Neutral citation [2009] CAT 6

IN THE COMPETITION APPEAL TRIBUNAL

Case Number: 1104/6/8/08

Victoria House
Bloomsbury Place
London WC1A 2EB

4 March 2009

Before:

THE HONOURABLE MR JUSTICE BARLING
(President)
PROFESSOR JOHN PICKERING
GRAHAM MATHER

Sitting as a Tribunal in England and Wales

BETWEEN:

TESCO PLC

Applicant

-v-

COMPETITION COMMISSION

Respondent

- supported by -

ASDA STORES LIMITED

MARKS AND SPENCER PLC

WAITROSE LIMITED

THE ASSOCIATION OF CONVENIENCE STORES

Interveners

JUDGMENT

APPEARANCES

Mr. Nicholas Green QC, Mr. Mark Hoskins and Mr. Julian Gregory (instructed by Freshfields Bruckhaus Deringer LLP) appeared on behalf of Tesco Plc.

Mr. Peter Roth QC, Mr. Daniel Beard, Ms Valentina Sloane and Mr. Ewan West (instructed by the Treasury Solicitor) appeared on behalf of the Competition Commission.

Mr. Tim Ward (instructed by Slaughter and May) appeared on behalf of Asda Stores Limited.

Ms Kassie Smith (instructed by Lovells LLP) appeared on behalf of Waitrose Limited.

Mr. Robert O'Donoghue (instructed by SJ Berwin LLP) appeared on behalf of Marks and Spencer Plc.

I. INTRODUCTION

1. By notice of application dated 30 June 2008 Tesco plc ("Tesco") applies pursuant to section 179 of the Enterprise Act 2002 ("the Act") for a review of part of the decision of the Competition Commission ("the Commission") contained in a Report entitled "The supply of groceries in the UK: market investigation" dated 30 April 2008 ("the Report").

2. In applications for review under section 179 of the Act the Tribunal is required by subsection 179(4) to apply the same principles as would be applied by a court on an application for judicial review.

3. The Report is the culmination of a wide-ranging market investigation lasting almost two years and attracting considerable public attention. The scale and scope of the investigation is note-worthy: the Commission collated a dataset of more than 14,000 UK grocery stores covering various aspects of competition between grocery retailers, received approximately 700 submissions from main and third parties, and held some 80 hearings with interested parties. The Commission found that, in many important respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers.

4. However, the Commission also found that a combination of one or more of the features of certain local markets for the retail supply of groceries by larger grocery stores prevents, restricts or distorts competition in connection with the supply of groceries by larger grocery stores in those markets. The features in question are: (1) high levels of concentration in a number of local markets which have persisted over several years; (2) barriers to entry or expansion in certain local markets caused by the planning regime which limits the construction of new larger grocery stores and imposes greater costs and risks on some retailers than on others; (3) barriers to entry caused by the control of land in some highly concentrated markets by incumbent retailers. The Commission estimated the consumer detriment arising from these features to be £105-£125 million in additional profits a year at larger grocery stores

and prices nationally at a higher level than would be the case were these stores facing stronger local competition.

5. The Commission adopted a package of measures to remedy, mitigate or prevent the adverse effects on competition and detrimental effects on consumers which it had identified. Of particular importance for the present application was the Commission's decision to recommend to the Government and The Northern Ireland Executive, the Scottish Government and the Welsh Assembly Government (together "the devolved administrations") that a "competition test" should be implemented within the planning system, with the Office of Fair Trading ("OFT") acting as statutory consultee. The OFT would be expected to provide advice to the local planning authority ("LPA") on whether a particular retailer has passed or failed the competition test. Applications would pass the test if within the area bounded by a 10-minute drive-time of the development site: the grocery retailer that would operate the new store was a new entrant to that area; or the total number of "fascias" in that area was four or more; or the total number of fascias in that area was three or fewer but the relevant grocery retailer would operate less than 60 per cent of groceries sales area (including the new development in relation to larger grocery stores). We describe the competition test in more detail below. The test is essentially designed to prevent LPAs from granting planning permission for the construction or expansion of a large grocery store if there is already a high level of concentration in the local market for large grocery stores, and the retailer applying for permission has (or would have) a substantial part of the market.

