UK NATIONAL REPORTER'S RESPONSE TO QUESTIONS FOR LIDC KIEV CONGRESS 2013

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QUESTION A: "THE FOOD DISTRIBUTION MARKET: IS ANTITRUST EFFICIENTLY HANDLING THIS MARKET?"

A. OVERVIEW

1. This report has been prepared to assist the International Rapporteur in reporting to the LIDC congress in Kiev in September 2013. It has been prepared in accordance with the Directives and Instructions issued by the LIDC in November 2012. It follows the structure of the Questions for National Reporters that were issued in January 2013. A draft version of this report was circulated to members of the Competition Law Association ("CLA") in April 2013. This report reflects the views expressed by CLA members at a meeting held on 9 May 2013 to discuss the draft.

2. In summary, the view of the CLA members in attendance was that the United Kingdom's competition law regime has, in recent years, handled the food distribution sector well and that further legislation is not needed. As explained below, the sector has come in for detailed scrutiny, in particular in the form of a market investigation which produced a number of significant remedies. We note, however, that in the absence of such a regime, other jurisdictions may well find that specific legislation is needed to deal with the sector effectively.

B. ECONOMIC BACKGROUND

3. The structure of the grocery production, processing and retailing markets in the United Kingdom is similar to that of many other developed countries, in that primary agricultural production markets are generally characterised by very low levels of concentration, whereas grocery retailing is characterised by relatively high levels of concentration, both at the national and local level. Intermediate steps in the supply chain (including processors and wholesalers) feature varying levels of concentration from product to product.

4. By way of (very crude) illustration, the United Kingdom's Department for the Environment, Food and Rural Affairs ("**Defra**") publishes annual statistics on various aspects of the food chain, including the total number of undertakings involved at each level. Needless to say, these data do not accurately reflect economic concentration levels because (i) they say nothing about the distribution of market shares between those undertakings; (ii) they are not broken down by product market; and (iii) they do not reflect the fact that primary producers can in some cases group together to market their products collectively (as noted below). However, they provide a broad overview of the UK food sector. Defra's latest figures, from 2011, are as follows:

   (a) Farmers and primary producers: 222,668 enterprises.

   (b) Food and drink manufacturing: 7,356 enterprises.

   (c) Food and drink retailers: 52,124 enterprises.[2]

[1] In addition to receiving helpful comments from the wider Competition Law Association, the Reporter is especially grateful for comments from last year's National Reporter, David Bailey, on an early draft. All errors and omissions remain those of this year's Reporter, however.

5. Some more detailed data are also available for particular segments of the food sector. In particular, the Competition Commission analysed the food supply chains for four types of food in the course of its investigation into "*The supply of groceries in the UK"* (the "**2008 Groceries Investigation Report**") (discussed in detail below): (i) red meat, (ii) pig meat; (iii) milk; and (iv) fruit. Its findings, based on data from 2005, are summarised in the table below:

Food type	Primary production	Processors
Red meat	80,000 cattle holdings. 87,000 sheep holdings.[3]	300 abattoir companies Largest 22 account for 59% of cattle slaughtering Largest 19 account for 45% of sheep slaughtering[4]
Pig meat	10,000 holdings.[5]	Six integrated pig-processors.[6]
Milk	20,000 holdings.[7]	Over 200 processors. Largest three account for more than 90% of milk sold to grocery retailers.[8]
Fruit	500 holdings[9]	Four marketing agents account for 80% of UK produced fruit sold to large grocery retailers.[10]

6. As for the retail level, although there were 93,000 grocery stores in the United Kingdom in 2009, 85% of grocery sales are accounted for by the eight large grocery retailers, and two thirds of sales are accounted for by the four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco).[11]

7. Finally, it should be noted that the levels of concentration described above do not necessarily provide a completely accurate reflection of the bargaining power and economic strength of the various levels of the supply chain. Although the primary production markets generally feature very low levels of concentration, it is common for producers to market their produce jointly through large cooperatives. In particular, the EU's common agricultural policy provides for "producer organisations" for certain types of produce (including fruit and vegetables as well

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2 Defra, *Agriculture in the United Kingdom 2011,* Chart 7.2, p 61, available at http://www.defra.gov.uk/statistics/files/defra-stats-foodfarm-crosscutting-auk-auk2011-120709.pdf.

3 2008 Groceries Investigation Report Annex 9.4 §4.

4 ibid §22.

5 2008 Groceries Investigation Report Annex 9.5 §6.

6 ibid §11.

7 2008 Groceries Investigation Report Annex 9.3 §3.

8 ibid §11.

9 2008 Groceries Investigation Report Annex 9.6 §13.

10 ibid §19.

11 Department for Business, Innovation and Skills, *Groceries Code Adjudicator: Impact Assessment*, May 2011, pp 8-9.

as milk and milk products) whose objectives are to plan production, increase the concentration of supple, optimise production costs and stabilise producer prices.[12] Furthermore, farmers have proven able to exert industrial and political pressure on processors and retailers through other forms of collective action. By way of example, as discussed below, the Office of Fair Trading found that in 2002, pressure from dairy farmers for an increase in the "farm gate" price of milk was so intense (including blockades of depots[13]) that grocery retailers and dairy processors implemented an across the board retail and processor price increases for the purpose of passing back an increase in the farm gate price of milk.[14] Far from being an isolated incident, similar incidents have occurred regularly, and again as recently as this year.[15] Finally, it is fair to say that at least some consumers in the United Kingdom have a preference for purchasing food that supports farmers, and this in turn is reflected in grocery retailers' efforts to demonstrate that they are farmer friendly in their practices.

C. LEGAL BACKGROUND

1 Overview of UK competition law

8. There are four principal elements of competition law in the United Kingdom, all of which apply to grocery retailing:

   (a) The market investigation regime (discussed in Part D below);

   (b) Merger control (discussed in Part E below);

   (c) The prohibition on anti-competitive agreements and concerted practices (discussed in Part F below);

   (d) The prohibition on abuses of dominant positions (discussed in Part F below).

9. Each of those elements is discussed in turn below. It should be noted, however, that the United Kingdom's competition law regime is in the process of undergoing substantial institutional reform. Whereas at present there are two general competition law authorities: the Office of Fair Trading ("**OFT**") and the Competition Commission, those two institutions are to be merged into a single Competition and Markets Authority which will commence work on 1 April 2014.[16] Various changes will be made to competition law procedures, and some changes to aspects of the substantive regimes, but little that is material to the issues discussed in this report will change.[17] In what follows, this report therefore discusses the current regime and the ways that it has been applied to this sector in recent years.

10. The first of those elements, the market investigation regime, is, to the reporter's knowledge, unique in global competition law. It combines the wide-ranging powers of investigation and

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12 See Council Regulation 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (as amended), Article 122. See also Case C-500/11 *Fruition* (opinion of 23 April 2013) §§23-32 for an account of their role in the common agricultural policy over time.

13 See OFT Decision of 26 July 2011, *Dairy retail price initiatives* §§5.29-5.36.

14 ibid §5.27, although the OFT noted that it could not establish whether the various dairy pricing initiatives had any lasting, appreciable impact on farm gate prices.

