purchase of this chain] indicated that suppliers' negotiating strength across all sectors had weakened since the CC's 2000 report.⁴² We have also been told that reductions in the market share of independent convenience stores as a result of acquisitions of some of them by large supermarkets have had an effect on the buyer power of the buying groups through which convenience stores predominantly obtain their supplies, and on the viability of their distribution chains.⁴³

The report did not directly address the complaints made about the Competition Commission's classification of the grocery market. Overall the OFT noted that it was "considering whether the issues raised by Friends of the Earth and others, or other concerns relating to competition in the grocery market, might provide a basis for a market investigation reference to the CC" – but made no firm commitment to do so.⁴⁴ (Under section 131 of the *Enterprise Act 2002*, the OFT may make a market investigation reference to the CC where it has "reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services, prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.")

As noted above, in August 2005 the OFT concluded that it did *not* have grounds to refer the market to the CC or launch a new market study. On the specific question of the supermarkets' entry into convenience store retailing the report said the following:

³⁹ *Supermarkets ... OFT783*, March 2005 pp 17-21

⁴⁰ Tesco's 2004 annual review and financial statement (see Tesco 2004 annual review) and Asda's website (All about Asda) refer.

⁴¹ Sources: comparison of the 1998/99 grocery market share data in relation to stores over 1,400 square metres in Table 2.3 on page 27 of the CC's 2000 report and the corresponding 2002/03 data in Table 2.2 on page 37 the CC's 2003 report.

⁴² Paragraphs 6.72–6.89 and 6.98–6.102 of [Competition Commission, *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc: a report on the mergers in contemplation* Cm 5950 September 2003].

⁴³ *Supermarkets ... OFT783*, March 2005 paras 4.4-4.6

⁴⁴ *Supermarkets ... OFT783*, March 2005 para 4.3

Inevitably, competition brings about change. That has manifested itself in the increased competitive pressure faced by smaller retailers as the large supermarkets have diversified into convenience retailing; and in changes in the respective market shares of the major supermarkets. It is not for the competition authorities to deny any players in a market opportunities for organic growth where they arise out of a perceived need and ability to meet consumer demand. We do, however, consider merger proposals very carefully and have acted and will act where these might give rise to a substantial lessening of competition.

We have received no firm evidence to show that below-cost selling and price flexing⁴⁵ are affecting competition adversely. The opinion has been expressed to us that price-flexing has decreased since 2000, driven no doubt by the increasing importance of the internet (which, by its nature, reflects national rather than regional prices) as a source of price data. There is no evidence that, as a result of supermarkets' entry into the convenience store sector, there has been any consumer detriment. We are not aware that any of the other practices which the CC's 2000 report identified as adversely affecting competition are continuing or of the emergence of any new practices with such an effect.⁴⁶

C. Debate on a reference to the Competition Commission

On 3 October 2005 the Association of Convenience Stores, supported by Friends of the Earth, launched a legal challenge against the OFT's decision in August not to make a market investigation reference.⁴⁷ Before the Competition Appeals Tribunal could rule on the case, the OFT announced that it would reconsider its decision afresh – with an aim to making a final decision by June 2006. In light of this, the Tribunal referred the matter back to the OFT, but it was strongly critical of the proposed timetable:

The first OFT investigation that took place in this case lasted from November 2004 until August 2005, which is already a period of some nine months. The OFT goes into some detail about the market in its contested Decision, and in an earlier preliminary report that it issued in March 2005. Against that detailed background it seems to us less than satisfactory that a further nine eight or nine months is now required in order to allow the OFT to decide whether or not it has reasonable grounds to suspect and, if so, whether a reference should be made. There is, if we may say so, some risk that one may mistake the height of the hurdle which s.131(1) presents. It is a "reasonable ground to suspect" test. The scheme of the Act is that a full investigation is carried out at the stage of the Competition Commission not at the stage of the OFT, although admittedly the OFT has to address the matter sufficiently to decide whether there are reasonable grounds "to suspect", and sufficiently in order to consider the question of undertakings under s.154 of the Act in lieu of making a reference.

Subject to that, it seems to us that on the presently envisaged timetable it would have taken some 16 months to decide even whether to make a reference in this case and,

⁴⁵ ie, charging different prices in different areas for the same groceries

⁴⁶ *Supermarkets ... conclusions OFT807*, August 2005 para 4.3-4.6

⁴⁷ Provision for this review process is made under section 179 of the *Enterprise Act 2002*: in brief, an aggrieved person may apply to the Competition Appeals Tribunal for a review of any decision made by the OFT, Secretary of State or Competition Commission under part 4 of the Act. This includes the power of the OFT to make a market investigation reference.

if a reference was then made, that would be followed by an investigation by the Competition Commission lasting up to two years making a total period of three or four years altogether. That seems to us to be unsatisfactory to all parties on which ever side of this particular argument they happen to be and, from the point of view of parties such as the Applicants, to involve some risk (if the Applicants are right) of shutting the stable door after the horse has gone. Of course, at this stage of the proceedings we express absolutely no view as to the merits of this case, our concern is simply about the envisaged timescale.⁴⁸

Critics of the OFT have often argued that the sector should have an ombudsman or regulator,⁴⁹ though at this time the Labour Government strongly opposed the idea. Malcolm Wicks, then Minister for Energy, set out the case against a separate regulator in response to an adjournment debate in December 2005:

We do not accept that a new supermarket regulator would add any value without duplicating regulatory processes and imposing increased burdens, not only on supermarkets but on the companies that supply them. It would be wrong to regulate in that way, and the Government would set a dangerous precedent if we created a regulator to oversee contracts between businesses. Unless unfair, anti-competitive or illegal practices are taking place there is no place for interference from regulatory bodies. British businesses would lose any competitive advantage over their competitors and the country as a whole would be poorer for it.⁵⁰

The Minister also addressed the specific point that the OFT was poorly informed about the operation of the market, because the Code of Practice prevented suppliers making anonymous complaints:

The major concern with the current code is that suppliers will not make complaints to the OFT for fear that such action would limit their ability to secure contracts with other supermarkets. I have listened carefully to that concern. Farmers and suppliers have indicated that they would be more likely to make formal complaints to the OFT if the OFT could guarantee anonymity for complainants. However, any complaint system will require the supermarkets to be made aware of the details of the complaint. An ombudsman or independent regulator would normally need to share complaints with operators, so that the circumstances and legitimacy of the allegations could be verified and the complaint addressed. Clearly, there are some difficulties here.

The code has a disputes process which incorporates the recognised ombudsman model. Introducing anonymity to the complaints process under the code would run counter to one of the code's main objectives—to put relations between supermarkets and their suppliers on a clearer and more predictable basis. In pursuit of that objective, the OFT has encouraged supermarkets to put more of their dealings with suppliers in writing. Of course, suppliers have a right under the code to seek terms of business offered by supermarkets to suppliers in writing. That should help suppliers to be more assertive in their dealings with supermarkets. We welcome the OFT's commitment to continue to monitor the operation of the code proactively. That is to be

⁴⁸ *The Association of Convenience Stores v Office of Fair Trading* [2005] CAT 36, Case Number 1052/6/1/05, 1 November 2005 para 7

⁴⁹ Andrew George MP argued for this in a debate in spring 2004 (HC Deb 16 March 2004 cc 23-32WH).

⁵⁰ HC Deb 7 December 2005 c 968

achieved through a number of measures, including encouraging greater use of written terms between suppliers and supermarkets.⁵¹

In February 2006 the All-Party Parliamentary Small Shops Group published a report on the long term prospects of the small retail sector, finding that among those giving evidence “there is widespread belief ... that many small shops across the UK will have ceased trading by 2015 with few independent businesses taking their place. Their loss, largely the result of a heavily unbalanced trading environment, will damage the UK socially, economically and environmentally.” The group made a series of recommendations, including:

- Implement a moratorium on further mergers and takeovers until the government has brought forward proposals to secure the diversity and vitality of the retail sector
- Establish a retail regulator
- Revise the two market ruling⁵²
- Introduce comprehensive codes of practice across the retail sector.⁵³

On the need for a retail regulator the group argued “the responsibility of maintaining a vibrant, diverse and sustainable retail sector falls outside the remit of the OFT who are principally bound to consider competition concerns to the exclusion of the other social and non commercial benefits generated by independent retailers.” On the question of complaints about the code of practice, it proposed that “the Government must provide whistleblower protection under the supermarket code for all those who highlight abuses. Evidence shows that a simple anonymity clause fails to address the concerns of those unwilling to bring forward complaints.”⁵⁴

The report received some coverage in the press,⁵⁵ and two EDMs – in October 2005 and March 2006 – cited the group’s inquiry, both criticising the OFT’s decision not to conduct a full review of the grocery market.⁵⁶ An editorial in the *Financial Times*, was critical, particularly of the group’s support for a new regulator: “competition is all that is needed to maintain a vibrant, diverse, and sustainable retail sector.” That said, the paper suggested the OFT was right to reconsider its decision in August 2005 not to refer the market, and that the Commission’s ruling in 2000 that supermarkets and convenience stores were separate “needs review”.⁵⁷

On 9 March 2006 the OFT published a consultation paper on its intention to refer the grocery market to the Competition Commission.⁵⁸ In explaining this decision the OFT’s Chief Executive, John Fingleton, said that the organisation had “built up substantial new evidence and knowledge about this sector in the past four months. Although consumers have

⁵¹ HC Deb 7 December 2005 cc 968-9

⁵² [This is a reference to the Competition Commission’s analysis in 2000 that argued that ‘one stop’ and ‘top up’ shopping were distinct categories in the grocery market – see Cm 4842 October 2000 para 4.20-46.]