6. The Commission's conclusion that certain features of the groceries market give rise to an adverse effect on competition and detrimental effects on customers is not challenged in these proceedings. Nor does Tesco challenge any of the Commission's findings of fact contained in the Report. Indeed reliance is placed by Tesco on those findings. Tesco's application challenges the lawfulness of the decision to recommend the competition test on two main grounds. In relation to both grounds Tesco's case is that the Commission's decision failed properly to take account of relevant considerations which ought to have formed part of its assessment.

7. Tesco seeks an order quashing those parts of the Report which set out the remedies relating to the competition test. In this regard Tesco identified paragraph 43 of the Summary of the Report and paragraphs 11.12 to 11.16 and 11.437 to 11.441 of the Report itself, whilst reserving the right to make further submissions on the appropriate scope of relief at any stage in the proceedings, in particular after the handing down of the judgment of the Tribunal (see letter dated 11 July 2008).

8. Asda Stores Limited ("Asda"), Marks and Spencer Plc ("M&S"), Waitrose Limited ("Waitrose") and Association of Convenience Stores ("ACS") were granted permission to intervene in Tesco's application, and in due course filed detailed Statements in Intervention in support of the Commission's position. Thereafter ACS wrote to the Tribunal indicating that it did not intend to make any further written or oral submissions. The other interveners and the main parties lodged skeleton arguments and appeared through counsel at the hearing. Following the hearing the Tribunal received additional written submissions from both the Commission and Tesco.

9. Annexed to the Commission's Defence were two witness statements, one by Mr Peter Freeman, the Chairman of the Commission and of the Group responsible for the groceries market investigation, and the other by Dr Benoit Durand, the Economics Director for the investigation. Tesco did not serve a Reply as such, but lodged expert evidence in reply. This consisted of witness statements by Professor Jerry Hausman of the Massachusetts Institute of Technology, and Mr Simon Gaysford and Mr Paul Johnson, both of Frontier Economics Limited. With the exception of the evidence of Mr Freeman, hardly any reference was made by any party to the substance of this evidence in the course of the hearing. At the outset of his opening submissions to us, and again at the end of them, Mr Nicholas Green QC, who represented Tesco, emphasised that whilst the allegations of inadmissibility levelled at the evidence filed by Tesco were not accepted, it was not necessary to address the points made in that evidence as these were reflected in the Report itself. The best approach was, he said, to stick to the Report. In the light of this it has not been necessary for the Tribunal to consider the admissibility of Tesco's expert evidence or indeed to consider that evidence in any detail.

II. THE REPORT: FACTUAL BACKGROUND AND LEGAL FRAMEWORK

10. Before dealing with the substance of Tesco's application, it is necessary briefly to describe the factual background and statutory framework. What follows is necessarily a very abbreviated account of an extremely detailed document comprising some 270 pages plus numerous appendices.

Background

11. In 2007, an estimated £110.4 billion of grocery sales were made through nearly 100,000 grocery stores in the UK. The Commission identified seven major categories of grocery retailer in the UK. The most important category for present purposes consists of the large grocery retailers. Large grocery retailers have operations throughout Great Britain and, in some cases, Northern Ireland. These retailers carry a full-range of grocery products and have an integrated grocery wholesaling function that purchases directly from grocery suppliers. There are currently eight such large grocery retailers in the UK, namely Asda, Co-operative Group (CWS) Limited ("CGL"), M&S, Wm Morrison Supermarkets plc ("Morrisons"), J Sainsbury plc ("Sainsbury's"), Somerfield plc ("Somerfield"), Tesco and Waitrose. (See Appendix 3.1 of the Report for further detail on these large grocery retailers.)

12. Tesco is the largest UK grocery retailer based on reported turnover. In the year ended February 2007, it reported worldwide turnover of £46.6 billion (including VAT) and employed over 400,000 full- and part-time staff. Tesco operates a wide portfolio of stores and has a broad mix of store sizes. Over the period since 2000 Tesco has significantly expanded its grocery sales share, accounting now for an estimated 28 per cent of the market. Asda (a subsidiary of Wal-Mart Stores Inc.), M&S and Waitrose are also categorised as large grocery retailers. Their respective grocery sales shares have all steadily grown between 2000 and 2007. (See Appendix 3.1 to the Report.)