15 Financial Times, *Morrisons Depots Blocked by Farmers*, 23 April 2013, p 20.

16 Enterprise and Regulatory Reform Act 2013, Part 3.

17 Enterprise and Regulatory Reform Act 2013, Part 4.

reporting that are common in market study/sector inquiry regimes in other jurisdictions with the extensive remedial powers that more commonly arise in the context of merger control or antitrust enforcement. The regime operates as follows:

(a) The OFT[18] has the power to refer a market to the Competition Commission for investigation where it has "*reasonable grounds for suspecting that any feature, or combination of features, 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*".[19] The term "*feature*" is defined very widely to include market structure or the conduct of suppliers or customers.[20]

(b) Where such a reference has been made, the Competition Commission must decide whether any feature of the relevant markets prevents, restricts or distorts competition.[21] It is allowed two years to investigate and publish its final report.[22]

(c) Where the Competition Commission identifies features of the market that restrict competition, it must also consider what measures it should take, or what measures it should recommend that others take, to remedy those features and any detrimental effect on consumers resulting from them.[23]

(d) The Competition Commission has extremely wide-ranging remedial powers, including the power to prohibit agreements, mandate various forms of conduct, order divestitures or prohibit acquisitions.[24]

(e) It should also be noted that Competition Commission market investigation references are very resource intensive, not just for the Competition Commission but also for the private parties involved. Given the expense involved and the risk of adverse outcomes (from the parties' perspective) the mere threat of a reference can have an impact on parties' behaviour and market outcomes.

11. The market investigation regime applies to grocery retailing markets in the same way as it does to other markets. Indeed, as discussed in Part D below, the Competition Commission published a market investigation decision on the groceries sector in 2008, which followed an earlier investigation under the predecessor regime in 2000.

12. The second element, merger control, is also somewhat distinctive. The Enterprise Act provides for "*relevant merger situations*", (broadly, acquisition of control or "*material influence"* over another undertaking) that satisfy either a turnover test (£70m for the target) or a market share test (25% combined share of supply) to be reviewed by the OFT and Competition Commission. Because the market share test can be applied in relation to local,

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18 The various sectoral regulators (e.g. for energy or telecommunications) can also make references in respect of markets in their sectors. However, grocery markets do not fall within the jurisdiction of any sectoral regulators, so those regulators are not considered further in this report.

19 Section 131(1) EA. The relevant government minister can also refer a market for investigation, but to date that power has not been used.

20 Section 131(2) EA.

21 Section 134(1) EA.

22 Section 137(1) EA.

23 Section 134(4) EA.

24 Sections 138, 161 and Schedule 8 EA.

regional or national markets, even very small mergers (such as the acquisition of a single grocery retailer store) can be reviewed.[25]

13. Unlike many other jurisdictions, the United Kingdom's merger control regime features voluntary notification, combined with a four month deadline (measured from when the fact that the merger has completed has been "*made public*") for the OFT to decide whether to refer the merger for in-depth investigation by the Competition Commission. As a result, it is possible for some small or inconspicuous acquisitions to escape scrutiny altogether if they do not come to the OFT's attention.[26]

14. The substantive test for review is whether the merger gives rise to a "*substantial lessening of competition*". In addition, the relevant minister can intervene in a case and take the final decision on wider public interest grounds if the merger engages one of the defined public interests set out in the legislation. Although there are not currently any public interests specified in relation to the grocery sector, in principle the government of the day could change that position in the course of a merger investigation if it saw fit to do so.[27]

15. The remaining two elements of competition law in the United Kingdom follow broadly the same pattern as other EU jurisdictions: a prohibition on anti-competitive agreements (the Ch I Prohibition/Article 101 Treaty on the Functioning of the European Union) and a prohibition on abuses of a dominant position (the Ch II Prohibition/Article 102 Treaty on the Functioning of the European Union). Both are enforced by the OFT, in conjunction with the national courts. Breaches of either provision can result in substantial financial penalties.

16. In principle, both prohibitions can be applied in the groceries sector, although to date only the Ch I prohibition has been (as discussed below). Both prohibitions require proof of an effect on trade within the United Kingdom (Ch I and II Prohibitions) or between Member States of the EU (Articles 101 and 102 TFEU).

2 Retail and grocery specific competition law rules and exemptions

17. The United Kingdom's competition law regime described above is (for the most part) generally applicable across all sectors. There are no sector specific exemptions or special provisions in respect of their application to grocery retailing.

18. However, one of the remedies imposed by the Competition Commission in the 2008 Groceries Investigation Report was the establishment of the Groceries Supply Code of Practice ("**GSCOP**"), which regulates the relationship between large grocery retailers and their suppliers. In particular, it imposes a general obligation of fair dealing, in addition to a number of specific requirements in relation to various aspects of the supplier-retailer relationship. At the time of the 2008 Groceries Investigation Report, the Competition Commission required the retailers to seek to agree the appointment of an Ombudsman to enforce the GSCOP. However, they failed to reach agreement and so Parliament decided to

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25 See, for example, Competition Commission decision of 28 November 2007 *Tesco/Co-op Store in Slough*.

26 See, for example, OFT decision of 2 February 2004 *Tesco/Co-op Store in Slough* under the heading "*jurisdiction*", in which the OFT recorded that Tesco had recently acquired three Co-op grocery retailing stores, only one of which fell within the four month deadline and therefore could be investigated.

27 Section 42 EA. For example, during the *Lloyds/HBOS* banking merger, the Government designated a new public interest of "*the stability of the UK financial system*" during the course of the OFT's review with the result that the minister could intervene and approve the merger without the need for an in-depth review by the Competition Commission. See, to that effect, Lord Mandelson's decision of 31 October 2008 *Lloyds/HBOS*.

legislate for a new role of Groceries Code Adjudicator to act as an enforcer for GSCOP.[28] Because it resulted from a market investigation rather than as a sui generis piece of competition legislation, the GSCOP is discussed in more detail in Part D below.

D. MARKET INVESTIGATIONS AND ADVOCACY

1. Overview

19. As discussed in Part C.1 above, one of the unique features of the competition law regime in the United Kingdom is its market investigation regime, which empowers the Competition Commission to impose wide-ranging remedies to address any features of markets that it considers to be undesirable from a competition perspective. One such recent investigation concerned the groceries sector, and is discussed in sections 2-4 below.

2. Background to the 2008 Groceries Investigation

20. As explained in Part C.1 above, the Competition Commission can only conduct a market investigation where the OFT (or other relevant body) refers a market to it for investigation. The reference that gave rise to the 2008 Groceries Investigation was made by the OFT in 2007, but was the product of many years of competition concerns in relation to the sector.

21. First, in 1999-2000, the predecessor to the Competition Commission, known as the Monopolies and Mergers Commission (the "**MMC**"), had conducted an inquiry into the groceries sector under the competition legislation that was in force at that time (the Fair Trading Act 1973) (the "**MMC Investigation**"). That legislation provided for a market investigation regime that is similar to that which is found in many other jurisdictions, in that the MMC had powers of investigation, but could only make recommendations as to what the Government or others should do to remedy any concerns that it identified.

22. The MMC Investigation arose out of concerns in the 1990s about high prices and profits in the grocery sector in the United Kingdom. Those concerns reflected a broader concern that consumer prices were higher in the United Kingdom than in continental Europe and the US, which the popular press dubbed "Rip off Britain".[29] The MMC Final Report identified a number of competition concerns, falling into two broad categories: (i) concerns about grocery retailers' pricing strategies (in particular below cost pricing and "price flexing", whereby higher prices were charged in some stores than others);[30] and (ii) concerns about grocery retailers' conduct towards their suppliers.[31] It decided not to recommend any action in relation to the pricing concerns, however, because it considered that the potential remedies (such as a prohibition on below cost selling or on price-variations across stores) would either have too many unintended consequences (such as prohibiting desirable price-cutting or differential pricing that reflects regional cost differences) or would be too difficult to implement.[32] In relation to the concerns about supplier practices, the MMC recommended the adoption of a Supermarkets Code of Practice for all grocery retailers with a national market share in excess of 8%. Such a code (the "**SCOP**") was drawn up and adopted by the four largest grocery retailers at the time.

