



TESCO PLC

TESCO HOUSE, DELAMARE ROAD, CHESHUNT, HERTS. EN8 9SL
Telephone: 01992 632222 Ext.

Tim Oyler
Competition Commission
Victoria House
Southampton Row
London WC1B 4AD

29 July 2009

By email and hand

Groceries Market Investigation (Remittal): comments on provisional decision

Thank you for sending us an advance copy of the Commission's provisional decision on the remittal of the competition test, and for providing the underlying spreadsheet model. We believe the weight of evidence we have submitted, and the views expressed at the plenary session in June, should have led to a different provisional conclusion.

I am conscious that we are due to meet you (and the other retailers) on 5 August to discuss the details of the CC's thinking. However, in the meantime, I set out some comments on the document. Read together, the issues identified suggest that the Commission's claim that the test generates significant net benefits is misconceived.

The Commission's model

A number of the issues raised at the 'modelling meeting' plenary session of 17 June and in our follow up letter on 19 June are not addressed in the model's design. For example, there appeared to be consensus at the meeting that it was inappropriate to assume that all stores imposed equal symmetric constraints on one another, as this is contradicted by other data the Commission has gathered. There was also a common view that blocking extensions in particular was less likely than the Commission recognises to lead to replacement entry by a rival. Likewise, the Commission assumes that whenever a new store is blocked a competitor would enter or expand within the same timescale. As we have noted previously, each year retailers enter only a small proportion of the areas listed on their development plans, making this assumption completely unrealistic.¹

By not reflecting these market realities, and by including in its base case a number of far-fetched assumptions (such as that a blocked extension will be replaced by a larger development), the Commission's modelling exercise produces unrealistic outcomes.

¹ See, for example, our letter of 24 April 2009.



TESCO PLC

TESCO HOUSE, DELAMARE ROAD, CHESHUNT, HERTS. EN8 9SL
Telephone: 01992 632222 Ext.

Extensions

The application of the test to extensions has not been adequately justified. By blocking these enhancements to existing stores, the competition test is effectively imposing a brake on the expansion by grocery retailers into non-food markets (only 40% of the space added by extensions is for grocery retail). This is despite the fact that retailers' entry into non-food has spurred competition in that sector. Extensions and replacements are pro-competitive: by modernising and updating the offering at a store, and increasing the available retailing space, they bring unambiguous improvement to customers. Moreover, the Commission has provided no evidence for moving from its previous position that "*an extension does not, in principle, eliminate a site that would otherwise be available to a competitor*"².

Facilitated v routine entry

The Commission previously acknowledged that the competition test would give rise to benefits by "*incentivising competitors to develop in that area when otherwise they would not have done so*".³ A development which would have happened in a concentrated area whether or not the test was in place – such as the entry reported in Appendix 7.3 of the Report – cannot be counted as a benefit of the test. Although the importance of the distinction between routine and facilitated entry is acknowledged in the text of the Commission's provisional decision, the base case nevertheless assumes that, in a future world in which the test is in operation, all entry which occurs into concentrated areas would not have happened but for the test. This is clearly incorrect.

Exaggerated benefits and understated costs

We believe the Commission's upper bound assessment greatly exaggerates the benefits likely to result from the test. Notably, the Commission has taken its previous finding that an additional competitor fascia reduces a store's variable profit margin by 3.79%, and multiplied this figure by four to set an upper limit on benefits. No evidence has been advanced to support this position.

Moreover, the test will initially generate significant costs, as retailers struggle to adapt their current strategies, and because long-planned developments with substantial sunk investment will not be allowed to come to fruition. The Commission's model suggests the hoped-for cumulative net benefits do not start to arise until eight years have passed, and those benefits are predicated on the impact of the test lasting for decades into the future. This must call into question whether the benefits are sufficiently certain and immediate to justify such an intrusive intervention in property rights.

² Competition Commission, *Framework for the assessment of the competition test*, 17 June 2009, para 19.

³ *Competition Commission's response to Tesco's note on information available to the CC*, 14 November 2008, para 5.



TESCO PLC

TESCO HOUSE, DELAMARE ROAD, CHESHUNT, HERTS. EN8 9SL
Telephone: 01992 632222 Ext.

At the same time, the Commission does not appear to have heeded our concern that the test will have wider costs for this sector and for related parts of the economy. These costs include the delay that users of the planning system recognise will flow from another hurdle and increased appeals; the inappropriate limitation on elected local authorities' power to approve welfare-enhancing developments; the effect an immediate curb on investment will have on the wider property market; the spillover effect on non-food retailing of limiting expansion by supermarkets; and the introduction of greater uncertainty and risk into an important economic sector. Although it may be difficult to capture such costs in an economic model, these qualitative factors suggest strongly that the test should fail a cost-benefit analysis.

Predictability of the test

The Commission suggests that the test will not result in delays because "*the test is designed to be predictable*", and that in practice retailers "*will be able to measure competitor size sufficiently accurately to predict the outcome of the test successfully*". Our initial assessment of the list of Tesco developments which the Commission considers would have failed the test between 2000 and 2006 suggests that, even though the overall total of affected developments is comparable, there are discrepancies in approximately one case in five. Moreover, even if a retailer accurately predicts the outcome of the test at the start of a store development project, the situation may well have changed over the (average) period of five years the Commission calculates are required to assemble a site and construct a store. As shown by industry developments in recent years, rival stores may open, close, be acquired or sold (including with the approval of the competition authorities or even at their insistence), or simply adjust their internal retail layouts to change the amount of grocery space. This all undermines the argument that delays will not occur, and adds to the uncertainty and deterrent effect of the test.

Taken together, we consider that these issues demonstrate that the Commission has not adequately made out its case for this intrusive remedy, which will potentially delay or freeze development at hundreds of stores across the country.

We look forward to discussing these matters further at the forthcoming plenary session.

Lucy Neville-Rolfe, CMG
Executive Director
(Corporate and Legal Affairs)