13. The ACS was established in 1995 and represents the interests of 32,000 UK convenience stores.

14. The structure of the UK groceries market has evolved rapidly in recent years. The four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco) have consolidated their position in total food retailing since 2000. In 2007, large grocery retailers accounted for an estimated 85 per cent of total grocery sales with the four largest grocery retailers (Asda, Tesco, Sainsbury's, and Morrisons) accounting for just over 65 per cent of total grocery sales (see Figure 3.1 of the Report). The large grocery retailers' increasing share of national grocery sales is largely due to the opening of new stores and the acquisition of other grocery retailers. In addition, certain larger grocery retailers, particularly Tesco and Sainsbury's, have expanded into the convenience store sector, competing directly with smaller chains and independent stores. The size of the convenience store sector has grown overall (by value), partly due to changes in consumers' shopping patterns, although the number of independent convenience stores has fallen. In parallel to these changes in grocery retailing, there has also been some consolidation in other parts of the groceries supply chain.

15. In terms of the performance of the UK grocery retailing sector: food prices declined, in real terms, by around 8 per cent from 2000 to 2007. Over the same period, large grocery retailers' product range increased, particularly in terms of the number of non-grocery products stocked by the four largest grocery retailers. Average operating margins for the UK operations of large grocery retailers varied between 3.6 and 4.5 per cent, which was often higher than independent retailers, although there were significant variations between large grocery retailers.

16. Aspects of the grocery retailing sector have been under the regulatory microscope in recent years. The Commission has conducted three inquiries into grocery retailing in the eight years prior to the latest market investigation. The first of these inquiries was an industry-wide investigation conducted under the monopoly provisions of the Fair Trading Act 1973 ("Supermarkets Inquiry"). The Supermarkets Inquiry culminated in a report by the Commission published in October 2000 (Cm 4842, October 2000). That report found that certain practices carried out by supermarkets gave rise to a complex monopoly situation. It also found that certain pricing practices and the behaviour of grocery retailers towards their suppliers may be expected to operate against the public interest. Among the Commission's

recommendations following the Supermarkets Inquiry was a proposal that the larger supermarket chains should have to seek approval from the OFT's predecessor before being allowed to acquire or develop large new stores close to their existing stores. This proposal was not implemented by the Secretary of State. The Supermarkets Inquiry was followed by two merger-related inquiries, when the Commission considered the anticipated acquisition of Safeway plc by one of Asda, Morrisons, Sainsbury's and Tesco in 2003 and the resulting Somerfield acquisition of around 100 stores from Morrisons in 2005.

17. On 9 May 2006, the OFT referred the supply of groceries by retailers in the UK to the Commission for investigation pursuant to section 131 of the Act.

The legislation

18. Pursuant to subsection 131(1) of the Act, the OFT may make a reference to the Commission for a market investigation:

> "...if it has reasonable grounds for suspecting that any feature or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom."

19. The definition of "feature" is set out in subsection 131(2) of the Act:

> "For the purposes of this Part any reference to a feature of a market in the United Kingdom for goods or services shall be construed as a reference to -
>
> (a) the structure of the market concerned or any aspect of that structure;
>
> (b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
>
> (c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services."

20. The OFT found that there were several features of the market for the supply of groceries by retailers in the UK that could reasonably be suspected to be preventing, restricting or distorting competition, including notably the planning system and the land holdings of large grocery retailers. The OFT's detailed reasoning is set out in a document entitled "The Grocery market: The OFT's reasons for making a reference to the Competition Commission" (OFT 845).

21. In connection with a reference under subsection 131(1) of the Act, the Commission's duties are defined by subsection 134(1) of the Act which provides:

> "The Commission shall, on a market investigation reference, decide whether any feature, or combination of features, of a relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom."

22. The definition of "feature" is that provided in subsection 131(2) of the Act (above). The definition of "relevant market" is provided in subsection 134(3):

> "(a) in the case of subsection (2) so far as it applies in connection with a possible reference, a market in the United Kingdom—
>
> (i) for goods or services of a description to be specified in the reference; and
> (ii) which would not be excluded from investigation by virtue of section 133(2); and
>
> (b) in any other case, a market in the United Kingdom—
> (i) for goods or services of a description specified in the reference concerned; and
> (ii) which is not excluded from investigation by virtue of section 133(2)."

23. Subsection 134(2) introduces the concept of an "adverse effect on competition" ("AEC"):

> "For the purposes of this Part, in relation to a market investigation reference, there is an adverse effect on competition if any feature, or combination of features, of a relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom."

24. If the Commission finds that an AEC exists it is required by subsection 134(4) of the Act to decide the following additional questions:

> "(a) whether action should be taken by it under section 138 for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition;
>
> (b) whether it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the adverse effect on competition concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the adverse effect on competition; and
>
> (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented."