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28 The Groceries Code Adjudicator Act received Royal Assent on 25 April 2013.

29 MMC Investigation §2.5. See http://en.wikipedia.org/wiki/Rip_Off_Britain for an account of the wider "Rip off Britain" phenomenon.

30 MMC Investigation §§2.435-2.436.

31 ibid §§2.548-2.550.

32 ibid §§2.558-2.577.

23. In the years that followed, complaints continued to be made to the OFT about grocery retailers' treatment of suppliers in particular, but also about competition in the sector more broadly. The OFT conducted a general review of SCOP in 2004, and commissioned and published a detailed audit of compliance with SCOP in 2005. At the same time, the OFT sought submissions on the effectiveness of competition in the grocery retail markets, but concluded in August 2005 that a further reference to the Competition Commission for a market investigation was not warranted because the SCOP and competition generally were both working well.[33] In October 2005, however, that decision was challenged by the Association of Convenience Stores (the "**ACS**"), which considered that competition was not working well at all. The OFT conceded that its decision had not been properly reasoned, consented to the quashing of that decision by the Competition Appeal Tribunal and undertook to investigate and consider the issues again.[34] On 9 May 2006, the OFT referred the market to the Competition Commission for investigation, citing concerns about (i) the operation of the planning system; (ii) barriers to entry raised by large grocery retailers' land holdings; (iii) grocery retailers' imposition of restrictive covenants when selling land; and (iv) the same retail pricing and supplier relationship practices that the MMC had found problematic in the earlier MMC Inquiry.[35]

3. The 2008 Groceries Investigation Report

24. The 2008 Groceries Investigation ran for nearly two years (9 May 2006 - 30 April 2008) and covered a comprehensive range of competition issues:

    (a) Competition between large grocery retailers and smaller convenience and specialist stores;

    (b) Concentration in local markets for grocery retailing;

    (c) Barriers to entry or expansion;

    (d) Possible collusion or coordination between grocery retailers; and

    (e) Competition issues in the grocery supply chain.

25. Its findings in relation to each topic are summarised below.

Competition between large grocery retailers and smaller convenience and specialist stores

26. As explained above, the 2008 Groceries Investigation only came about because of pressure from the convenience store sector based on their concerns that large grocery retailers were squeezing them out of the market. But for their intervention, the 2008 Groceries Investigation would not have happened. The ACS actively participated in the Investigation as well, submitting 16 documents over the course of the Investigation. As explained below, however, although the Competition Commission investigated a number of the concerns raised by the ACS, in each case the Competition Commission concluded that there was no restriction of competition.

27. First, the Competition Commission investigated the so called "waterbed effect", whereby large grocery retailers use exercise their buyer power to obtain low cost prices for themselves,

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33 OFT decision of 3 August 2005, *Supermarkets: The Code of Practice and other Competition Issues*, OFT807.

34 *ACS v OFT* [2005] CAT 36.

35 OFT decision of 9 May 2006, *The Grocery Market: The OFT's reasons for making a reference to the Competition Commission*, OFT845.

with the result that suppliers need to charge higher cost prices to smaller grocery retailers in order to recover their costs. As a consequence, large grocery retailers are able to offer more competitive retail prices, which in turn allows them to increase their market shares at the expense of smaller retailers and thereby reinforces their buyer power. Ultimately (according to the theory), consumers are harmed by the reduction in competitive constraint posed by small retailers.

28. Although the Competition Commission's investigation confirmed the accuracy of ACS' complaint that large grocery retailers pay less for their supplies than their smaller competitors, and although the Competition Commission accepted that the "waterbed effect" theory was logically coherent, the Competition Commission found that there was no such effect in the United Kingdom grocery markets. In that regard, the Competition Commission placed weight on (amongst other factors) (i) evidence suggesting that there is a limit to the extent to which growth in the size of a retailer translates into lower supply prices,[36] and (ii) because competition between large grocery retailers is intense, any reductions in supply prices that they achieve are likely to be passed on to consumers.[37]

29. Second, the Competition Commission considered the argument that the closure of some convenience stores was leading to a "*tipping point*" in the viability of the wholesalers that supply them as those wholesalers become unable to recover their fixed costs from a more limited customer base. The Competition Commission rejected that argument, however, on the basis that both the convenience store sector and the wholesaler sector were growing rather than declining, and in any event any decline in customer base would be more likely to lead to consolidation amongst wholesalers rather than resulting in a "*tipping point*" for the viability of the whole sector.[38]

30. Third, the Competition Commission investigated whether below cost pricing by large grocery retailers might foreclose competition from specialist and convenience grocery stores. Although the Competition Commission found that large grocery retailers do sell products below cost, unlike the MMC in the MMC Investigation, the Competition Commission did not consider this to be problematic from a competition perspective. In particular, the Competition Commission rejected the suggestion that the below cost pricing might be an attempt to "*predate*" smaller stores, not least because the Competition Commission found that such smaller stores do not in general place a competitive constraint on larger stores.[39] Similarly, the Competition Commission rejected the suggestion that the foreclosure of convenience and specialist stores might be an "*unintended consequence*" of below cost selling because the evidence showed that the local entry of a large grocery retailer (which tend to engage in below cost pricing) had no impact on the rate of entry or exit of convenience stores or off-licence alcohol retailers.[40] Finally, the Competition Commission also rejected the argument that below cost selling by large retailers might "*mislead*" consumers into believing that such retailers were better value than small retailers across the board. The Competition Commission

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36 2008 Groceries Investigation Report §5.31.

37 ibid §5.29.

38 ibid §5.51.

39 ibid §5.58.

40 ibid §§5.65-5.66. The Competition Commission pointed out that, because alcohol was one of the items that was regularly sold below cost by large grocery retailers, it might be expected that any impact that such below cost selling would have would be felt by alcohol specialist retailers.

considered that the evidence showed that consumers take into account a broad range of factors, rather than just the price of a select few items, in determining where to shop.[41]

31. Fourth, the Competition Commission considered the argument that local discount voucher campaigns by large grocery retailers (and in particular Tesco) might be part of a predatory strategy to exclude smaller retailers from the market. The Competition Commission rejected that argument on the basis that the evidence did not show any impact of those strategies on the entry or exit of convenience stores, and because local voucher campaigns were not used extensively in any event.[42]

32. Finally, the Competition Commission considered the entry by Tesco and Sainsburys (two of the largest grocery retailers) into the convenience store sector. However, the Competition Commission concluded that their efforts to compete in this sector were pro-competitive and did not provide any evidence of predation.[43] It should be noted, however, that the Competition Commission's findings that there had not been predation and that competition from large grocery retailers was pro-competitive do not provide a complete answer to concerns that the expansion of large grocery retailers might be socially undesirable for other reasons (i.e. reasons that do not relate to competition). For example, the Competition Commission could not consider in its investigation the question of whether diversity in high streets across the country is desirable in its own right irrespective of the impact on competition. As the Competition Commission explained, that and a wide range of other public policy issues were outside of its remit under the United Kingdom's market investigation regime.[44]

Concentration in local markets for grocery retailing

33. The Competition Commission conducted an in-depth investigation of the extent to which competition between grocery retailers in highly concentrated local markets might be restricted. In contrast to the situation at the time of the MMC Investigation, by 2006-2008, most large grocery retailers had stopped engaging in "price-flexing", and had rather adopted uniform national pricing policies pursuant to which prices only varied between stores according to their overall size.[45] Moreover, most large grocery retailers took a similar approach to other aspects of their retail offering, including product range and the use of promotional discounts.[46]

34. Nevertheless, the Competition Commission was concerned that a lack of competition at the local level could manifest itself in one or both of two ways: (i) a deterioration in the quality of those parts of the retail offering that were determined at a local, store level (ie opening hours, stock levels, cleanliness, quality of service); and (ii) influencing the overall pricing and quality decisions applied by the retailers across the board. As explained below, the Competition Commission found evidence of both forms of anticompetitive harm.