⁵³ All-Party Parliamentary Small Shops Group, *High street Britain: 2015*, February 2006 pp 6-7

⁵⁴ *op.cit.* pp 72-3

⁵⁵ for example, “MPs urge ban on takeover of small grocers”, *Financial Times*, 15 February 2006; “10 years to save the high street, MPs warn”, *Guardian*, 15 February 2006

⁵⁶ EDM 876 of 2005-06, 26 October 2005 & EDM 1747 of 2005-06, 2 March 2006. These motions attracted 98 and 78 signatures respectively.

⁵⁷ “Leader: bogus backlash over supermarkets sweep”, *Financial Times*, 16 February 2006

⁵⁸ *Grocery market: proposed decision to make a market investigation reference OFT838*, March 2006

benefited from lower prices, the restrictions in the planning system, and the possible incentives those restrictions create for retailers to distort competition, may harm consumers and mean that competition in the market is less than it might otherwise be.” Further details were given in the press notice which quoted Mr Fingleton’s comments:

The grocery market is evolving rapidly. The four largest supermarkets (Asda, Morrisons, Sainsbury’s and Tesco) have consolidated their share of total food retailing since 2000, and some supermarkets have moved into the convenience store sector, competing directly with smaller chains and independent stores. While the number of convenience stores has fallen slightly since 2000, sales per store have risen and symbol groups and co-ops have grown within this sector.

The evidence built up by the OFT presents a mixed picture regarding competition in the market. It suggests that prices are falling, with some evidence of increasing choice and improving quality. It suggests that consumers have benefited from strong competition between supermarkets, and from the entry of the supermarkets into the convenience sector.

However, there are features of the market which, when considered in the context of increased consolidation and the move by supermarkets into the convenience sector, could reasonably be suspected to distort competition and harm consumers. In particular, the evidence suggests that:

- the planning regime, and in particular the 'needs test' acts as a barrier to entry, making it difficult for new stores to open and compete with those already in the market
- big supermarkets appear to have significant land banks which could, coupled with the planning system, aggravate barriers to entry or otherwise harm consumers
- in some instances, supermarkets have attached restrictive covenants in selling sites.

There is also some evidence to suggest that the big supermarkets' buyer power has increased, and that there are aspects of the big supermarkets' pricing behaviour - below-cost selling and price flexing - which could distort competition. Although consumers have benefited from lower prices, the data does not allow the OFT to reach a firm conclusion on whether choice and variety for consumers in local markets - whether choice of fascia or on-shelf product variety - have increased. Because pricing practices and buyer power interact with local concentration to affect product variety and choice of fascia, the OFT proposes also to refer to these features in making the reference.⁵⁹

Although this note does not discuss the planning regime in any detail, it may be helpful to reproduce a short section of the OFT’s report, which explains the “needs test” mentioned in their press notice:

The planning process for supermarkets outside areas designated for retail development differs from most other planning applications in that there is an initial test of 'need'. That test has been extended (in 'Planning Policy Statement 6' [PPS6])

⁵⁹ OFT press notice 49/06, *OFT proposes to refer grocery market to Competition Commission*, 9 March 2006

to include 'choice'. However, PPS6 does not take different fascias into account when reviewing a planning application – merely the retail offering – so for example it would not consider whether there were already four fascias of the same supermarket already in the area, as long as the new supermarket could meet the retail 'needs' of the area as identified by PPS6.

The needs test is formulated by calculating the retail need of an area in sales. This is then turned into £'s capacity, which in turn is then translated into square metres. The effect is that if a retailer has high sales per square metre, it will be given less space to develop. This could make a difference and determine whether or not it is worth a potential entrant developing on a smaller site if it has to compete with a large incumbent. One of the smaller supermarkets provided examples of target towns which have fewer than four fascias – and therefore for the purposes of competition analysis a potential lessening of competition - but which it cannot gain entry to due to 'full capacity'.⁶⁰

The consultation lasted for four weeks and ended on 6 April 2006.⁶¹

On the particular question of market definition the OFT commented as follows:

We are aware of criticism of the 'two markets' approach from a number of groups ... In practice, recent merger decisions have acknowledged the links between the two markets ... and to that extent we believe that the criticisms of the approach are misplaced. In particular, the fact that one type of retailer starts to supply in hitherto different markets does not necessarily result in those markets being regarded as merged into one. Nevertheless, these are issues that any CC investigation may wish to reconsider.

For the purposes of this investigation and our proposed decision on a market investigation reference, we have used the CC's product market definitions as the starting point. However, we have kept in mind the importance of considering the linkages between these markets, particularly when analysing the growth of the Big Four into smaller format stores. Where we refer to 'the market' in general terms in the document, we mean the market(s) for grocery sales to final consumers in the UK, covering both one-stop shopping and secondary shopping.

In addition to the definition of the relevant product market, there is also a question of the relevant geographical market(s) in consulting on a reference. The CC's 2000 report concluded that 'Taking the evidence as a whole, our view is that the ambit of consumers' search for groceries is essentially local'.⁶² The analysis of mergers involving grocery retailing since the 2000 report has developed a detailed methodology using 'isochrones' based on average drive times between stores. For the purposes of this investigation, we have assumed that market power could, theoretically at least, be exercised at a local as well as at a national level, although national competition clearly constrains the degree to which firms can operate in any locality unconstrained by competition. We are proposing to refer the whole UK market

⁶⁰ OFT838, March 2006 paras 7.5-6

⁶¹ Under section 169 of the *Enterprise Act 2002*, where the OFT is proposing to make a decision on a reference to the Competition Commission it must first consult, so far as practicable, any person on whose interests the reference is likely to have a substantial impact.

⁶² *Supermarkets*, Competition Commission 2000, paragraph 2.47

because the features we have identified apply to most local areas and, in the case of buyer power, affects more national upstream markets such as wholesaling.

We emphasise that these comments only give an overview of the possible relevant economic markets. A central task for the CC in any investigation would be to come to its own view of the appropriate market definition(s).⁶³

There was a variety of responses to the OFT's announcement. A leader in the *Guardian* noted, "so much has happened since [the 2000 Competition Commission report] ... that a new inquiry has been long overdue. The politics of the high street have also changed as reflected in the fact that both the Liberal Democrats and the Conservatives welcomed the decision - with the Tories even calling for a much wider inquiry into the future of the high streets."⁶⁴ The *Times* argued that "the speed of change makes for a confusing picture", noting that "the convenience market is growing healthily, although the larger fishmongers, greengrocers and independents are losing out to chains." The paper hoped that if an investigation found evidence of anti-competitive practices they should "be punished and dismantled", but if not, "it should be easier to draw a line under the blend of romance and conspiracy theory that makes the supermarket debate so emotive."⁶⁵ The *Financial Times* was uncertain if a new investigation by the Commission was the best course of action:

So why another inquiry? The Office of Fair Trading has realised the 2000 report that provided the framework for allowing the 2003 acquisition of Safeway by Wm Morrison is out of date. It divided grocery retailing between one-stop shopping outlets - supermarkets - and secondary outlets such as convenience stores. The expansion of supermarket chains into convenience stores means the two markets have merged and competition policy needs to evolve.