25. Subsection 134(6) provides that, in reaching its conclusions under subsection 134(4) of the Act, the Commission:

> "...shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition concerned and any detrimental effects on customers so far as resulting from the adverse effect on competition."

26. A detrimental effect on customers is defined in subsection 134(5) as being a detrimental effect:

> "...on customers or future customers in the form of -
>
> (a) higher prices, lower quality or less choice of goods or services in any market in the United Kingdom (whether or not the market to which the feature or features concerned relate); or
>
> (b) less innovation in relation to such goods or services."

27. Under subsection 134(7) the Commission may have regard to the effect of any action on any relevant customer benefits "of the feature or features of the market concerned".

28. Subsection 137(1) of the Act provides that the Commission shall prepare and publish a report on a market investigation reference within 2 years of the date of the reference concerned. By virtue of subsection 136(2) such a report shall "in particular" contain:

> "(a) the decisions of the Commission on the questions which it is required to answer by virtue of section 134;
>
> (b) its reasons for its decisions; and
>
> (c) such information as the Commission considers appropriate for facilitating a proper understanding of those questions and of its reasons for its decisions."

29. Where the Commission has published its report within the two-year time-limit and has found an AEC, subsection 138(2) provides that:

> "The Commission shall, in relation to each adverse effect on competition, take such action under section 159 or 161 as it considers to be reasonable and practicable—
>
> (a) to remedy, mitigate or prevent the adverse effect on competition concerned; and

> (b) to remedy, mitigate or prevent any detrimental effects on customers so far as they have resulted from, or may be expected to result from, the adverse effect on competition."

30. Section 138 further provides:

> "(3) The decision of the Commission under subsection (2) shall be consistent with its decisions as included in its report by virtue of section 134(4) unless there has been a material change of circumstances since the preparation of the report or the Commission otherwise has a special reason for deciding differently."

31. Sections 159 and 161 of the Act provide the Commission with the powers, respectively, to accept final undertakings to remedy the adverse effects and to make final orders for the same purpose. A final order made under section 161 may contain anything permitted by Schedule 8 to the Act, which covers a wide range of actions including division of a company, divestment of assets and restrictions on conduct.

The Report

32. On 30 April 2008 the Commission published the Report. The Commission found that larger grocery stores (i.e. stores with a full range offer and groceries sales area in the range of or larger than 1,000 to 2,000 square metres) operated by large grocery retailers are competitively constrained by larger grocery stores operated by other large grocery retailers, but not by convenience or mid-sized stores. Accordingly, the Commission found that for larger grocery stores, other larger grocery stores are in the same product market, but mid-sized stores (i.e. all stores larger than 280 square metres but less than 1,000 square metres), convenience stores and other grocery stores are not in the same market. In other words only other larger grocery stores impose a sufficiently strong competitive constraint on larger grocery stores, although mid-sized stores are constrained by both other mid-sized stores and larger stores. (See paragraphs 4.1 to 4.86 of the Report.)

33. The Commission also found that the relevant geographic market for the supply of groceries by grocery retailers is local. For the most part, consumers use their car for shopping – the Commission therefore considered that "drive-time" was a useful means of expressing the size of the relevant geographic market (paragraph 4.89).

The Commission decided that larger grocery stores will, in general, be constrained by other larger grocery stores within a 10 to 15-minute drive-time.

34. The Commission found that in many respects competition in UK groceries is effective and delivers good outcomes for consumers. The Commission concluded that there are no AECs relating to the cost advantages of national grocery retailers over their smaller competitors as a result of their distribution systems. The Commission did not find any evidence of distortions in competition between the large grocery retailers and convenience store operators, or that the expansion in convenience store retailing by large grocery retailers gave rise to competitive concerns. To the extent that such expansion has resulted in increased competition, the Commission concluded that consumers will have benefited. The Commission also found that while the conditions for tacit coordination exist in the UK grocery retailing sector, sustaining such coordination over thousands of differentiated products would be complex and could prevent the emergence of tacit coordination.

35. But not all in the garden was rosy: the Commission had concerns about the strong positions of several grocery retailers' groups in a number of local markets. The Commission found that between 11 per cent and 27 per cent of larger grocery stores are in highly-concentrated local markets, and that consumers are adversely affected by the weaker competition existing in such markets (paragraph 6.14 of the Report).