35. First, the Competition Commission analysed the extent to which retailers might soften their competitive efforts in local markets in which they faced reduced competition. Although the Competition Commission conceded that it could not measure this directly, it could analyse store level profit margins, and the evidence showed that profit margins were higher in highly

41 ibid §5.67.

42 ibid §§5.81 and 5.86.

43 ibid §§5.88-5.98.

44 ibid §§2.11-2.18.

45 ibid §6.31.

46 ibid §6.32.

concentrated local markets. The Competition Commission concluded that those higher profit margins reflected the deterioration of the retailer's local competitive efforts.[47]

36. Second, the Competition Commission concluded that, when setting national price levels, retailers would take into account the extent to which they faced competition in the various local markets in which they compete. Because the Competition Commission found that a significant proportion of grocery stores were located in highly concentrated local markets (11-27% for large stores and 10-22% of mid-large stores), it stood to reason that retailers would take that into account and set higher national prices than they would have if more of their stores were located in highly competitive local markets.[48]

Barriers to entry or expansion

37. The Competition Commission investigated a number of potential barriers to entry or expansion in grocery retailing, both in general and in local markets that are currently highly concentrated. In particular, the Competition Commission considered three potential barriers (i) cost advantages held by large grocery retailers, and Tesco in particular; (ii) the planning system; and (iii) large grocery retailers' land banks.

38. In relation to cost advantages, the Competition Commission found that large retailers (and in particular Tesco) had such advantages, but that they did not give rise to material barriers to entry. The evidence showed that other retailers successfully acquired and developed new sites notwithstanding their cost disadvantages.[49]

39. In relation to the planning system, the Competition Commission noted that it necessarily has the effect of restricting entry and expansion, both because it constrains retailers' freedom to choose where to build new stores or enlarge existing ones, and because the planning approval process itself is costly and time consuming.[50] Further, the Competition Commission noted that the system favours incumbents, both because it is easier to obtain approval for expansions of existing stores than for building new stores, and because the existing large grocery retailers have more expertise and resources for dealing with the process than new entrants would have.[51] However, the Competition Commission considered that the planning system only gave rise to a material barrier to entry in respect of large stores, because medium and smaller stores could more easily be established in areas that are not subject to planning restrictions.[52]

40. The Competition Commission also identified material barriers to entry arising from large grocery retailers' holdings of land, and the restrictive covenants and exclusivity arrangements that attach to those holdings. Although the Competition Commission accepted that none of the retailers pursued a strategy of using those holdings to exclude competition, it found that the presence of such holdings in highly concentrated local markets had the effect of restricting competition in those local markets.[53]

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47 ibid §§6.60-6.63.

48 ibid §6.73.

49 ibid §§7.115-7.117.

50 ibid §7.118.

51 ibid §§7.118-7.119.

52 ibid §7.120.

53 ibid §7.121.

Coordination between grocery retailers

41. The Competition Commission also investigated the possibility that large grocery retailers might collude or coordinate with each other. It noted that the OFT was in the process of conducting a number of cartel investigations involving the sector, which are discussed in Part G below. It also noted that the conditions that make collusion or tacit coordination possible were evident in the sector, although it found no evidence of such behaviour taking place.[54]

Supply chain issues

42. Finally, the Competition Commission considered whether large grocery retailers have significant buyer power and whether they use that power in a way that distorts competition.

43. The Competition Commission concluded that large grocery retailers do have buyer power,[55] but that this is not in itself problematic from a competition perspective because the lower supply prices that their buyer power makes possible are passed on to consumers.[56] In particular, the Competition Commission rejected the suggestion that retailers exercised their buyer power by withholding demand, which (if it had been established) would have had adverse effects on consumers.[57] However, the Competition Commission drew a distinction between the normal exercise of buyer power to obtain better trading terms, and the use of buyer power to "*transfer excessive risks or unexpected costs to their suppliers through practices involving retrospective adjustments to supply agreements or giving rise to moral hazard on the part of the grocery retailer*".[58] According to the Competition Commission, such conduct "*is likely to lessen suppliers' incentives to invest in new capacity, products and production processes ... [and] will be detrimental to the interests of consumers.*"[59] Particular examples of retrospective conduct that the Competition Commission identified included imposing price changes on suppliers after goods had been ordered or delivered, or requiring them to contribute to the costs of promotions that had not been agreed in advance.[60] Examples of excessive risk transfer giving rise to moral hazard included the practice of making suppliers liable for losses arising from goods being lost or stolen in store.[61]

44. In addition to its investigation of buyer power and supply chain practices, the Competition Commission also investigated whether the sale by retailers of "*own label*" products alongside branded products gave rise to distortions of competition by reason of the retailers acting as both customers and competitors of suppliers of branded products. The Competition Commission rejected the suggestion that their privileged position gave retailers a substantial competitive advantage, however, because the evidence did not show that own label products had been consistently growing at the expense of branded products.[62]

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54 ibid §8.40.

55 ibid §9.21.

56 ibid §9.41.

57 ibid §§9.68-9.69.

58 ibid §9.41.

59 ibid.

60 ibid §9.45.

61 ibid §9.48.

62 ibid §§9.74-9.75.

Remedies

45. As explained above, the Competition Commission identified four features of the relevant markets that distort competition: (i) high levels of concentration in some local markets; (ii) the planning system; (iii) retailers' land holdings; and (iv) supply chain practices. In each case the Competition Commission found that the features gave rise to detrimental effects on consumers, and accordingly the Competition Commission had a statutory duty to impose remedies.[63]

46. The Competition Commission decided to impose a package of remedies to address those concerns, including:

    (a) A recommendation that a new "*competition test*" be incorporated in the planning regime, which would block the development of new large grocery stores or the extension of existing ones where the operator of the new store would have a local market share in excess of 60%;[64]

    (b) Measures in relation to restrictive covenants and exclusivity arrangements:

        (1) Requiring the release of restrictive covenants in highly concentrated local markets;

        (2) Imposing a prohibition on new restrictive covenants that restrict grocery retailing;

        (3) Prohibiting the enforcement of exclusivity arrangements in highly concentrated local markets beyond a period of five years;

        (4) A recommendation that the then existing exemption from competition law for Land Agreements should be amended to exclude exclusivity arrangements which restrict grocery retailing;[65]

    (c) The establishment of a Groceries Supply Code of Practice ("**GSCOP**"), based on the existing SCOP, but amended to include a general requirement of fair dealing and specific prohibitions of the retrospective and excessive risk transferring forms of conduct considered above, together with a requirement that retailers should enter into binding arbitration to resolve any disputes arising under the GSCOP;[66] and

    (d) A recommendation that unless the retailers themselves established a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP, that the Government should establish such an ombudsman.[67]

4. Implementation of the 2008 Groceries Investigation Report

47. Although the findings and remedies made, recommended and imposed by the Competition Commission were quite clear and detailed, the implementation of those remedies has been far from smooth.