But it is far from clear that anything else needs to change soon. If Tesco continues to raise its grocery market share - it now has more than 30 per cent - it will eventually achieve a level of market dominance that might justify intervention. The best way to avoid that would be to reduce barriers to entry for new competitors by loosening planning restrictions - which the government is reluctant to do. Meanwhile, any attempt to make supermarkets charge higher prices to protect less efficient competitors is unlikely to be popular. The supermarkets thus face up to two years in regulatory limbo that are unlikely to be more productive than previous inquiries. The referral would be justified only if it produced a new framework for competition rulings that reduced the amount of time supermarkets have to spend with the regulators.⁶⁶

In a second editorial which appeared some weeks later, the paper acknowledged the concerns the OFT had raised about the impact of the planning regime on competition:

The real Tesco competition issue lies among the supermarkets. A regulatory inquiry into this sector looks set to be announced early next month. It should concentrate on the planning regime. There is evidence that this does distort competition and can reinforce the dominance of a particular chain in a given locality. One improvement

⁶³ *OFT838*, March 2006 paras 2.6-9

⁶⁴ "Leader: supermarkets – change on the high street", *Guardian*, 10 March 2006

⁶⁵ "Leader: food for thought", *Times*, 10 March 2006

⁶⁶ "Leader: back to the checkout", *Financial Times*, 10 March 2006. The business editor of the *Independent*, Jeremy Warner, made similar criticisms: "Another supermarket investigation", 10 March 2006.

would be to require local planners to favour an approach that would bring a different retailer into the area, instead of being fascia-neutral as they are now. This would remove the bias that currently makes it worthwhile for the incumbent to pay more than others for a site, tightening its grip on a town or city.⁶⁷

Writing in the same paper a few days after the OFT's announcement, Jonathan Guthrie made some interesting observations:

It is assumed that the correct *laissez faire* capitalist response to Tesco-phobia is to shrug and say "So what?" The British Retail Consortium responded with characteristic blimpish annoyance to news of the likely Competition Commission investigation last week. The more emollient Lucy Neville-Rolfe, a director of Tesco, told me: "Our mandate comes from our customers. We feel we are a good company that helps poorer people to have a better life." Perhaps. But I have one quibble. Enterprise also helps poor, and not-so-poor people, have a better life. Advisers and investors who once promoted retail to aspiring entrepreneurs now steer them away. Economies of scale have allowed big chains, led by supermarkets, to create steep barriers to entry. Such disruptive creators of new businesses as Jack Cohen, founder of Tesco, would give food retailing a wide berth these days.

The weakness of the Tesco-phobes' case is that there is, as yet, zero evidence of consumer detriment. Tesco's weakness is to believe that that fact has talismanic power to ward off regulatory intervention. The competition authorities lazily went with the flow in waving through Tesco's acquisition of the T&S convenience store chain in 2002. Now the current has changed direction. The campaign against supermarkets has established a foothold in public opinion and in parliament.

Ms Neville-Rolfe talks fondly of Tesco as "an unfashionable little guy in the days when most supermarkets were posh". But it is delusional to see your company as a lovable maverick when it is the UK's largest private sector employer. Tesco has a tendency to stick its fingers in its ears and hum loudly when its impact on small retailers is mentioned ... Tesco should tread gingerly as the competition authorities consider the case against it. The store chain must avoid repeating such public relations debacles as its attempt to take business from Proudfoot, a family-owned supermarket, through aggressive discounting. Last Saturday in my local Tesco, shoppers I spoke to railed against the power of supermarkets even as they loaded up their trolleys. Tesco's mission to please the Great British Public should not blind it to the fact that the Great British Public can be stunningly, if unconsciously, two-faced.⁶⁸

In this context it is striking that around this time the chief executive of Tesco, Sir Terry Leahy, announced a series of initiatives to reflect customers' demands that "businesses – including supermarkets – [are] good neighbours in the communities they serve."⁶⁹ These included commitments on the company's use of degradable plastic bags and its provision of recycling facilities, better labelling for healthier foods, more sourcing of local supplies, and changes in the planning process for building new stores:

We work with the grain of national planning policy, and believe in a planning system that promotes sustainability as much as it promotes development ... [Of the ten

⁶⁷ "Leader: Tesco the tall poppy in full bloom", *Financial Times*, 26 April 2006

⁶⁸ "Tesco-phobes and the two-faced British public", *Financial Times*, 16 March 2006

⁶⁹ "Every little helps store to become good neighbour", *Financial Times*, 11 May 2006

measures in this plan] our eighth change is that we will improve the way we consult local communities before building new stores so that we can be sure that we have understood local issues and concerns. So, from 2007, we will hold a public exhibition or consult local communities proactively in other ways on every new Tesco superstore. We are discussing with the Campaign to Protect Rural England what consultation processes work best – for example in market towns.⁷⁰

In fact Sir Terry's statement was made in a speech to the Work Foundation think-tank on 10 May, the day after the OFT confirmed that they would refer the grocery market to the Competition Commission.

D. The OFT's reference to the Commission – May 2006

On 9 May 2006 the OFT announced that the Competition Commission would carry out a full investigation of the grocery market.⁷¹ It appears that the "vast majority" of respondents to the OFT's consultation favoured a reference. In a summary of this exercise, the OFT noted, "aside from the four largest supermarkets, only two respondents argued against a reference. However, respondents also raised many substantive issues about the analysis in the Proposed Decision, and the scope of a possible CC investigation."⁷² In coming to its decision the OFT explained that its *main* concerns about the state of competition in this sector related to the planning regime and the practice of the major players in buying, holding and selling land, though the Commission would be able to examine the issue of buying power as well:

Aspects of the large supermarkets' pricing behaviour – below-cost selling and price flexing – also provide reasonable grounds for suspecting that competition is being distorted, though the extent of the possible distortion is unclear. Although the OFT has not found evidence that consumers are being harmed as a result of these pricing practices, a CC market investigation would be able to examine in greater detail the effects that these practices may be having on competition and consumers.⁷³

As in earlier debates, some respondents had been critical of the OFT's analysis of what constituted the grocery market. For its part the OFT reiterated its view that it had not underestimated the impact of the supermarkets in the convenience store sector, but said the CC might look at this issue in its investigation. Similarly, the OFT decided to refer the *whole* UK market to the CC, as it had initially proposed:

For the purposes of this inquiry, the OFT has assumed that market power could, theoretically at least, be exercised at a local as well as at a national level, although national competition clearly constrains the degree to which firms can operate in any locality unconstrained by competition. The terms of the OFT's reference to the CC cover the whole UK because the features it has identified are likely to apply to most

⁷⁰ Tesco press notice, *Tesco in the community - Sir Terry Leahy speech to The Work Foundation*, 10 May 2006

⁷¹ OFT press notice 84/06, 9 May 2006. For background detail on the process for these enquiries see, OFT, *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act*, March 2006.

⁷² *The grocery market: the OFT's reasons for making a reference to the Competition Commission OFT845*, May 2006 p88.

⁷³ *OFT845*, May 2006 p2

local areas and, in the case of buyer power, affect broader upstream markets in the supply of groceries and in wholesaling, which then affect the downstream retail market.⁷⁴

Notably the OFT confirmed that the Supermarkets Code of Practice would remain in force during the CC investigation:

Following the reference to the CC, the Code will remain. Therefore, the OFT continues to encourage supermarkets to provide written terms to suppliers. The OFT will also refocus its monitoring of the Code on facilitating and checking compliance. This could involve talking to the supermarkets and supplier trade associations on a regular basis, and discussing any scope for improvement and changes as they arise. The OFT remains willing to discuss alleged specific breaches of the Code with suppliers and their trade associations on a confidential basis.⁷⁵

It also underlined that a future revision of the Code might be an appropriate remedy for concerns about buyer power:

Although the market investigation reference that the OFT is now making to the CC is focused on competition at the retail level, one of the features of the market which the OFT suspects of distorting competition on that market is the buyer power of the large supermarket multiples. In looking at that suspected feature, the CC can be expected to consider the ability of the supermarkets to exercise buyer power in their dealings with suppliers. If the CC decides that buyer power is a feature which is distorting competition, the CC might reasonably be expected to consider changes to the Code as a possible route for remedying that feature.⁷⁶

This point was made by the then Minister for Trade, Ian McCartney, in response to an adjournment debate on small shops soon after the OFT's announcement:

The supermarket code of practice, which regulates the relationship between the big four chains and their direct suppliers, is not affected at this time, and remains in place until the companies bound by it—Tesco, Sainsbury's, Asda and Morrisons—are released from the undertakings that form the basis of the code. It will be for the Competition Commission to make recommendations in its report on whether it believes that the code should be maintained, amended or repealed.⁷⁷

In its analysis of the planning system, the OFT repeated its concerns about the operation of the 'needs test', but went on to make a more general point:

The need to gain planning permission means that the process of building a new supermarket is protracted. One supermarket operator suggested to us that developing a site for retail could take up to five years, and another told us that site development could take between 54 and 76 months, depending on the extent of central government involvement in the planning approval decision. Therefore, it is difficult for new stores – primarily large supermarkets – to enter the market, and entry