36. The Commission's analysis of local market concentration was undertaken using a database of stores provided by the main parties in response to the main party questionnaire as at June 2006. The Commission noted that some stores included in the analysis may have since closed or been relocated, and other stores may have since opened, but had no reason to think that the current situation is significantly different from the situation as of June 2006 (see footnote 175 of the Report).

37. For the purposes of assessing the extent of concentration in local markets for grocery retailing, the Commission defined "highly-concentrated markets" as markets with three or fewer "fascias" in total, and where one of those fascias has a share of local grocery sales areas that is greater than 60 per cent within a 10-minute or 15-minute drive-time between competing stores (paragraph 6.13 of the Report).

"Fascia" refers to a grocery retailer brand, e.g. Asda or Tesco: thus there may be fewer fascias than stores in a local market.

38. The Commission's analysis showed that using a 10-minute drive-time, 27 per cent (i.e. 495) of all larger grocery stores in the UK are in highly-concentrated local markets. Each of Morrisons and Tesco has around 30 per cent of all their larger grocery stores in these highly-concentrated local markets, while the proportions for Sainsbury's and Asda are 26 per cent and 23 per cent respectively. Using a 15-minute drive-time, CGL, Morrisons, Tesco and Waitrose each has a similar proportion of its larger stores in highly-concentrated local markets (around 14 per cent). A smaller proportion of Asda's and Sainsbury's larger grocery stores are in highly-concentrated local markets (around 10 per cent). Of the total number of larger grocery stores in highly-concentrated local markets, Tesco accounts for the greatest proportion (around 30 per cent), while Morrisons and Sainsbury's account for about 20 per cent, and Asda accounts for a smaller proportion (around 13 per cent). (See paragraph 6.14 ff of the Report. A more detailed summary of the analysis is set out in Appendix 6.1 to the Report.)

39. The Commission investigated whether the degree of local market concentration could influence the retail offer in two ways: (i) by influencing those components of the retail offer (the main components of which are price, quality, range and service) that are adjusted locally at the store level (paragraphs 6.34 to 6.63 of the Report); and (ii) by influencing the overall level at which nationally uniform components of the retail offer are set (paragraphs 6.64 to 6.73 of the Report).

40. The Commission reviewed evidence from three sources to assess the extent to which grocery retailers adjust components of their retail offer at store-level in response to local competitive conditions. The Commission considered: (i) qualitative evidence from grocery retailers; (ii) certain empirical studies by Tesco and a market research company called GfK NOP; and (iii) its own margin-concentration analysis, which investigated the extent to which store-level profit margins for larger grocery stores vary with the intensity of local competition.

41. Grocery retailers provided the Commission with a significant amount of qualitative evidence regarding the way in which they vary aspects of their retail offer, including pricing, food counters, store presentation and staffing according to local competitive conditions, and, in particular, in response to changes in local competitive conditions brought about through the opening of new stores by competing retailers. This evidence was corroborated by the results of the margin-concentration analysis which demonstrated that the retail offer was adversely affected by a higher level of concentration.

42. The Commission discounted the two empirical studies by GfK NOP and Tesco, both of which had found that many aspects of the retail offer did not vary from store to store according to the intensity of local competition. The Commission was concerned, in particular, that the effects of local concentration on certain intangible aspects of the retail offer, such as service levels, were not taken into account in either study. By contrast, the Commission considered that a store's margin captures the effect of all variations in the store offer. It was for this reason that the Commission used store-level profit margin as a proxy for the effect of all local variations in the retail offer.

43. The Commission's margin-concentration analysis revealed that more intense local competition resulted in lower store-level profit margins. The Report states that the presence of an additional larger grocery store within a 10-minute drive-time reduced the store-level profit margin of a monopoly store by approximately 3.8 per cent. For an average larger grocery store, this would amount to a profit reduction of £300,000 to £350,000 a year. Based on a mid-point estimate of the number of larger grocery stores in highly concentrated local markets in 10-minute and 15-minute drive-times, the Commission calculated the additional profits for the grocery retailers operating these stores to be approximately £105-125 million a year. This represents around 3 per cent of the combined annual profits of £3.6 billion that the four largest grocery retailers earned in 2007 from UK grocery retailing (paragraphs 6.52-6.63 of the Report).