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63 ibid §§10.13-10.17.

64 ibid §§11.437-11.441.

65 ibid §§11.442-11.444.

66 ibid, §11.445.

67 ibid §§11.446-11.448.

48. First, Tesco challenged the Competition Commission's decision to recommend the introduction of a "*competition test*" in the planning regime. The Competition Appeal Tribunal upheld that challenge on the basis that (i) the Competition Commission had failed to investigate to what extent it would be effective at reducing concentration in highly concentrated local markets;[68] and (ii) the Competition Commission had failed to take into account the extent to which the remedy itself would harm consumers by preventing the expansion of incumbents in highly concentrated local markets.[69] Both points were based on the proposition that the direct effect of the competition test could only be to *prevent* the building of new capacity, which would (in the absence of prompt entry or expansion by a competitor) harm consumers. So the desirability of the competition test depended critically on the extent to which the expansion that was blocked by the competition test would be offset by new entry or expansion by smaller competitors in the highly concentrated local markets. Although this was crucial to the analysis, the Competition Appeal Tribunal found that the Competition Commission had not investigated it sufficiently, and so quashed and remitted the decision to the Competition Commission for reconsideration.

49. The Competition Commission then reconsidered the desirability of the competition test remedy, focussing on the question of how long it would take for competitors to replace any expansion by incumbents that was blocked by the test. The Competition Commission concluded that the benefits substantially outweighed the costs, and therefore reinstated its recommendation that it should be implemented, subject to only to the introduction of a *de minimis* exception whereby small extensions could be made by incumbents without needing to pass the competition test.

50. By the time the new recommendation had been made (October 2009), however, the then Labour Government's term in office was coming to an end. The Government did not have time to decide whether or not to accept the Competition Commission's recommendation before the election in May 2010 which led to a change in Government. The new Conservative/Liberal Democrat coalition has not implemented the competition test and at the time of writing there do not appear to be any proposals to do so.[70]

51. The other remedies have fared better, but have also been affected by delays:

    (a) The GSCOP came into force on 4 February 2010 (ie nearly two years after the Competition Commission decided it should be implemented),[71] and legislation providing for an enforcement mechanism was enacted on 25 April 2013.[72]

    (b) The remedies in relation to restrictive covenants and exclusivity arrangements were implemented in the Groceries Market Investigation (Controlled Land) Order 2010, which was issued on 10 August 2010 (ie more than two years after the Competition Commission decided that the remedies should be implemented);

    (c) The recommendation that exclusivity arrangements restricting grocery retailing should be removed from the exemption from competition law that land agreements enjoyed at

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68 *Tesco v Competition Commission* [2009] CAT 6 §§111-128.

69 ibid §§144-165.

70 House of Commons Library, *Supermarkets: competition inquiries into the groceries market*, 2 August 2012, p 34.

71 See s 1(2) of the Groceries (Supply Chain Practices) Market Investigation Order 2009.

72 In the intervening period the OFT has played a limited monitoring role as set out in its guidance document, *Monitoring and Enforcement by the Office of Fair Trading of the Groceries (Supply Chain Practices) Market Investigation Order 2009*, first published in August 2009 and then updated through to August 2012.

the time was effectively implemented by the revocation of that exemption in its entirety as of 6 April 2011.[73]

E. MERGER CONTROL

52. As noted above, the food distribution sector (including grocery retailing) is subject to exactly the same merger control regime as every other sector of the economy. The jurisdictional thresholds are twofold: (i) that the target's turnover in the United Kingdom exceeds £70m;[74] or (ii) that the parties' combined share of supply (or purchase) for any goods or services in respect of which they overlap exceeds 25% in the United Kingdom or a substantial part thereof.[75] It should be noted that the "share of supply" test is not a market share test, in that the competition authorities have the flexibility to define product and geographic combinations that would not amount to relevant markets for antitrust purposes. There is no fixed definition of a "substantial part" of the United Kingdom either, although in practice it has been given a wide interpretation. By way of example, in the *Slough* case referred to above, the Competition Commission said that the Borough of Slough (population c. 140k) was a substantial part of the United Kingdom.[76] As a result, even very small acquisitions can qualify.

53. The position is even more extreme in respect of Tesco's largest grocery retailer, Tesco. Because the OFT considers that Tesco accounts for more than 25% of supply across the United Kingdom, even the acquisition of a single store by Tesco anywhere in the United Kingdom (i.e. even in a local market in which Tesco's market share would be less than 25%) satisfies the share of supply test.[77]

54. The substantive approach that the United Kingdom authorities take to investigating grocery retail mergers is relatively flexible. As with the jurisdictional thresholds, there are no special statutory rules applicable to market definition or measuring competition in the grocery sector. That said, the authorities have developed a relatively detailed methodology through their decisional practice, while retaining the flexibility to adjust it to the particular features of the case at hand. Their methodology is broadly reflected in guidance that they have published in relation to the appraisal of mergers in the retail sector.[78]

55. Although the authorities do take a standard product and geographic market definition based approach to evaluating mergers, they do not apply the resulting market definition strictly, but rather take account of competition both within and outside of the defined markets. The main function of the initial market definition is to act as a filter (by reference to a fascia count and simple "indicative price rise" calculations based on diversion ratios and profit margins) to identify the local markets that require more detailed investigation.

56. In terms of product market definition, broadly speaking, the OFT and Competition Commission distinguish between the following three types of grocery retailers:

    (a) **One-stop stores**: those with a net sales area of 1,400 square metres or above. These stores form their own product market and are not materially constrained by any other stores.

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73 Competition Act 1998 (Land Agreements Exclusion Revocation) Order 2010/1709.

74 Section 23(1)(b) Enterprise Act.

75 Section 23(2)(b) Enterprise Act.

76 Competition Commission decision of 28 November 2007 *Tesco/Co-op Store in Slough* §4.6.

77 See, for example, OFT decision of 14 July 2009 in *Tesco/SPAR*.

78 OFT and Competition Commission, *Commentary on retail mergers*, March 2011.

(b) **Mid-size stores:** those with a net sales area between 280 square metres and 1,400 square metres. These stores are also constrained by one-stop stores and so should be assessed by reference to a combined one-stop/mid-size market.

(c) **Convenience stores**: those with a net sales area of less than 280 square metres. These stores are constrained by all grocery stores and so should be assessed as part of a wider market including one-stop stores and mid-size stores as well.[79]

57. In addition to defining the market by store size, the authorities also distinguish between stores according to the range of groceries that they sell. In particular, when assessing competition from the perspective of the large grocery retailers, the market excludes frozen food retailers, specialist retailers (such as butchers, bakers, etc) and limited assortment discounters (which tend to sell fewer than 1,000 products, compared with the 5,000 - 10,000 sold by larger grocery retailers in stores of a similar size.[80] The authorities' approach is flexible enough to recognise, however, that when a large grocery retailer acquires (for example) a limited assortment discounter, there may be an asymmetric loss of competitive constraint from the large grocery retailer to the discounter.[81]

58. In terms of geographic market definition, the starting point is usually as follows:

(a) **one-stop stores**: 10 minutes drive time in urban areas and 15 minutes drive time in rural areas;

(b) **mid-size stores**: 5 minute drive time in urban areas and 10 minute drive time in rural areas, but these stores are also constrained by one-stop stores within a 10 minute drive time in urban areas or 15 minutes in rural areas; and

(c) **convenience stores**: five minutes drive time in all areas (and one mile as a sensitivity), but these stores are constrained by one-stop stores within a 10 minute drive time in urban areas (or 15 minutes in rural areas) and by mid-size stores within a five minute drive time in urban areas (or a 10 minute drive time in rural areas).

