

Comments on the Competition Commission's approach to assessing costs and benefits in the Groceries Remittal

1. Introduction

- 1.1 This document sets out a number of Asda's observations on specific aspects of the Competition Commission's ("CC") approach to assessing the costs and benefits of the Competition Test ("CT"), as set out in the Provisional Decision ("PD") of the Groceries Remittal.
- 1.2 These observations relate to areas of the PD where Asda considers that further reasoning could be beneficial. They are structured as follows:
- (i) Observations on the CC's market model (Appendix A);
 - (ii) Observations on the CC's Net Present Value model (Appendix B);
 - (iii) Observations on the main PD document;
 - (iv) Further observations arising from the plenary hearing of 5 August 2009; and
 - (v) Observations on out of model benefits.
- 1.3 We support the CT as it would facilitate Asda's ability to expand¹.

2. Observations on the CC's market model (Appendix A)

- 2.1 **Scenarios considered:** the CC has identified 9 scenarios under which to evaluate the impact of the CT (3 for new build, 6 for extensions). We consider that an additional scenario that may be worth considering concerns a situation where the market features a duopoly ex ante and strong incumbent expansion is blocked, being replaced by a weak incumbent extension (as opposed to new build, which is considered). This is a logical possibility (although Asda has not assessed its likelihood in practice), and is also raised by the CC (e.g. at Appendix A, para 3). We further note that this is also raised by Tesco in its 26 June submission at paras 12 and Appendix 2, point 1(f).
- 2.2 **Other modelling assumptions:** the CC's analysis makes various assumptions about for example utility functions and functional forms. At times the motivation for particular modelling choices is not entirely clear, nor is the sensitivity of outcomes to modelling choices discussed. Accordingly, greater clarity in this area might assist.

¹ See for example Asda's response to the original provisional decision on planning remedies at paragraph 5.1 (7 March 2008) and Asda's comments on the remittal provision decision at section 4 (14 August 2009).

2.3 **Calibration of the model:** the model is calibrated to yield the average large store AMST profit levels (Appendix A, para 50). We suggest that the CC comments on whether the market sizes thus obtained are realistic.

3. Observations on the CC's Net Present Value model (Appendix B)

3.1 Rationale for the CC's assumption on replacement rates:

- (i) With regard to new build, we consider that the CC should review the statement made at Appendix B, para 7 to the effect that "*Given this size, we assumed that all the new-build stores deterred by the Test would be replaced by a competitor development*", as the CC has not looked into the link between size of developments and probability of replacement, although it has other evidence on the likelihood of replacement of new-build stores;
- (ii) Asda agrees with the CC's use of MPR evidence as one type of evidence to inform likely replacement rates and welcomes the CC's use of MPR evidence among other types of available evidence where possible. In relation to interpretation of MPR evidence, we consider that the CC's reliance on current MPRs, comparing these to historical information for planned developments, likely creates a downward bias;²
- (iii) The probability of replacement in the case of extensions is discussed at PD para 5.60. We note that at PD footnote 46, the CC qualifies its MPR-based evidence since it cannot show whether retailers would be interested in the specific 10-minute isochrones considered (as opposed to the general areas). However, it is possible that further work could yield more evidence on the typical size of MPRs and the typical size of isochrones and allow this qualification to be removed or weakened.

3.2 **Weak incumbent expansion:** we consider that the statement at PD para 5.63 to the effect that weak incumbents would have an ability to expand where they have the incentive could potentially be linked to the CC's specific evidence on ability.

3.3 **Assumptions on delays and transition periods:** the CC's assumptions on delays and transition periods are set out at Appendix B, Table 2. We suggest that providing a more detailed explanation of each of the figures individually (including the length of pre-announcement assumed by the CC before the CT is implemented) would aid understanding.

² Suppose that an incumbent builds a development which would have been blocked by the CT, as has happened historically; this will likely result in the area being dropped from the *subsequent* MPRs of rivals, but it may well have been present on *contemporaneous* MPRs.

4. Observations on the main PD document

- 4.1 **Language relating to effectiveness and timeframe of remedy:** the CC provisionally concludes that the CT and controlled land remedies would be sufficient/effective "over time" to "address" the AEC (PD paras 7.3, 7.4). The CC could consider revising this language since "over time" and "address" were criticised by the CAT (main judgment para 147).
- 4.2 **Provision of information to OFT and notification of acquisitions of stores >1,000m² to OFT:** the paragraphs of the original CC report referring to the requirements to provide information to the OFT (paras 11.15, 11.440) and notify acquisitions of stores >1,000m² to the OFT (paras 11.16, 11.441) were included in the list of those quashed by the CAT (relief judgment para 51, relief order para 1). The CC should include reasoning in support of these additional remedies in its new decision.
- 4.3 **Expansion by a strong incumbent and the need test:** the CC refers to expansion by a strong incumbent reducing the likelihood of a new large store passing the need test (PD para 4.6(a)). It may be helpful for the CC to refer also to other aspects of planning such as the RIA, consistent with the report finding that the need test does not act as a barrier to entry on its own (report para 7.43). And to the potential for similar effects under PPS4.

5. Further observations arising from the plenary hearing of 5 August 2009

- 5.1 **Assumed size of replacement space versus blocked space:** we consider that the CC should provide reasoning for any modelling assumptions that imply replacement space exceeds blocked space.
- 5.2 **Impact on GM:** we consider that the CC should address the possibility of any impacts on GM markets arising from the CT, even if the CT does not itself directly relate to GM space additions.

6. Out of Model Effects

- 6.1 **Role of local concentration:** In relation to Appendix A, paragraph 9, Asda considers that the other benefits at paragraph 5.2 also stem from changes in local concentration (e.g. national effects are caused by changes in local concentration via aggregation).
- 6.2 **Reaction of mid-sized stores:** It is conservative to omit the competition reaction of mid-sized stores to intensified larger store competition. At paragraph 2.3, the CC should consider repeating its claim from the Report that "The additional store-level profits at mid-sized grocery stores as a result of weak local competition may be of a similar order" (Report, para 10.14). The CC could also consider capturing this omitted benefit in the modelling.
- 6.3 **National effects:** Asda considers that at paragraph 5.18, the CC should include its finding in the Report, with which Asda agrees, that "The scale of the impact on national

price levels arising from weak local competition, while difficult to measure, is potentially very substantial” (Report, para 10.15).