⁷⁴ OFT845, May 2006 pp 7-8

⁷⁵ OFT845, May 2006 p 90

⁷⁶ OFT845, May 2006 pp 90-91 – see also, p 75

⁷⁷ HC Deb 13 June 2006 c 748

takes a long time. The OFT understands that the Government has acted to speed up the planning process, reducing the validity of planning permissions for outline and detailed permission from three to two years and five to three years respectively. This is a welcome development.⁷⁸

Although respondents to the consultation had agreed the planning system was an important issue, the OFT found contrary views about a solution:

A significant proportion of consultation responses, including those from individuals, commented on the planning regime and agreed that it should be considered as part of a CC investigation. However, a large number of respondents appeared to oppose a liberalisation of planning law that could make it easier to develop new large stores. For example, one respondent argued that allowing a significant increase in new supermarket growth would not be in the long-term interest of consumers. Another respondent commented that liberalisation of the planning regime could expose small retailers to more supermarket competition rather than less. A further respondent stated that competition policy should not take primacy over planning laws.⁷⁹

The report went on to discuss the evidence the OFT had gathered on the supermarkets' ownership of land, leading it to make a central conclusion:

In relation to land holdings, sale and acquisition of sites, and applications for planning consent, the evidence the OFT has seen suggests that the four largest supermarkets:

- hold a significant stock of undeveloped land, which could, in principle, act as a barrier to entry at a local level
- have an incentive to engage in strategic behaviour with regard to obtaining planning consents and bidding for land, which could have the effect of restricting competition at a local level, and
- have all imposed restrictive covenants on sites they have sold, which restrict the future use of those sites in a way which reduces the threat of competition.⁸⁰

The OFT's decision to refer the market was widely expected.⁸¹ The *Times* noted, "shares in all four big supermarkets held up yesterday as there were few surprises in the OFT's referral document."⁸² The *Financial Times* reported that "the decision prompted a sigh of collective resignation from the big supermarket chains ... it means the sector will now be under investigation for up to two years at a cost to the supermarkets of about £20m between them."⁸³ However, on starting the CC's investigation, the Commission's Chairman, Peter Freeman, said, "We recognise that an inquiry like this puts big demands on the parties involved, so we will aim to be as quick as we can, although we are required to conduct a comprehensive investigation. The law permits us two years to complete our investigation [ie, by 8 May 2008], but we aim to finish in substantially less time than that." The press notice went on to describe the procedure for the investigation:

⁷⁸ OFT845, May 2006 p 58

⁷⁹ OFT845, May 2006 p 59

⁸⁰ OFT845, May 2006 pp 66-67

⁸¹ The *Financial Times* predicted the announcement a few days before: "OFT to confirm full grocery market probe", 4 May 2006.

⁸² "OFT opens door wide for grocery inquiry", 10 May 2006

⁸³ "Planning laws a big threat to grocery competition, says OFT", 10 May 2006

In its inquiry, the CC is required to decide whether: 'Any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.' If so, then there is an adverse effect on competition and the CC will also consider whether this is resulting in a detrimental effect on customers such as higher prices, lower quality or less choice of goods or services. The CC will then decide whether the CC should introduce remedies to tackle the adverse effect on competition or detrimental effect on customers or whether the CC should recommend action be taken by other bodies to remedy the adverse effects on competition and if so, what actions or remedies should be taken. If the CC finds there is no adverse effect on competition the question of remedies will not arise ... The CC will now appoint members to its inquiry group and will then publish a draft timetable for the inquiry. The first task for the group will be to gather evidence by contacting all involved parties and by advertising for submissions from any other interested groups or individuals ... The CC would like to hear from all interested parties, in writing, by 6 June 2006.⁸⁴

Nils Pratley, business columnist in the *Guardian* argued that there might be major repercussions: "what everybody seems to have missed is a parallel drawn by John Fingleton, the OFT chief executive. Could a would-be Ryanair of the supermarket scene get a foothold, he once asked, implying it would currently be impossible. Whether a Ryanair-style supermarket is really desirable is another matter ... but the airline analogy gives a flavour of the radical nature and scale of the OFT's thinking."⁸⁵ In a slightly cynical vein, Damian Reece, city editor at in the *Telegraph*, wrote, "the fundamental answer, if there is a lack of competition, has to be more supermarkets, not fewer ... With this in mind, the OFT reckons the planning system "can reasonably be suspected of restricting or distorting competition", particularly by way of new large-format stores. This is probably not what the green lobby had in mind when complaining to the OFT."⁸⁶ In a long piece supportive of the major supermarkets, Richard Tomkins in the *Financial Times* argued that complaints about the demise of small independent grocers relied in part on a romantic illusion about the nation's shopping past:

Just as there are two kinds of eating, there are two kinds of shopping: one is done out of necessity and the other, for pleasure. In less prosperous times, shopping for food in Britain never was undertaken very much for pleasure (nor, for that matter, was eating). The great triumph of the supermarkets was to make that kind of shopping as easy and cheap as possible. Shops that could not compete on that level were wiped out. In these more prosperous times, however, new opportunities have opened up for small, specialist stores: they can offer that other kind of shopping - for pleasure. If they can differentiate themselves from the supermarkets by offering delicious and interesting food accompanied by friendly, knowledgeable service - in other words, by masquerading as the shops we imagine once existed but probably never did - they can do very well.

⁸⁴ Competition Commission press notice 27/06, *OFT refers groceries market to Competition Commission*, 9 May 2006

⁸⁵ "Viewpoint: Inquiry spells trouble for big four", 10 May 2006

⁸⁶ "Business comment: Big stores' opponents should be careful what they wish for", *Telegraph*, 10 May 2006

Looking at one town without a supermarket chain, Wells-next-to-the-Sea, the author went on to argue that far from having a destructive impact, the presence of a supermarket on the high street might be the best way to guarantee its future:

Joyce Trett, chairman of North Norfolk district council and a Wells resident all her life, says people in Wells are "desperate" for the choice a supermarket would have brought ... many or even most people in Wells go to other towns to use their supermarkets. "Like that, you're taking the trade out of Wells because while you're going down the street to the supermarket, you're just as likely to nip into one of the other shops to make a purchase," Trett says. "So the more you can hold within your town to keep it alive, the better." Who would have thought? Not just for shoppers but for a lot of shopkeepers too: if there is one thing worse than having a Tesco in town, it is not having one.⁸⁷

E. The start of the Commission's inquiry

On 15 June 2006 the Commission published an 'issues statement', setting out its approach to the inquiry. In an accompanying press notice the Chairman of the Commission, Peter Freeman, reiterated his determination to have the inquiry completed before the end of 2007, and sought to reassure those worried about giving evidence:

"For us to do our job properly, we need people to come forward and provide us with evidence. We know there are concerns about preserving the anonymity of those giving evidence to us, but I must stress that we are very well practised in dealing with confidential material and protecting the identity of parties who provide submissions, where this is requested. Many parties have already helped us by sending in evidence and I would urge other people to come forward."⁸⁸

The issues statement set out three areas 'most relevant' to the market study:

- (a) whether any aspect of the behaviour of grocery retailers towards their suppliers affects competition in any market;
- (b) whether any aspect of the structure of any local market for groceries,⁸⁹ or any aspect of the conduct of grocery retailers or consumers in the market for groceries (or in any other market in which grocery retailers operate) affects competition in one or more local markets for groceries, or in any other product market; and
- (c) whether the operation of the planning regime as it affects grocery retailing, or any conduct by grocery retailers, including any aspect of the acquisition, disposal, development or use of land, affects competition in any market.

It also emphasized that the Commission's focus had to be on competition:

The [Commission] is required to determine whether any feature, or combination of features, of the market prevents, restricts or distorts competition.⁹⁰ If this is so, there

⁸⁷ "The town with no Tesco", *Financial Times*, 6 May 2006

⁸⁸ Competition Commission News Release 33/06, *Groceries Issue Statement*, 15 June 2006

⁸⁹ The reference to local markets for groceries is without prejudice to our consideration of the relevant product and geographic market [paras 13-16 of the statement say more on this]

⁹⁰ Section 134 of the *Enterprise Act 2002*.

will be an 'adverse effect on competition', and we will seek to identify the detriment to consumers resulting from the adverse effect on competition (which might take the form of higher prices, less choice, lower quality of available products or lower innovation than if competition was working effectively) ...