59. The most significant grocery retailer merger investigation of the past five years was the 2008/2009 investigation of the Cooperative Group's acquisition of Somerfield ("***CGL/Somerfield***").

60. The *CGL/Somerfield* case saw the merger of two large national grocery retailers. CGL had 2,228 stores at the time, of which 59 were "one-stop", 452 were "mid-size" and 1,717 were "convenience stores". Somerfield had 877 stores, of which 40 were "one-stop", 616 were "mid size" and 221 were "convenience stores". Notwithstanding that they were both large retailers, however, their combined share of total groceries sales in the United Kingdom was less than 8%, so the merger was not thought likely to have a significant negative effect on competition at the national level. On the contrary, the OFT said that "*it is reasonable to consider that CGL will in effect become a stronger fifth rival to the UK's four largest supermarket operators*".[82] The investigation therefore focussed on the local markets in which the two retailers overlapped. There were 295 Somerfield stores that overlapped with CGL stores, although only 139 called for any real investigation because the others were in geographic markets in

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79 See OFT decision of 15 January 2009 in *CGL/Somerfield* §10.

80 ibid §§13-15.

81 See OFT decision of 9 March 2011 in *Asda/Netto*.

82 See OFT decision of 15 January 2009 in *CGL/Somerfield* §27.

which at least three other competitors already operated.[83] There were 153 CGL stores that overlapped with Somerfield stores, but only eight of those were in areas that required investigation in addition to the areas in which the 139 Somerfield overlap stores were located.[84]

61. The OFT then reduced the list of markets to investigate further by applying a simply economic test for "illustrative price rises" based on diversion ratios and profit margins.[85] That reduced the number of markets to investigate to 98.[86] Further qualitative investigation reduced the number to 94.

62. In addition, the OFT identified a further 32 areas in which competition concerns arise because of overlaps between Somerfield and other cooperatives that are closely affiliated with CGL.[87] CGL was therefore required to divest a total of 126 stores to obtain clearance for its acquisition of Somerfield.[88] Subsequently that figure was increased by seven to account for various calculation errors that the OFT had made,[89] by a further four to account for an additional acquisition that CGL made before it had implemented the divestments required by the *CGL/Somerfield* case,[90] and then reduced by five to reflect material changes in circumstances (entry of new competitors or exit of either CGL or Somerfield) in some of the areas in the course of the period in which CGL was to divest stores.[91]

63. There have been a significant number of other grocery retailer merger investigations over the past five years as well, many of which concerned the divestments that CGL was required to make as a result of the *CGL/Somerfield* case. That is one of the features of merger control in the United Kingdom's grocery retail markets: because local markets are so highly concentrated, even divestments made to satisfy the conditions of a merger control clearance frequently raise their own merger control issues because the acquirers also have stores that overlap with the divestment stores. It is fair to say, however, that the scale of the divestments in required in the *CGL/Somerfield* case were exceptional: the Chief Executive of the OFT at the time said that it was "*the largest divestiture package [ever] accepted in UK merger control*".[92]

64. Most grocery merger cases following *CGL/Somerfield* have concerned very small acquisitions of no particular significance. One exception, however, was the recent *Asda/Netto* case, in which the OFT approved the acquisition by Asda (one of the big four) of Netto, one of the largest limited assortment discounters with 194 stores across the United Kingdom, subject to an obligation to divest 47 stores.[93]

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83 ibid §51.

84 ibid §53.

85 See OFT and Competition Commission, *Commentary on retail mergers*, March 2011, section 4 for an explanation of those simple economic tests.

86 ibid §56.

87 ibid §§121-122.

88 ibid §178.

89 ibid endnotes.

90 OFT decision of 13 May 2009 in *CGL/LBA*.

91 OFT decision of 21 December 2009 in *CGL/Somerfield*.

92 OFT press release of 20 October 2008, OFT considers grocery store divestments in Co-op/Somerfield merger.

93 OFT decision of 9 March 2011 in *Asda/Netto*.

65. There have also been a number of merger investigations further up the food distribution chain.[94] Given the diversity of upstream markets, however, the issues raised vary greatly between cases. One common theme, however, is the extent to which the countervailing bargaining power that the large grocery retailers enjoy downstream negates the possibility of an upstream merger giving rise to anticompetitive effects. One case in which a merger was cleared in part because of retailers' buyer power was *Cott/Macaw*, in which two suppliers of own label plastic bottled carbonated soft drinks merged. Although their combined market share of 65% (with a 25% increment)[95] might otherwise have been thought to be quite substantial, the Competition Commission cleared the merger, citing the importance of retailer bargaining power that would be likely to continue post-merger.[96] More recently, the Competition Commission approved the *Kerry Foods/Headlands Foods* frozen ready meals merger on the basis that evidence of customers actually finding new suppliers in response to the merger proved that the merger did not limit competition.[97] It is fair to say, however, that retailer bargaining power is far from a "silver bullet" for upstream merging parties. The egg merger case of *Clifford Kent/Deans Food* provides an example of the Competition Commission rejecting that argument.[98]

F. ABUSE OF BUYING POWER, ABUSE OF DEPENDENCY

66. As noted above, competition law in the United Kingdom treats abuses of buyer power or dependency as part of the wider category of abuses of dominant positions which is one of the two antitrust prohibitions. However, the prohibition of abuses of dominant positions is of little or no application to the food distribution sector because the threshold for dominance is so high. In practice it is difficult to establish dominance with market shares (in this case, purchasing market shares) below 40%. None of the large grocery retailers in the United Kingdom have market shares close to that level. Although there may be pockets of very high concentration further up the chain (i.e. for manufacturers of specific products), only one of those has ever featured in an abuse of dominance investigations in the United Kingdom, and that did not concern buyer power.[99]

G. COMPETITION LAW ENFORCEMENT (ANTITRUST)

67. There has been a significant degree of antitrust enforcement activity in the food (and other grocery) distribution sector in recent years, although it fair to say that (i) it mostly concerned conduct that took place much longer ago (reflecting the lengthy nature of antitrust investigations in the United Kingdom); and (ii) very few of the allegations that have been made by the OFT have resulted in findings of infringement that have withstood the scrutiny of the Competition Appeal Tribunal.

68. In particular, there have been three separate investigations involving large grocery retailers and a fourth involving allegations of collusion between upstream producers:

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94 For example, the Competition Commission's decision on 19 April 2013 to approve the merger between two "cash and carry" wholesalers, Booker and Makro; and its decision on 8 October 2008 to approve the merger of two Stilton suppliers, Long Clawson Dairy and The Millway.

95 Competition Commission Decision of 28 April 2006 in *Cott/Macaw* Table 4 on p 35.

96 ibid §§7.5-7.7.

