

BERR | Department for Business
Enterprise & Regulatory Reform

**THE SUPPLY OF GROCERIES IN
THE UK**

THE GOVERNMENT
RESPONSE TO THE
COMPETITION
COMMISSION MARKET
INVESTIGATION

JULY 2008

Government Response to the Competition Commission's report into the supply of groceries in the UK

Introduction

The Government welcomes the Competition Commission's (CC) thorough report into the UK grocery market. This market investigation was launched by the CC in May 2006 following referral of the market by the Office of Fair Trading. The CC's final report was published on 30 April and the Government is required to publish its response within 90 days of the CC publishing its report.

The report considers the £110 billion UK grocery market in detail including the position of convenience stores relative to large grocery retailers. The CC found that although the process of competition is very challenging and that the pressure can be intense, it found no evidence that there were distortions in competition between large grocery retailers and convenience store operators. The final report therefore concentrates on competition between the larger grocery retailers and those that supply them and on how this could be improved to benefit consumers.

This report highlights a number of complex and important issues for the future of the groceries market. The CC report recognises that the grocery market is generally working well for consumers, but identified two areas where consumers could be better served. First, a significant number of local markets for grocery retailing are highly concentrated, and barriers to entry allow highly concentrated local markets to persist. Consumers suffer as a result of grocery retailers providing a poorer retail offer at stores in those areas and through higher prices.

Second, grocery retailers with buyer power can pass on excessive risk and unexpected costs to their suppliers. The CC believes that consumers suffer harm as a result of reduced investment and innovation in the supply chain.

It is the job of Government to provide the right market conditions to enable fair and free competition. The Government is keen to establish what can be done, working with others, to address the issues identified by the CC most effectively. This response is therefore the start of an ongoing dialogue and plan of work that we hope to have with our delivery partners.

The CC has the powers to implement the majority of the remedies outlined in the report. These cover the creation of a new grocery supplier code of practice (GSCOP) and a package of planning remedies including the lifting of existing exclusivity arrangements and restricting future ones, a ban on the imposition of future restrictive covenants, and a requirement for grocery retailers to release existing restrictive land covenants.

The remainder of this Response considers each of the recommendations and sets out a Government response to each. The response covers England, Scotland Wales and Northern Ireland, although it should be recognised that,

unlike competition matters, land use planning is a devolved matter and the response therefore reflects the positions of the respective Administrations.

The response also reflects the fact that Tesco has, under section 179 of the Enterprise Act 2002, challenged the legality of certain findings made by the Competition Commission.

The recommendations and the Government response

Highly-concentrated local markets

Planning and the competition test

11.437 To address the AEC that we (the CC) found in relation to local market concentration, we (the CC) decided to recommend the following measures in order to establish the competition test within the planning system:

(a) that the Department for Communities and Local Government (CLG) and the devolved administrations take such steps as are necessary for the OFT become a statutory consultee;

(b) that CLG and the devolved administrations take such steps as are necessary (including changes to the GDPO and its equivalents and to planning policy) to ensure that the OFT is consulted by LPAs on all planning applications for grocery store developments (including new stores and extensions, whether submitted by large grocery retailers or third parties including other grocery retailers) where the developed store will be in excess of 1,000 sq metres net sales area;

(c) that CLG and the devolved administrations take such steps as are necessary (including changes to planning policy) to ensure that where LPAs give open A1 planning permission that is not to be used for grocery retail, planning conditions are applied that limit groceries floorspace to less than 1,000 sq metres;

(d) that CLG and the devolved administrations take such steps as are necessary (including changes to the GDPO and its equivalents and to planning policy) to ensure that LPAs take account of the OFT's advice on the result of the competition test (see below) and that LPAs may only determine planning applications in a manner inconsistent with that advice where they are satisfied that:

(i) the particular development would produce identified benefits for the local area that would clearly substantially outweigh the detriment to local people from the area becoming or remaining highly concentrated in terms of grocery retailing; and

(ii) the development, or any similar development, would not take place without the involvement of a large grocery retailer that had failed the competition test (see below);

(e) that CLG and the devolved administrations take such steps as are necessary (including changes to guidance) to make clear that where LPAs determine planning applications in a manner inconsistent with the OFT's advice on the result of the

competition test, they do so only when they have demonstrated on the basis of sound evidence that the criteria set out above have been satisfied and set out publicly the reasons for overriding the OFT's advice; and

(f) that CLG and the devolved administrations take such steps as are necessary (including changes to planning policy) to ensure that section 106 contributions in connection with matters unrelated to competition should not be considered by LPAs as sufficient to offset the effect the development would have on concentration in the local market.

11.438 We note that the introduction of the competition test into the planning system is contingent on action by CLG and the devolved administrations. We recommend to BERR that, if the competition test is not established within the planning system by CLG and the devolved administrations, it should consider taking steps to introduce the competition test outside the planning system.

11.439 In applying the competition test as part of the planning system, we recommend that the OFT provide advice on the result of the competition test to LPAs.

Government Response

The Government accepts that this is an important recommendation both for the Competition Commission and for large grocery retailers. We are considering this recommendation carefully and are working through a number of implementation issues were we to decide to introduce such a competition test into the planning regime. We note that Tesco has appealed this decision to the Competition Appeal Tribunal (CAT). CLG are also separately consulting on wider planning reforms which include the recently published proposed revisions to town centre policy in *Planning Policy Statement 6: Planning for town centres*. We want to reflect further on the Commission recommendation. Government will report more fully on its decision later in the year in the light of developments.