But we must distinguish competition issues from other issues of public concern associated with grocery retailing which we have no power to investigate or resolve. Unless they affect competition, issues such as the environmental impact of the grocery supply chain, the composition of the high street and its impact on communities, rural land usage or employment conditions in overseas suppliers are not things we can decide on. These issues and public concern about them may interact with competition issues and provide background and context for our investigation, but our focus must be on the competition issues.⁹¹

In December the Commission acknowledged that the number of submissions it had received would delay their final report by a month: to November 2007.⁹² On 23 January 2007 it published its 'emerging thinking', summarising the evidence it had gathered in areas such as the supply chain, planning and land banks, and outlining the next steps in the inquiry – though without drawing any conclusions. As with previous inquiries the Commission was concerned that farmers and other suppliers had not provided enough specific examples of supermarkets abusing their buyer power; as the Commission's press notice summarised:

Many general assertions made about the activities of and the power held by supermarkets but less specific evidence than might have been expected. Not clear that this is all down to 'fear factor', given our comprehensive procedures to deal with this. Picture so far of supply chain practices is varied and not always bad for the consumer.⁹³

Chairman of the Commission, Peter Freeman, explained that the inquiry would now focus on local markets, going on to appeal for more information on the supply chain:

"We need to see what choices shoppers have in particular areas and how competition works between retailers of different sizes. We know about the extent of retailers' land holdings, but it's how these are used at local level, and the related effect of the planning system, that matters. It would be a cause for concern if supermarkets, either individually or collectively, were in a position to increase prices or lower their offer in any particular locality or region because of lack of effective competition ...

We have found that bigger buyers do not always appear to get better terms from suppliers, and food and drink manufacturers and processors, as well as wholesalers, seem to be in reasonable shape. However, we have some concerns about farmers and we have not received as much specific evidence about unfair treatment of suppliers as we might have expected. There may well be many more examples out there but we need to hear them otherwise we would have difficulty coming to a conclusion. So we would appeal once more for suppliers with examples to come forward and assure them that requests for confidentiality will be taken on board."⁹⁴

⁹¹ Competition Commission, *Groceries market investigation: Statement of issues*, June 2006 paras 8, 4-5

⁹² "Timetable for grocery inquiry pushed back", *Financial Times*, 12 December 2006

⁹³ Competition Commission News Release 03/07, *Groceries Inquiry goes local*, 23 January 2007. The document was accompanied by eight working papers and a survey of suppliers.

⁹⁴ Competition Commission News Release 03/07, 23 January 2007

In evidence to the Commission some respondents had argued that Tesco's land holdings gave the company means to establish market domination; indeed, Sainsbury's made this argument in their submission:

[Tesco's ability to have relatively high local market shares in certain areas] is caused by Tesco exploiting the planning and regulatory environment that considers "need" for new space and fascia for acquisition and mergers, neither of which provide an appropriate assessment of competition issues or choice for consumers ... Tesco's high levels of market share have been achieved by a combination of three factors: opening or acquiring a large store, opening or acquiring a number of smaller stores, or extending existing stores in the same area. Once stores are built, acquired or extended to such a scale that they meet a sufficiently large share of local demand, then the apparent "need" for additional space becomes more difficult to justify in current planning terms. This restricts local choice and creates the potential for future consumer harm.

The fascia test - as used in the 2003 Competition Commission inquiry - for deciding who, on a local analysis, would be able to acquire the 297 Safeway stores, similarly took no account of size of store, sales per sq ft and market share. The outcome of this was that Tesco and Sainsbury's were similarly affected, in spite of the difference in their market positions. In this situation the fascia test was a blunt tool that led to an inappropriate effect. In a market where there is a greater variability in store size and sales, the fascia test is now wholly outdated ...

Tesco's growth strategy means that local market share concentration is likely to worsen over time. In addition to its current 34 per cent share of the one-stop market, Tesco has 55 per cent of the publicly-known industry land bank. Consequently, Tesco's market share could reach 38 per cent by 2010, simply if all one-stop competitors rolled out their current land banks. Moreover, if recent differential growth rates were projected forwards, Tesco would achieve an even greater market share of 43 per cent.⁹⁵

The Commission acknowledged the company's pre-eminent position, but did not find the evidence supported this conclusion:

In relation to land, we have obtained substantial data on the land holdings and intentions of the major grocery retailers. An initial analysis confirms Tesco's pre-eminent position in terms of the holding of land for retail development. The suggestion that Tesco can build on its owned land to achieve a 45 per cent share of grocery retailing is not in our view, on present evidence, substantiated ...

Based on existing land holdings, pending land acquisitions and proposed developments as well as a range of other assumptions covering matters such as the existing ratio of grocery sales to land area, and recent sales trends for smaller grocery retailers,⁹⁶ we have developed two sets of projections for future national shares of grocery sales for the four largest grocery retailers. These projections do not

⁹⁵ Sainsburys, *Competition Commission Inquiry Overview of Sainsbury's position*, 20 October 2006 pp 2-3. Submissions to the inquiry are published on the Commission's website.

⁹⁶ [The assumptions underpinning this analysis are set out in one of the working papers issued by the Commission: *Working paper on land holdings and use issues*, January 2007.]

show Tesco's share of national sales increasing to 43–45 per cent. Our projections do, however, show some increase in Tesco's share of national sales over the period until 2011 with the extent of that increase varying according to the assumptions that are made. For the other three major grocery retailers (Asda, Morrisons and Sainsbury's), our projections vary.⁹⁷

The Commission's work drew criticism from both Tesco and Sainsbury's. Tesco's chief executive, Sir Terry Leahy, was quoted in the *Financial Times* as saying the inquiry was "more and more about less and less ... Any evidence that has come forward has dispelled many of the myths which have been asserted predominantly by our competitors, whether that has been on suppliers, on land or pricing policies."⁹⁸ By contrast Sainsbury's argued that the Commission had misunderstood its submission, and in particular, its projections that Tesco's market share could grow to 43 per cent.⁹⁹ However, the Commission's work was given a cautious welcome in two EDMs: the first focusing on the "poor and unfair prices often paid [by supermarkets] to farmers, especially dairy farmers", the second raising concerns about the abuse of power by supermarkets against "their smaller and dependent suppliers and small shops."¹⁰⁰

As noted above, one contentious issue in assessing competition in the grocery market has been how the market should be defined.¹⁰¹ In its consultation paper on a potential reference to the Commission, published in March 2006, the OFT noted the geographical dimension to the grocery market:

In addition to the definition of the relevant product market, there is also a question of the relevant geographical market(s) in consulting on a reference. The CC's 2000 report concluded that 'Taking the evidence as a whole, our view is that the ambit of consumers' search for groceries is essentially local'.¹⁰² ... For the purposes of this investigation, we have assumed that market power could, theoretically at least, be exercised at a local as well as at a national level, although national competition clearly constrains the degree to which firms can operate in any locality unconstrained by competition. We are proposing to refer the whole UK market because the features we have identified apply to most local areas and, in the case of buyer power, affects more national upstream markets such as wholesaling.¹⁰³

In its 'emerging thinking' document, the Commission noted that, "the weight of evidence to date supports a finding that the relevant geographic market for the supply of groceries is local, rather than national", and that "while remaining open on the issue of the appropriate definition of the relevant geographic market, we have adopted a working assumption of local markets for the purpose of progressing our analysis."¹⁰⁴ In April 2007 Tesco made a further submission to the Commission, arguing both that the grocery market was a single national

⁹⁷ Competition Commission, *Groceries market investigation: emerging thinking*, January 2007 paras 25, 164

⁹⁸ "Tesco boss hits back in stores inquiry", *Financial Times*, 24 January 2007

⁹⁹ "Sainsbury accuses watchdog of getting its sums wrong", *Daily Telegraph*, 8 February 2007

¹⁰⁰ EDM 714 of 2006-07, 23 January 2007 & EDM 961 of 2006-07, 22 February 2007. The two motions were signed by 36 and 176 Members respectively.

¹⁰¹ As noted in section B of this note, one of the main criticisms of the OFT's review of the supermarket Code of Practice, published in March 2005, had been that it saw 'one stop' and 'top up' shopping as distinct markets.

¹⁰² *Supermarkets*, Competition Commission 2000, paragraph 2.47

¹⁰³ *OFT838*, March 2006 paras 2.6-9

¹⁰⁴ *Groceries market investigation: emerging thinking*, January 2007 paras 95,98

market, and that in looking at local markets, markets were now up to “30 minutes wide”, rather than 10-15 minutes.¹⁰⁵ Using this test, the company argued, would show that the average number of stores in a local market was “six times as many as the 2000 Inquiry approach would suggest.”¹⁰⁶ However, Tesco’s analysis was strongly criticised,¹⁰⁷ and when the Commission published its provisional findings – in October 2007 – it confirmed that the grocery market was a *local* one: “larger stores compete with other larger stores within a 10 to 15 minute drive-time, with the distance between competing stores in the same local market progressively reducing for small stores.”¹⁰⁸

More generally, the Commission found no cause for concern in the majors’ expansion into the convenience store sector, but that there was evidence that supermarkets had exploited their relationships with suppliers:

The concerns regarding convenience stores have been raised against a backdrop of declining numbers of independent non-affiliated convenience stores as many of these stores have joined symbol groups, while others have exited the sector completely. The evidence on trends in the overall number of convenience stores, however, is more mixed. We have thoroughly examined the full range of concerns that have been raised with us. These include a possible waterbed effect, the impact of below-cost selling, local vouchering activities and the financial viability of the grocery wholesalers that service convenience stores. Concerns have also been raised regarding Sainsbury’s and Tesco expansion in convenience store retailing. We do not find any adverse effect on competition arising from these issues. We consider that those convenience store operators that provide consumers with a strong retail offer will continue to survive and prosper, and the evidence suggests that current developments in convenience store retailing reflect consumer preferences.