97 Competition Commission Decision of 2 December 2011 in *Kerry Foods/Headlands Foods* §§7.49-7.50.

98 Competition Commission Decision of 20 April 2007 in *Clifford Kent/Deans Food* §6.73.

99 See *Claymore Dairies v OFT* [2005] CAT 30.

(a) The *Tobacco* case: in which the OFT found that two major tobacco manufacturers (Imperial and Gallaher) had entered into bilateral agreements with several grocery retailers beginning in the mid 1990s and running up to the OFT's investigation in 2003 that effectively linked the retail prices of each manufacturer's product at a particular retailer to the retail price of the other manufacturer's product at the same store.[100] The OFT considered that those agreements had the object of restricting competition between the manufacturers (i.e. inter-brand competition).[101] The OFT imposed fines of £225m in total on the manufacturers and retailers. A number of parties (including Imperial and several retailers) appealed to the Competition Appeal Tribunal. During the course of the appeal, the OFT's case collapsed (i.e. it considered that it could no longer support the findings of infringement it had made in light of the evidence) with the result that the decision was quashed as against the appealing parties.[102] Gallaher and some other retailers have since applied for permission to appeal out of time, and their appeals remain outstanding at this stage.[103]

(b) The *Dairy* case: in which the OFT found that in 2002/2003 a number of milk processors and dairy product manufacturers orchestrated an increase in the retail price of dairy products so as to fund an increase in the cost price (i.e. the price paid by grocery retailers to processors/manufacturers).[104] The background to that case was that the price paid to dairy farmers for milk was extremely low and farmers were protesting and blockading processor and retailer depots to put pressure on them to increase prices. In response to that pressure, the processors/manufacturers acted as conduits for the exchange of future pricing intentions among the retailers to increase their confidence in their ability to increase retail prices (and therefore be in a position to pay increased cost prices) without being undercut by rivals and therefore losing market share. This is referred to as a "hub and spoke" infringement. Initially the OFT alleged that this occurred in five separate initiatives (i) fresh liquid milk in 2002, (ii) cheese in 2002; (iii) fresh liquid milk in 2003; (iv) cheese in 2003; and (v) butter in 2003. Indeed, all of the alleged participants in those alleged infringements admitted that they occurred as alleged, with the exception of Tesco (the largest grocery retailer) and Morrisons[105] (another large grocery retailer). Notwithstanding those admissions, however, the OFT ultimately accepted the position put forward by Morrisons and Tesco in relation to the alleged fresh liquid milk collusion in 2002 (point (i) above)[106], and the position put forward by Tesco in relation to the alleged fresh liquid milk and butter collusion in 2003 (points (iii) and (v) above). Indeed, in relation to fresh liquid milk in 2002 and butter in 2003, the OFT felt unable to conclude that even the parties who had admitted being involved in collusion had actually done anything wrong. The OFT did ultimately find infringements had taken place in relation to Cheese in 2002 and 2003 (involving Tesco amongst others) and in relation to fresh liquid milk in 2003 (not involving Tesco) and imposed fines totalling £50m. Tesco appealed, however, and the Competition Appeal Tribunal quashed the entirety of the Cheese 2003 infringement finding and most of the OFT's findings in relation to 2002.[107] What was left was a finding that Tesco's cheese

100 OFT Decision of 15 April 2010 in *Tobacco*.

101 ibid §1.13.

102 *Imperial Tobacco and Ors v OFT* [2011] CAT 41.

103 *Gallaher v OFT* [2013] CAT 5.

104 OFT Decision of 10 August 2011 in *Dairy*.

105 Morrisons was only accused of being involved in the fresh liquid milk collusion in 2002.

106 As a result, the OFT accepted that Morrisons had not been involved in any dairy product collusion in that period.

107 *Tesco v OFT* [2012] CAT 31.

buyer had exchanged future pricing intentions in relation to cheese with Tesco's competitors (via its suppliers) on three occasions in 2002, but that, contrary to the OFT's case, there was no overall plan to coordinate retail prices.[108] As an aside, it is also noteworthy that the *Dairy* case gave rise to the *Safeway v Twigger* litigation, in which one of the Dairy infringers (Safeway) sued its former employees and directors for damages (including the penalties imposed by the OFT). That claim failed, however, on the basis of the English law principle (which is also common to many other jurisdictions) of *ex turpi causa*.[109]

(c) The *Scottish Milk* case: Between 2001 and 2008 the OFT investigated allegations of price-fixing between Scottish milk processors. It ultimately concluded, however, that the evidence did not support a finding of infringement and that further investigation was not an administrative priority.[110]

(d) The *Other Groceries* case: Between 2008 and 2010 the OFT also investigated allegations that suppliers of a wide range of grocery products had been acting as conduits for the exchange of future retail pricing intentions between retailers in the years 2005-2008 (i.e. a hub and spoke infringement). Several parties admitted having acted unlawfully, but the OFT ultimately decided on administrative priority grounds not to pursue the investigation to a conclusion one way or the other.[111]

69. Several interesting features emerge from that selection of cases. First, none of them involve anything that could be described as classic cartel conduct between grocery retailers. Nor is that merely a matter of form rather than substance. The *Tobacco* case was really about a restriction of competition between different brands of tobacco products (i.e. inter-brand competition) rather than a restriction of competition between retailers of the same product (i.e. intra-brand competition). Similarly, although the *Dairy* case involved indirect sharing of future retail price intentions between retailers, that was a means of facilitating the satisfaction of farmers' demands for an increase in the upstream price of milk. There was no evidence that the retail price increases that retailers were coordinating were higher than would normally be expected as a market response to the cost price increases that were being imposed by their suppliers: on the contrary, the evidence was that retailers were being encouraged to *restrain* the extent of their retail price increases.[112]

70. Second, as noted above, the *Dairy* case in particular provides an example of a highly fragmented upstream market (dairy farmers) bringing enormous and ultimately irresistible pressure to bear on the more highly concentrated dairy processing and grocery retailing markets. While traditional economic models may predict that more highly concentrated levels of the market are likely to have greater market (or negotiating) power, the logistical consequences of their concentration (for example, large and strategically important depots) leave them exposed to industrial action from the politically powerful and highly motivated farmer lobbies. As noted above, the behaviour of the dairy farmers in 2002 has been repeated at regular intervals since then as well. Although competition law does in principle apply to

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108 ibid §202.

109 *Safeway v Twigger* [2010] EWCA Civ 1472.

110 OFT case closure summary of October 2008 in *Scottish Milk*.

111 OFT case closure summary of November 2010 in *Other Groceries*.

112 *Tesco v OFT* [2012] CAT 31 §202, in which it was noted that Dairy Crest, a cheese supplier, had proposed "that there be a £200 per tonne cost price increase for cheese and a concomitant retail price increase, which should, in Dairy Crest's view, be limited to cash margin maintenance."

farmers as well,[113] there is a wide exemption for farmers set out in paragraph 9 of Schedule 3 to the Competition Act, which protects, *inter alia*, agreements between farmers within the United Kingdom concerning the production or sale of agricultural products, so long as there is no obligation on farmers to charge identical prices. Although it is not clear whether that would cover agreements to engage in what amounts to industrial action, and although the OFT retains a power to disapply the exemption, no enforcement action has ever been taken by the OFT against farmers. Nor have intermediate processors or retailers yet found any other way to protect themselves from such action.

