

**RESPONSE TO COMPETITION COMMISSION'S PROVISIONAL DECISION IN
THE GROCERY MARKET INVESTIGATION: REMITTAL OF THE COMPETITION
TEST (the "Test") BY THE COMPETITION APPEAL TRIBUNAL PUBLISHED 16
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NON-CONFIDENTIAL VERSION**

1. In reaching a provisional decision that, in competition terms, operation of the Test will convey net benefits on consumers measured in the short, medium and long-term (and therefore that it should remain the subject of a recommendation as to its introduction into the planning regime), the Commission has carried out market modelling of two key metrics:
 - a) measured against a start point of the status quo, the additional benefit that will be conveyed upon consumers by (i) a notional store development (whether new build or extension) which would infringe the Test and, therefore, presumptively, not proceed and (ii) an alternative development by another player in the local market or by a new entrant which would not infringe the Test and, therefore, presumptively would proceed; and
 - b) the interval between (i) its becoming apparent that one retailer's store development would infringe the Test (to the point where embarking on an alternative development would represent a legitimate proposition to another retailer as matter of competition law risk) and (ii) that alternative development actually opening to customers, i.e. how many months or years would pass before the second local market player/new entrant elected to develop, and did indeed develop, a permitted store "safe" in the knowledge that its principal rival was unable to develop because of the Test?
2. We have some concerns about the assumptions that may have been made in the course of the modelling in terms of its being reliably predictive of future events in, what may prove, a significant number of local markets. Our concerns are four-fold.
3. *First*, the model appears to assume that stores being developed by the weaker incumbent player or a new entrant, in the knowledge that the stronger incumbent is highly unlikely to be able to build because of the Test, will not themselves encounter planning problems measured against the sequential test (which the government may yet, as a matter of planning reform, look to preserve as a necessary filter to application of the "social, economic and environmental" test) or on the ground of "need" which, although not described as such, will doubtless continue to be a strand of enquiry running through each of the "social", "economic" and "environmental" components.
4. So, for example, a weaker incumbent/new entrant may decide that, in a market currently distributed, as to floorspace, stronger incumbent 55%, weaker incumbent 25%, third player 20%, its only realistic prospect of challenging or eclipsing the stronger incumbent is to build a store of equivalent size in an out-of-town location. The planning application for such a store will pass the Test but could readily be frustrated if a sequentially



preferable site exists in the mind of the LPA (but not in the mind of the weaker incumbent in terms of its providing the best possible opportunity to challenge/eclipse its rival) or because the LPA is unconvinced that there is enough unsatisfied demand to justify, on social, economic and environmental grounds, a 30% (existing store of weaker incumbent closes) – 55% (that store does not close) addition to grocery floorspace in the catchment – a not improbable outcome given that, in these circumstances, the stronger incumbent might have no expansion plans or only those going to a relatively modest extension of its store.

5. *Secondly*, all of the modelling appears to assume (and must, we think, assume) the weaker incumbent looking to carry out a store development that does not itself infringe the Test (new entrants, we accept, will always pass the Test). Imagine a local market in which floorspace is distributed: stronger incumbent 80%, weaker incumbent 20% (e.g. a 24,000 square foot store versus a 6,000 square foot store). The response of the weaker incumbent here might be to seek planning permission for a 34,000 square foot store to eclipse successfully, it would hope, the presence of its stronger rival. Putting to one side the questions of sequentiality and need discussed above, such a planning application would not pass the Test as it would involve delivering to the initially weaker incumbent a floorspace share in excess of 60% in a market comprising only two fascias. The weaker incumbent could, of course, reduce the size of its proposed development so as to pass the Test but, in doing so, might reach the view that armed with that store of reduced size it could not compete effectively against the stronger rival.
6. *Thirdly*, and obviously inter-woven with some of our observations in paragraphs 3-5, any model driven by a floorspace test presumably takes no account of the productivity, in terms of sales per square foot, achieved by a retailer with that space now/in the fairly recent past, let alone what might be achieved in the future. So, for example, the view that Sainsbury's might take as the most appropriate store development reaction in a local market where it runs second to a dominant Tesco might be quite different to that which it would take where, in the same circumstances, the dominant player were Waitrose or ourselves or Asda or Morrisons or one of the regional retailers. The permutations here are almost endless influenced not only by the perceived/known productivity of the stronger incumbent in absolute terms but also by the weaker player's perception of at the least (i) the relative locational merits of the stronger player's existing site and the prospective development site (and indeed the sites of any other player in the market), (ii) local demographics, (iii) the strength of the offering and size of the stores of competing retailers outside the "concentrated" catchment, (iv) potential for new entry and (v) likely changes (subtle or more marked) in the asymmetrical features of the market in terms of which stores are constrained by which other stores. There can, we would suggest, be no satisfactory modelling of this that is not dependent upon assumption and averaging to a point where, inevitably, it will not predict with accuracy the actual turn of events in many local markets.
7. *Fourthly*, the modelling work seems to take no account of the "biting back" risk. A weaker incumbent or a new entrant in developing its store necessarily dilutes the floorspace share hitherto occupied by the stronger incumbent. In some cases, and we do not speculate on how many, this may present the real risk (putting other planning considerations to one side) of that originally strong player having sufficient floorspace head-room, below the 60% threshold, in

the now enlarged market to be able to, at the least, develop a store extension or, as Tesco are doing at a number of locations at the moment, raising their existing store to the ground and building a larger store (either because they have the land site available to them or by placing the store on stilts to allow more creative use of space for car parking). If the "biting back" risk is real then this too may actually deter the weaker incumbent from developing a store (new build or extension) at all.

8. Paragraphs 3-7 above serve to illustrate the complex web of dynamics at work on weaker incumbent players in, and prospective new entrants to, local markets when confronted with the task of delivering the most economically effective response to a stronger incumbent consistent with their overall corporate food retailing strategy and competencies. Whilst freely admitting that we have done no economic market modelling of our own, we suspect that the Commission's work may well exaggerate (and perhaps significantly) the likelihood of weaker incumbent/new entrant store development consequent upon their understanding that the stronger incumbent player can, for the time being, develop no further because of the Test.
9. Finally and separately, we would wish to refresh our previous observations with regard to "gaming" of the Test. Our reading of the Commission's provisional decision tells us at paragraph 5.20 (as indeed the Report did at paragraph 11.81) that the gaming risk is low because retailers have a strong allegiance to existing formats and are unlikely to depart from these in the foreseeable future. We have considerable misgivings about this conclusion: Tesco and Sainsbury are already fully flexible in format and there are indicators in the market currently that each of Asda, Morrisons and Waitrose will, or are likely to, explore a medium sized supermarket format - at its most acute, in terms of the Test, pitched at 999 square metres. Even if this evidence were not to hand now, the Report underlined (again) the many and varied shopping missions consumers continue to undertake with the likelihood of that variety increasing still further in response to emerged and emerging lifestyle changes. [REDACT 1].
10. There is the lesser risk of gaming the 60% floorspace threshold as operators balance and re-balance their food/non-food content within any particular store. Nonetheless, unless as we have previously advocated the Commission is willing to look at total floorspace, we suspect that "muddying the water" around the food/non-food split may still bedevil the OFT in its work as a statutory consultee.
11. [OMIT – COURTESIES ONLY]
12. [OMIT – NOT RELEVANT]

Co-operative Group Limited
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