Controlled land

11.444 We further recommend to BERR that it amend the Land Agreements Exclusion Order so that exclusivity arrangements which restrict grocery retailing and which are entered into by grocery retailers which were previously within its scope should no longer benefit from exclusion from the Competition Act 1998.

11.230 We also observe that there may be merit in revoking the Land Agreements Exclusion Order in its entirety. We thought that it was something of an anomaly in the current competition regime. It may be appropriate for BERR to consider whether the Land Agreements Exclusion Order remains appropriate.

Government Response

In response to this recommendation, HMG proposes to conduct a public consultation on three options.

- Option One - No change to the exclusion order;
- Option Two - Amend the exclusion order in the way recommended by the Competition Commission to remove its application to exclusivity arrangements in the groceries sector;
- Option Three - Repeal the exclusion order altogether.

An initial examination of the original purpose in making the exclusion order suggests that a key concern was to provide legal certainty to businesses about the legality of land agreements – most of which would not be likely to raise competition concerns. Providing such certainty was also intended to avoid generating unnecessary notifications to the Office of Fair Trading (OFT) of large numbers of what would mostly be benign agreements. But such certainty has never been absolute since the OFT can, in any case, call in agreements that it considers anti competitive. It is no longer the case that agreements must be notified to the OFT. Following modernisation of competition law in 2004, it falls to businesses to self assess and ensure their agreements are compatible with the law.

Under option 3, the commencement of repealing the exclusion order would be delayed for a period to allow businesses time to review their agreements. It would also be necessary for the OFT to publish revised guidance on the application of competition law to land agreements to help businesses conduct their self assessments.

The Competition Commission's primary recommendation relates to land agreements in the groceries sector – the subject of their investigation. However, they observe also that “there may be merit in revoking the ... order in its entirety” on the basis that it may be an anomaly. Clearly, it is feasible that agreements that currently fall within the scope of the exclusion order and relate to other sectors, may similarly have an adverse effect on competition.

The Government starts from the position that the Chapter I prohibition on anti competitive agreements should apply across all the economy with the minimum of exceptions. There has to be a clear, valid justification for excluding an agreement or category of agreements from the effect of that prohibition. It is not clear that a strong argument exists as to why there should

be a general exclusion for land agreements. It seems reasonable that businesses should be required to examine such agreements to ensure that they are indeed compatible with competition law in that they do not have an appreciable effect on competition. Revised guidance from the OFT will be published to assist businesses in conducting such assessments and the effect of the repeal of the exclusion order will be delayed for a period to give businesses time to adjust and review their agreements. This was the same approach taken when the Government repealed the exclusion order that was previously in place for vertical agreements.

It is also the case that the scope of the current exclusion is strictly limited to land agreements as defined in the order. An agreement only benefits from the exclusion to the extent that its provisions fall within that definition. The existence of the exclusion order might promote an inaccurate impression that any agreement relating to land must automatically be excluded from prohibition without proper regard to the definition set out in the order.

Against that general background, the Government wishes to obtain views from interested parties on whether to implement the CC recommendations and on the merits and possible effects of the three options outlined above. We will be consulting on this issue later this year and will announce decisions in due course.

Supply Chain Practices

11.447 We recommend to BERR that if we do not obtain satisfactory under-takings from the retailers creating the GSCOP Ombudsman within a reasonable period, it should take such steps as are necessary to establish the Ombudsman. We further recommend that, if this is the case, BERR take steps to give the Ombudsman the power to levy significant monetary penalties on retailers for non-compliance with the GSCOP.

11.448 If neither we nor BERR are successful in establishing the Ombudsman within a reasonable period of time, the functions of the Ombudsman will be carried out by the OFT, with the exception of dispute resolution, which will be carried out by a recognized independent dispute resolution body (such as CEDR).

11.449 Although our terms of reference do not permit us to make any finding in this regard, and we are therefore unable to make a formal recommendation, we suggest that, if it subsequently appears that, despite the operation of the GSCOP (and the Ombudsman) intermediaries continue to transfer excessive risk and unexpected cost further up the supply chain, Defra and BERR should consider the introduction of appropriate measures, including the extension of the GSCOP and the role of the Ombudsman or the introduction of a similar, complementary code

and arrangements to cover the intermediaries and primary producers.

Government Response

The Government notes that the CC will be creating a new strengthened and extended GSCOP and that the CC will be seeking undertakings from grocery retailers to establish a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP. The CC has recommended that if it does not obtain satisfactory undertakings within a reasonable period, BERR should take the necessary steps to establish the Ombudsman. Should this be the case, the CC also recommends that BERR takes steps to give the Ombudsman the power to levy significant financial penalties on the retailers for non-compliance.

We will await the outcome of discussions between the CC and its grocery retailers about the establishment of the Ombudsman. Should no voluntary agreement be possible and the matter came back to Government, HMG would make any assessment primarily based on what is likely to be in consumers' best interests.

We also note the CC's suggestion that if, despite the operation of the GSCOP and the Ombudsman, intermediaries continue to transfer excessive risk and unexpected cost further up the supply chain, that DEFRA and BERR should consider the introduction of appropriate measures. We are grateful to the CC for highlighting this issue, but would want to see how any change impacts on the operation of the supply chain before considering whether any further action might be necessary.