71. Third, both the *Tobacco* and *Dairy* cases illustrated the tendency of suppliers to want to influence retail prices. Resale price maintenance is generally treated as a "hardcore" restriction "by object", meaning that competition authorities do not need to prove that it has anti-competitive effects in order to establish an infringement and that a sceptical approach is taken to attempts by suppliers or retailers to justify their use of it.[114] Thus, while it is perfectly lawful for suppliers and retailers to discuss (on a purely bilateral basis) the current or future retail prices for the suppliers' products, or for a supplier to seek to persuade a retailer to adopt a particular retail price, the retailer must always retain an unfettered discretion as to its own retail prices. What those cases also show, however, is that the grey area in which suppliers seek to influence retail prices while leaving retailers ultimate discretion is a very dangerous place indeed. It is natural that suppliers will seek to give retailers comfort that they can accept a cost price increase by commenting on how other retailers would be likely to respond. But, as in the *Dairy* case, that can easily slip into anti-competitive territory if it results in future retail pricing intentions effectively being communicated from one retailer to another. It is also unsurprising that suppliers should be concerned about the relationship between retail prices for their own products and those of their competitors, as in *Tobacco*. More generally they are likely to be concerned by the overall positioning (including physical positioning on shelves) of their products relative to their competitors. But the extent to which suppliers can actually set targets for retailers to achieve for their products by reference to competitors remains unclear. All of this gives rise to material challenges both for suppliers and for retailers in finding ways to carry out their day to day business while ensuring that all of their staff comply with this complex aspect of competition law.

H. REGULATION

72. As noted above, the most prominent forms of regulation for the groceries sector that are relevant from a competition perspective are those that have been put in place as a result of the 2008 Groceries Investigation, and in particular the GSCOP. In addition, that investigation also considered the competitive effects of other important forms of regulation, most notably the planning system, which is also discussed above. The two main forms of regulation that were not discussed in those sections relate to (i) consumer protection, where there has been important enforcement activity by the OFT in relation to misleading promotions; (ii) public health, where there has been actual (in Scotland) and proposed (in England and Wales) legislation for minimum prices or prohibitions on below cost selling in relation to alcohol. These are discussed in turn below.

73. The legislative framework for the OFT's relevant consumer protection powers are principally set out in the Consumer Protection from Unfair Trading Regulations 2008 (the "**CPUTR**"). Regulation 3 CPUTR sets out a broad prohibition on unfair commercial practices, which includes both misleading actions and misleading omissions.

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113 See the OFT's guidance paper, *How competition law applies to co-operation between farming businesses: Frequently asked questions,* November 2011.

114 European Commission Guidelines on Vertical Restraints, §223.

74. In January 2012, the OFT had been concerned that grocery retailers were taking a variety of different approaches to presenting their promotions which might give rise to confusion amongst consumers. Although it did not reach any conclusions as to whether any unlawful conduct had occurred, the OFT did set out some principles for retailers to follow in respect of "internal reference pricing" (e.g. "Was £3, Now £2" labels) and "pre-printed value claims on packs" (for example, "Bigger Pack, Better Value"). Those principles were:

    (a) Prices should never be artificially manipulated so that future planned discounts are made more attractive;

    (b) Where a price has been marketed as a discount price for longer than the period of time for which the higher selling price was initially charged, retailers should generally consider that the value of the product is now established at the lower price and that it is no longer appropriate to describe this as a discount;

    (c) References to previous selling prices should only be used where they give a relevant and meaningful basis for comparison;

    (d) Where packaging carries best/better value claims, they should be objectively accurate. In particular, there should exist no cheaper way of buying the same volume of the identical good in the same store.[115]

75. In relation to alcohol prices, there have for many years now been concerns about the impact of low alcohol prices on public health, in particular through binge drinking and the effects of alcoholism in general. In Scotland, those concerns resulted in the Scottish legislature passing the Alcohol (Minimum Pricing) (Scotland) Act 2012, which will set a minimum retail price of 50p per unit of alcohol.[116] That minimum price has not yet come into force, however, and the Government has said it will not bring it into force until the result of certain legal challenges (brought by, amongst others, the Scottish Whisky Association) is known. Those legal challenges recently failed at the first instance but could be subject to appeal.[117]

76. Similar measures have been considered by the Westminster Parliament as well, but so far legislation has not been forthcoming. The Coalition Agreement between the Conservatives and the Liberal Democrats in May 2010 said "*We will ban the selling of alcohol below cost*". In July 2010 the Home Office consulted on amending the Licensing Act 2003 to introduce such a prohibition. No such amendment was forthcoming, however. Instead, in March 2012 the Government published a new strategy which proposed the establishment of a minimum alcohol price, similar to (but lower than) the Scottish approach. In November 2012, the Government consulted on plans to establish a minimum alcohol price of 45p per unit.[118] The Home Office (which is the responsible government department) is now considering the responses, but it appears that certain members of the Cabinet (including the Home Secretary) have scuppered that policy, notwithstanding strong support from the Prime Minister.[119]

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115 OFT, *Principles on food pricing display and promotional practices* 30 November 2012.

116 Note that in the United Kingdom, an alcoholic unit is defined as 10ml by volume or 8g by weight, of pure ethanol. A single 25ml shot of spirits (with a strength of 40%) therefore amounts to a single unit.

117 [2013] CSOH 70.

118 Home Office, *A Consultation on delivering the Government's policies to cut alcohol fuelled crime and anti-social behaviour* November 2012.

119 See, for example, "Plans for minimum alcohol pricing reportedly dropped after cabinet revolt", The Guardian, 13 March 2013, available at http://www.guardian.co.uk/society/2013/mar/12/alcohol-health.

77. As explained above, one of the competition concerns that had been raised in the 2008 Groceries Investigation was that supermarkets were selling alcohol below cost, with the result that specialist alcohol retailers and convenience stores were struggling to compete. Although the Competition Commission agreed that supermarkets did engage in below cost selling, it said that the evidence did not establish that below cost selling foreclosed those smaller competitors. Even so, if minimum alcohol pricing or a prohibition of below cost selling were to be introduced for public health reasons, it stands to reason that those smaller retailers (not to mention pubs) would benefit.

78. Finally, it should also be noted that the pressure that farming lobbies exert through industrial action (as discussed above) also sometimes finds expression in legislative proposals to increase the regulation of supermarkets' relationships with farmers. On one such occasion, the Conservative MP for Shrewsbury and Atcham (a largely rural constituency) proposed a specific piece of legislation to give the OFT specific powers to investigate what supermarkets pay for their milk.[120] Although that legislation never came to pass, it illustrates the ongoing political sensitivity of the topic of supermarket-supply chain relations in the United Kingdom.[121]

I. PROSPECTIVE

79. The view of the CLA members who assembled to discuss this report is that the United Kingdom's competition law regime is working well in relation to the food distribution sector and that there is no need for the introduction of further, specific rules to deal with the sector. There is a general sense that competition in the sector is improving, perhaps in part due to the various competition investigations in recent years that are discussed in this report.

80. The CLA members note, however, that part of the reason why we do not consider that further legislation is needed in this area is that the Competition Commission's market investigation report in 2008 (combined with support from Parliament to implement some of its remedies) has already investigated the need for special rules in respect of grocery retailing and has implemented some such rules. Of particular note in that regard is the GSCOP. It may be that in other jurisdictions that do not have a comparable market investigation regime, specific competition rules for the sector may add value.

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120 Hansard, *Commons* Debates, 25 July 2007: Columns 884-886.

121 It also illustrates the colourful means by which farmers often bring their political pressure to bear. In the MP's words: "*The greatest publicity came not just from us politicians, but from a single individual [Women's Institute] member from Gloucestershire who came on a very cold January morning wearing nothing but a bikini. People were pouring bottles of milk all over her as she sat in a bath just outside the House of Commons. That went down very well, I have to say, and got us a great deal of publicity. I applaud her for doing that on such a cold day and for being prepared to be photographed in a bikini with all that milk being poured all over her*."