In relation to the groceries supply chain, the grocery retailers and their suppliers have worked to achieve an efficient supply chain that delivers low prices for consumers, and in recent years has achieved high rates of product innovation. We are, however, concerned that the transfer of risk and unexpected costs by grocery retailers to their suppliers through various supply chain practices that we have observed will result in problems in the future unless otherwise addressed. We are also concerned that the situation that we currently observe would be somewhat worse if the Supermarkets Code of Practice (SCOP) were not in place.¹⁰⁹

The Commission argued that, despite its size and market share, Tesco was not in a position to be able to exploit its market power, though “that is not to say that this situation could not change.” The Commission also noted that many respondents had raised a wide variety of concerns about the impact of supermarkets on different aspects of public life, but that these questions fell beyond its brief:

¹⁰⁵ In its inquiry in 2000 the Commission had found that “one-stop shopping patterns are primarily local, with consumers rarely travelling more than 10 minutes in urban areas, and rarely more than 15 minutes elsewhere to do their main weekly shopping” (Cm 4842 October 2000 para 1.5).

¹⁰⁶ Tesco, *Geographic market definition in the groceries inquiry*, April 2007 para 1.8

¹⁰⁷ “Critics attack Tesco’s new ‘monopoly test’”, *Independent*, 3 April 2007; “Tesco says ‘local’ means up to a 30-minute drive away”, *Times*, 3 April 2007

¹⁰⁸ Competition Commission News Release 61/07, *Groceries market provisional findings*, 31 October 2007

¹⁰⁹ *The Supply of Groceries in the UK market investigation: provisional findings report*, 31 October 2007 p5

A range of issues not normally associated with an inquiry by a competition authority has also been brought to our attention during this investigation. These issues relate to matters such as the impact of grocery retailing on the nation's health and the social impact of low-priced alcohol sales, the importance of high streets and rural shops to social cohesion, the future of UK farming and the issue of self-sufficiency in food, working conditions at grocery suppliers in the developing world, and the environmental impact of the grocery supply chain and retailing activity. In a number of cases these concerns have interacted with competition issues and provided background and context for our inquiry. We have given careful consideration to all the issues that have been raised and have carefully assessed the extent to which they impinge on competition.

Against this background, our investigation has sought to establish whether UK grocery retailing is competitive, as that seems to us to offer the best guarantee that consumers will be able to exercise their own judgement as to what grocery retail offer they prefer. If consumer preferences change, retailers in a competitive market must alter their offering or lose customers, market share and profit. We prefer, therefore, to seek, so far as possible, to empower the consumer rather than to impose on the consumer our own judgement of what the grocery retailing offer should be.¹¹⁰

Some critics were disappointed by the Commission's reluctance in this area, and that, as the *Financial Times* reported, its work constituted a "tweaking of the terms of engagement between the Big Four supermarkets, rather than a threat to their collective pre-eminence."¹¹¹ An editorial in the paper suggested that the Commission had shown "a welcome sense of proportion":

The commission said that on most counts the groceries market delivered value, choice, innovation and convenience. It found nothing to substantiate the more highly coloured claims of unfair competition enabling supermarkets to prosper at the expense of small shops. It also - rightly - rejected complaints that Tesco's dominance as market leader prevented other large grocers from growing: the continuing expansion of Tesco's rivals is evidence that this charge is misplaced.

The watchdog did express concern about some aspects of how supermarkets treat suppliers. Its most eye-catching suggestion here is the idea of appointing an ombudsman to monitor and enforce the existing code of conduct. This could help root out practices such as transferring unexpected costs to suppliers. But it will not change the imbalance between large retailers and small suppliers who fear that complaining will destroy their relationship with their biggest customers. The main focus, however, was how existing land banks can act as a barrier to entry in some areas. The commission identified 110 supermarket sites held by the four largest grocery retailers where competition could be constrained by the stockpiling of land or covenants limiting its use. Possible solutions range from forced divestment or outlawing restrictive agreements, to changing planning law to make it easier for rivals to open new stores. Banning arrangements that make it less likely a competitor could use a site makes sense. So does altering planning rules so that they do not reinforce the dominance of a particular chain in a given locality. Insisting on the forced sale of a site or store should be only a last resort.

¹¹⁰ op.cit. pp6-7

¹¹¹ "Tweaks but little threat to the Big Four role", *Financial Times*, 1 November 2007

In setting aside the chorus condemning supermarkets and focusing on the facts as the basis for its findings, the commission has done well. If its final recommendations head off yet another supermarket inquiry in the near future, it will be doing even better.¹¹²

F. The Commission's Final Report

In February 2008 the Commission published details of its 'proposed remedies' to the deficiencies it had found in the groceries market, to allow interested parties "to have a further opportunity to comment" before its final report – which it anticipated publishing in April. Among these proposals was the creation of a new Groceries Supply Code of Practice, to replace the existing code, and an ombudsman, to arbitrate on disputes under the new code.¹¹³ Notably the Commission proposed no action on the supermarkets' ownership of large areas of land for development – 'land banks' as they are known – which many commentators had argued were being used a major barrier to any new entrants to the market:

We have provisionally identified only nine land bank sites that may be acting as barriers to entry in areas of high concentration. We do not consider it appropriate to put in place a remedy specifically designed to deal with land bank sites. In general we do not consider the scale of the [adverse effect on competition] (AEC) we have found from land bank sites acting as barriers to entry to be large and note that we have found little evidence that they are primarily being used as such. We note that in many cases in the past commercial agreements have been reached between retailers that have allowed store developments to take place. We are also concerned that placing restrictions on land bank sites in the future would inhibit legitimate site assembly.¹¹⁴

However, in light of its concern about the restrictions to competition in local markets, the Commission proposed that the planning system should incorporate a new planning test:

Our provisional decision is to recommend to the Government and the Governments of the devolved administrations that the competition assessment should be implemented within the planning system, with the OFT acting as statutory consultee. We consider that the competition assessment could operate effectively either inside or outside the planning system. However, the inclusion of competition into the planning regime, as part of an existing regulatory process, has merit and would allow local planning authorities (LPAs) to trade off competition issues and other planning issues when this meets local needs.¹¹⁵

For their part, the supermarkets appear to have welcomed the proposals, though Tesco was characteristically robust in its rejection of the Commission's findings:

¹¹² "Editorial: Making sense of the supermarkets", *Financial Times*, 1 November 2007

¹¹³ Competition Commission News Release 05/08, *Groceries market investigation – provisional decision on remedies*, 15 February 2008

¹¹⁴ *Groceries market investigation - Provisional decision on remedies: background and overall assessment*, February 2008 para 19

¹¹⁵ *op.cit.* para 24

Lucy Neville-Rolfe, executive director of corporate and legal affairs at Tesco, said: "[A competition test would] ... introduce additional bureaucracy, costs and delays - which we estimate at up to £150m a year - slow down the planning process and hit investment." Rivals were more sanguine about additional compliance costs, believing that the benefits of the competition test outweighed the expense. "Broadly happy," said Paul Kelly, corporate affairs director at Asda. "It would be a shame if in a sector which is highly competitive by the Commission's own acknowledgement consumers were to be disadvantaged with higher prices because the cost of bureaucracy put prices up." "Does it add more bureaucracy? Not clear yet," said Mr Kelly. But since the exact terms have not yet been decided, there is the prospect that another legal and media circus will congregate when the final report is published by May.¹¹⁶

The Commission published its final report on 30 April 2008 – an 'exhaustive inquiry', in its own words, having considered 700 submissions from retailers, suppliers, consumers, local authorities and other interested parties, and held 81 hearings in England, Scotland, Wales and Northern Ireland. At this juncture, it may be worth emphasizing, amid this long chronology of events, the sheer size and scope of the major supermarkets. The report estimated the UK grocery market sales were £110.4 billion in 2007: large grocery retailers accounted for 85% of these sales, with the major four alone taking just over 65%.¹¹⁷ While supermarkets were "delivering a good deal for consumers", the Commission argued that "action is needed to improve competition in local markets and to address relationships between retailers and their suppliers"; to this end, the Commission made four major recommendations:

- a recommendation for the inclusion of a 'competition test' in planning decisions on larger grocery stores;
- action to prevent land agreements which can restrict entry by competitors;
- the creation of a new strengthened and extended Groceries Supply Code of Practice (GSCOP); and
- a recommendation to establish an independent Ombudsman to oversee and enforce the Code.¹¹⁸

Notably, the Commission did *not* see proof of anti-competitive activities in the decline of independent convenience stores:

Whilst we have been sympathetic to those finding themselves under pressure in this market, particularly independent retailers, this does not mean that competition is not working well—it is often the effects of rivalry between retailers which benefit the consumer. Competing with large retailers is difficult but our evidence does not show that independent retailers or the wholesalers that supply them are in terminal decline. It is not impossible for them to compete and in the current economic climate the benefits of vigorous competition are as relevant as ever.¹¹⁹

On the expansion of Sainsburys and Tesco into this sector, the Commission concluded:

¹¹⁶ "Battles and bureaucracy in store", *Financial Times*, 16-17 February 2008. See also, "Supermarkets emerge unscathed after third major inquiry in eight years", *Guardian*, 16 February 2008

¹¹⁷ *The supply of groceries in the UK market investigation*, 30 April 2008 paras 3.2, 3.4

¹¹⁸ Competition Commission News Release 14/08, *Groceries market investigation – final report*, 30 April 2008

¹¹⁹ Competition Commission News Release 14/08, 30 April 2008

We found that Sainsbury's and Tesco's expansion in convenience store retailing was likely to have been supported in large part by their existing advantages in terms of brand reputations, low purchasing prices and distribution networks. We did not find their expansion in this sector to be anti-competitive, and to the extent that it has resulted in increased competition, consumers will have benefited. Further, we did not find that Sainsbury's and Tesco's expansion in convenience store retailing weakened the competitive constraint on Sainsbury's or Tesco such that it led to a deterioration in their retail offer (either at their convenience stores or other grocery stores) or a loss of choice in grocery stores for consumers.¹²⁰

Clearly it is beyond the scope of this note to summarise the report, but in light of later developments regarding the creation of an ombudsman's office, it is worth reproducing the report's discussion of how this proposal had been received:

Many parties (the Association of Convenience Stores, suppliers, supplier organizations, non-governmental organizations and primary producer organizations, and consumers) questioned whether the OFT was the best authority to supervise and enforce retailers' compliance with the SCOP, and, in addition, whether the monitoring authority should have a proactive role in reviewing retailer practices more generally. These submissions supported the establishment of an Ombudsman.

By contrast, many submissions from retailers supported the continued involvement of the OFT in this role. Morrisons said that the costs of an Ombudsman would be excessive, relative to the consumer detriment arising from supply chain practices. Certain retailers (Waitrose, Morrisons) suggested that the burden of the costs of the Ombudsman, should one be established, ought to be weighted towards retailers which are the subject of complaints and disputes. ... Some retailers (Asda, Waitrose) said that there was a danger of 'regulatory creep' (ie the Ombudsman extending its remit to non-competition issues). Waitrose said that if the Ombudsman were to have active investigatory powers and duties, these should be specified in detail to avoid expensive expansions of the Ombudsman's role.

The OFT recognized that a dedicated body with industry expertise, which would build working relationships with supplier trade associations and retailers and monitor compliance and promote best practice, would have advantages. It suggested that this entity could also raise the profile of the GSCOP and encourage best practice and monitor compliance. However, the OFT expressed reservations about the effectiveness of a remedy involving the creation of an Ombudsman. It was concerned that the creation of an Ombudsman would not fully address suppliers' fears of raising complaints, since dispute resolution would still require complainants to be identified.¹²¹

In this section of the report the Commission goes on to explain its reasons for persisting with its view, though one of its members dissented from this conclusion:

We agree with the OFT that a dedicated body with industry expertise, which could build working relationships with suppliers, their trade associations and also with retailers, would be advantageous. We therefore decided that a GSCOP Ombudsman should be established to monitor and enforce the GSCOP, and to resolve disputes

¹²⁰ *The supply of groceries in the UK market investigation*, 30 April 2008 p9

¹²¹ *The supply of groceries in the UK market investigation*, 30 April 2008 paras 11.333-6

between retailers and suppliers under the GSCOP. One of our members dissented from this view ...

In considering the role of the Ombudsman, we had regard to the role of the Office of the CRR Adjudicator.¹²² As in the case of the CRR Adjudicator, and consistent with the statutory function of the OFT in monitoring ongoing compliance with market investigation remedies,¹²³ we decided that the Ombudsman should be appointed by the OFT. The Ombudsman would, however, be independent from the OFT and from all parties involved in any dispute. The OFT would set the Ombudsman's annual budget (with a contingency¹²⁴), and would pay the Ombudsman's salary and expenses. These sums would then be recouped from the grocery retailers covered by the GSCOP, according to a predetermined formula. In response to submissions from Waitrose and CGL, we decided that, since the Ombudsman's activity will be driven to a large extent by complaints and disputes, it would be appropriate for the formula to take account of the number of complaints and disputes involving a retailer, as well as its UK groceries turnover.

The Ombudsman would have an overriding objective of monitoring and enforcing the GSCOP and thereby of promoting the long-run interests of consumers. Providing the Ombudsman with this express objective should address retailers' concerns regarding 'regulatory creep'. Although it is our intention that the Ombudsman should fully and effectively monitor and enforce the GSCOP, we do not seek any role for the GSCOP Ombudsman that goes beyond this. Moreover, we expect that the GSCOP Ombudsman will use its resources efficiently, focusing on those disputes and complaints concerning suppliers without market power over and above those concerning suppliers of major branded products.¹²⁵

The one member of the Commission who opposed the idea of an independent Ombudsman did so on the grounds that the new body would be "susceptible to external pressures and regulatory creep":

[Professor Lyons] was concerned that the Ombudsman may find a role 'proactively' representing the interests of suppliers, including global manufacturers and large intermediaries, which he considered would reduce the benefits of competition. He noted that the usual role of an ombudsman is to deal with complaints from ordinary citizens/consumers about public bodies or private sector suppliers, and that it is a qualitatively different and more difficult task to reverse this in order to deal with complaints from suppliers about their customers with a view to promoting the future welfare of final consumers. In his view, the OFT is well placed to refrain from undesirable intervention because it has an embedded mission to make markets work well for consumers.¹²⁶

The Commission went on to explain that "given the importance of involving stakeholders in the process of establishing an Ombudsman scheme" it would "seek undertakings pursuant to

¹²² The CRR Adjudicator monitors the 'contract rights renewal' remedy put in place following the CC's investigation into the merger of Carlton Communications plc and Granada plc.

¹²³ Section 162 of the Act.

¹²⁴ We consider the existence of a generous contingency fund to be important for the effectiveness of the Ombudsman. Without this, retailers may attempt to exhaust the Ombudsman's budget in the knowledge that it would be unable to function effective once this had been achieved.

¹²⁵ *The supply of groceries in the UK market investigation*, 30 April 2008 paras 11.337-9

¹²⁶ *op.cit.* para 11.347

section 159 of the Act from all retailers that we have decided should be covered by the GSCOP.” However, if retailers failed to agree to these undertakings, it recommended that the Department “should take the necessary steps to create an Ombudsman.”¹²⁷

G. Implications of the Commission’s report

Unsurprisingly, the Commission’s final report did not see an end to the controversy over the impact of supermarkets in public life, or, more narrowly, what remedies, if any, were necessary to ensure free and fair competition in the groceries market. As the chairman of the Commission, Peter Freeman, was quoted on the report’s release, “given the variety of views and evidence we have received, I would be amazed if everyone is happy.”¹²⁸ A debate in Westminster Hall some weeks later illustrated this variety of views, though responding to the debate, the then Parliamentary Under-Secretary of State, Gareth Thomas, suggested that it was important to recognise a “truism”:

Supermarkets are a thriving and dynamic part of the economy, and their success benefits not only their shareholders, but local communities, their employees, their customers and our regional and national economies. In 2007, an estimated £110 billion-worth of grocery sales were made through nearly 100,000 grocery stores across the UK. It is true that the eight largest grocery retailers accounted for about 85 per cent. of total grocery sales, with the largest four accounting for just over 65 per cent., but it is important to recognise that some supermarkets play a vital, anchoring role in a number of town centres. Occasionally, they also play a crucial role in regenerating town centres. ... Supermarkets provide much-needed employment and help to attract other, smaller retailers to set up shop in their shadow [and make a contribution] ... in improving their ethical sourcing and environmental performance, whether on climate change or waste.¹²⁹

That said, in their initial response, the major supermarkets hardened in their position on an ombudsman – Asda and Sainsbury voicing concerns, alongside Tesco’s strong opposition.¹³⁰

On 29 July 2009 the Labour Government published its first formal response, welcoming the report in general, though deferring any decision as to the introduction of a competition test in the planning system, or the creation of an independent ombudsman. In the case of the latter, the Government simply stated that if the matter returned to it, voluntary agreement having proved unsuccessful, it would “make any assessment primarily based on what is likely to be in consumers’ best interests.”¹³¹

In February 2009 the Commission published a draft code of practice for consultation, and gave notice of its intent to obtain voluntary agreement from the supermarkets on an

¹²⁷ *op.cit.* para 11.343

¹²⁸ “Stores resist plan for ombudsman”, *Financial Times*, 1 May 2008; see also, “Inquiry lets the big stores off the hook”, *Guardian*, 1 May 2008

¹²⁹ HC Deb 13 May 2008 cc371-2WH

¹³⁰ “Grocer chiefs scorn call for supplier tsar”, *Daily Telegraph*, 1 May 2008

¹³¹ Dept for Business Enterprise and Regulatory Reform, *Letter ... from Gareth Thomas MP to Peter Freeman, Chairman, regarding the supply of groceries in the UK market investigation*, Commons Library Deposited Paper DEP2008-2119, 29 July 2008; BERR new release 2008/156, 29 July 2008

ombudsman to regulate the code.¹³² A draft version of these undertakings was published in April.¹³³ In August the Commission completed the new Groceries Supply Code of Practice (GSCOP), with which retailers would have six months to comply, but conceded that agreement on an ombudsman had proved impossible:

Peter Freeman, CC Chairman and Chairman of the Groceries inquiry said: "Our inquiry clearly revealed problems that require action and which, if left unchecked, would damage the consumer. We continue to believe that everyone's interests—and that includes retailers—would be served by tackling a problem that has clouded the industry for many years now ... We made every effort to persuade retailers of our case as it would be the quickest way to establish the Ombudsman. We are now left with no alternative but to set out the new Code of Practice and recommend that BIS set up the Ombudsman to oversee its operation."

"It is clearly desirable that the Ombudsman be established as soon as is practicable. The new Code of Practice will work much better as a result and suppliers and retailers will have greater confidence that its terms will be observed. The costs of the Ombudsman, which we think would be about £5 million a year in total including initial set-up costs, are very modest compared with the annual turnover of £70 billion in grocery supplies to retailers. It is obviously for BIS to consider these matters very carefully but we are making our views as clear as we can."¹³⁴

In a letter to the Department explaining its decision, the Commission said a little about how, in its view, the changed economic climate *strengthened* the case for an ombudsman:

The CC recognizes that since the report was published there have been major economic changes in the retail trading environment. Several grocery retailers have suggested that these changes mean it is not a good time to create the Ombudsman. The CC disagrees. The need for the Ombudsman should be assessed in the current economic context, but the Ombudsman is a very important addition to the GSCOP which will help to make the groceries supply chain work more in the interests of consumers. In the prevailing economic conditions, a greater number of suppliers will be subject to the sort of pressure that the Ombudsman would be best placed to observe and, where necessary, act upon. In the CC's view, this suggests that there is an even greater need for the Ombudsman now than at the time the report was published.¹³⁵

The Commission also published a summary of the responses it had received on this proposal, and within this, it addressed the vexed problem of anonymity, and the difficulties in getting suppliers to go on record with complaints about supermarkets' anti-competitive practices:

A number of suppliers emphasised the need for the Ombudsman to maintain the anonymity of individuals who made complaints regarding retailer behaviour. It was submitted that suppliers would be unlikely to come forward with information on

¹³² Competition Commission News Release 08/09, *CC publishes code of practice order*, 26 February 2009

¹³³ Competition Commission News Release 20/09, *CC consults on ombudsman plan*, 28 April 2009

¹³⁴ Competition Commission News Release 36/09, *CC publishes code of practice and ombudsman recommendation*, 4 August 2009

¹³⁵ Competition Commission, *Letter from Peter Freeman to Kevin Brennan MP, Minister of State, Department for Business Innovation & Skills*, 4 August 2009 para 2.9

GSCOP practices unless they could be assured of anonymity. In contrast, a number of retailers were concerned with the anonymity provisions, stating that anonymity will limit the ability of retailers to respond to the proposed investigation and defend its supply chain procedures. Our view is that complainant anonymity should be considered against the role of the Ombudsman in investigating complaints.

As set out in the Groceries Report, there is an important distinction between the investigative function of the Ombudsman and the dispute resolution function in the GSCOP. A dispute involves a single complaint by a supplier against a retailer, whereas an investigation would follow a period of information-gathering, through which the Ombudsman may identify, for example, a pattern of behaviour or area of concern from a particular retailer or set of retailers. We have reflected this in the undertakings. Given that an investigation will likely cover a broad area of concern, rather than focussing on individual complaints, we do not think that the anonymity of complainants should be a problem for retailers in responding to investigations. We therefore recommend that the anonymity of persons who provide information to the Ombudsman be maintained.¹³⁶

During this period the Commission suffered a serious setback in March 2009 when Tesco successfully challenged its proposal for the introduction of competition test into the planning system, on the grounds that the Commission had failed to consider all relevant factors in making this assessment.¹³⁷ In April the Tribunal ‘remitted’ the matter back to the Commission, over Tesco’s objections, in order for it to carry out further work and analysis to address the CAT’s concerns over some issues related to the introduction of the test.¹³⁸ Having undertaken further analysis the Commission reiterated its recommendation in October 2009,¹³⁹ though the Labour Government did not make a final decision on this issue,¹⁴⁰ and to date the Coalition Government has not taken this up.¹⁴¹

A third recommendation made in the Commission’s final report was to remove the special exemption of land agreements from the general prohibition in competition law on collusive agreements – under the ‘Land Agreements Exclusion Order’.¹⁴² In July 2009 the Department consulted on this change, and in January 2010 it confirmed that it would revoke this Order. At the same time, the Labour Government confirmed it would consult on establishing an ombudsman:

The Minister for Further Education, Skills, Apprenticeships and Consumer Affairs (Kevin Brennan): Today the Government are publishing the Government response accepting the Competition Commission’s recommendation to establish an enforcer to monitor and enforce the Groceries Supply Code of Practice (GSCOP). The Government want to ensure that the GSCOP can be independently enforced, and have the important power to hear anonymous complaints. However, the Government are mindful of placing unnecessary costs on to business especially in a

¹³⁶ Competition Commission, *Undertakings to establish a Groceries Supply Code of Practice Ombudsman Scheme - Response to consultation*, August 2009 paras 15-16

¹³⁷ *Tesco Plc v Competition Commission* Case 1104/6/8/08 [2009] CAT 6, 4 March 2009. See also, “Tesco victorious after ruling on competition test”, *Financial Times*, 5 March 2009

¹³⁸ [2009] CAT 13, 3 April 2009. Details of the case [are collated on the Tribunal’s site](#).

¹³⁹ Competition Commission News Release 46/09, 2 October 2009

¹⁴⁰ See for example, HC Deb 25 Feb 2010 c764W

¹⁴¹ For more details on this issue see Library standard note SN01106, 29 July 2011.

¹⁴² *The supply of groceries in the UK market investigation*, 30 April 2008 paras 11.217-.230

period of economic difficulty, which is why we plan to issue a consultation on how best to take matters forward. We have also taken the decision to revoke the Land Agreements Exclusion Order following a recent public consultation resulting from a related Competition Commission recommendation. We will proceed to make the Revocation Order at the earliest opportunity but give businesses a transitional period to ensure that their agreements are compatible with competition rules. Copies of the responses, have been deposited in the Libraries of both Houses and will be available on the BIS website at: www.berr.gov.uk/files/file54194.pdf.¹⁴³

As noted at the very start of this note, the Labour Government launched its consultation in February 2010, but this was interrupted by the General Election some weeks later. In turn, in the agreement underpinning the Coalition, the new Conservative-Liberal Democrat Government stated that it would set up an a grocery market ombudsman *within* the OFT, and since then it has consulted on its proposals, published a draft Bill in May 2011, and introduced a final Bill as one of the first Bills of the 2012/13 Session.

¹⁴³ HC Deb 13 January 2010 cc23-4WS. Legislation to cancel the exemption of land agreements was approved in March: Sixth Delegated Legislation Committee, 2 March 2010. On this occasion the Minister stated that implementation would be delayed a year to help businesses adjust.