44. The Commission also concluded that a larger grocery retailer that has many stores in highly-concentrated local markets would be expected to set prices (or other

aspects of its nationally uniform retail offer) at a different level than would be the case were those stores facing stronger local competition. As most grocery retailers do not vary prices at the store level, any weakness in local competition will be reflected in higher national prices rather than higher prices at stores where competition is weak. Although it was not considered feasible for the Commission to estimate the additional profits earned by grocery retailers as a result of higher national prices arising from weak local competition, it noted that for each 0.1 per cent increase in national price levels, consumer expenditure on groceries at the four largest grocery retailers would increase by £80 million per year (paragraphs 6.64-6.73 of the Report).

45. In assessing the barriers to entry and expansion in grocery retailing, the Commission assessed whether highly-concentrated local markets for larger grocery stores had persisted over time, rather than attract new entry. The Commission found that 86 per cent of the grocery stores that were identified as being monopoly or duopoly stores in 2000 continued to be monopoly or duopoly stores in 2006 (see Table 7.1 of the Report). The persistence of local concentration was, in the Commission's view, indicative of barriers to entry in these areas, especially since, in most cases, there was sufficient demand to support an additional store. The Commission's analysis of the persistence of local market concentration has assumed some importance in this case and we shall return to it below.

46. The Commission examined three possible barriers to entry and expansion in grocery retailing, namely cost advantages for large grocery retailers, the existing planning regime as it applies to grocery retailing, and the control of land by large grocery retailers.

47. The Commission concluded that any distribution and purchasing cost advantage for larger grocery retailers did not create a barrier to entry or expansion for other retailers that gave rise to an AEC (paragraphs 7.28-7.33).

48. In examining whether the planning regime acted as a possible barrier to entry and expansion in grocery retailing, the Commission found:

> "7.35 The purpose of the planning system is to control and shape development to meet a broad range of economic and social objectives. It aims to promote the orderly growth and development of town centres and the provision of a wide range of services in a pleasant and widely accessible environment. These specific objectives are set in the context of wider objectives regarding economic growth, regeneration, social inclusion, sustainability and good design.
>
> 7.36 In support of these objectives, the planning regime as it applies to grocery retailing seeks to focus grocery retail developments in town centres, and to this end puts in place a number of requirements that must be met before out-of-centre development that is not provided for in an LPA's development plan can take place. These include a requirement that no suitable location in the primary shopping area is available (the sequential test), there is a demonstrated 'need' for the development (the need test), and the development is of an appropriate scale and will not have an undue impact on existing retail centres (the retail impact assessment). In May 2007, the Government announced that it would replace the need and impact tests with a new test that will have a strong focus on its town-centre-first policy, and which will promote competition and improve consumer choice, avoiding the unintended effects of the current need test. Appendix 7.2 sets out further details on the planning system as it relates to grocery retailing.
>
> 7.37 An inevitable consequence of a plan-led system that seeks to meet the broad range of objectives set out in paragraph 7.35 is that grocery retailers may not always be able to open a new larger grocery store in the location of their choice. That is, the planning system will, quite deliberately and appropriately for the purposes of meeting its objectives, act—to some extent—as a barrier to entry and/or expansion.
>
> 7.38 The planning regime acts as a barrier to entry or expansion primarily for larger grocery stores. This is because, in general, it is easier to secure suitable sites for mid-sized grocery stores or convenience stores in those areas where planning consent is already in place or where planning requirements are significantly less onerous, in particular in town centres."

49. The Commission also found that the planning regime places more limited constraints on the extension of existing stores by grocery retailers compared with new larger store entry; and an incumbent grocery retailer, by extending its store, makes new larger grocery store entry by a rival grocery retailer more difficult (paragraph 7.67 of the Report). Although the reason for the latter finding is not expressed, it appears to be related to the application of the "need" test in the planning process. (See paragraph 7.64.) Presumably the Commission took the view that by extending its existing store a retailer would reduce the "need" otherwise available to a new entrant. (See also paragraph 11.84: "…a retailer could use an extension to absorb consumer demand thereby making it less attractive for new entry to occur and reinforcing its own position.")

50. The control of land by large grocery retailers was the third area that the Commission examined as a possible barrier to entry and expansion. The Commission found no systematic holding of land by retailers with the sole purpose of creating a barrier to entry by competitors (paragraph 7.81). The Commission did have concerns, however, that the shortage of land available for new grocery stores, arising in part from the planning system, meant that the control of this land by grocery retailers in certain highly-concentrated markets facilitated the persistence of weak competition in those areas. Incumbent retailers controlled land in highly-concentrated local markets through land bank sites, restrictive covenants, exclusivity arrangements, and landsites that are leased to third parties. The Commission identified 90 "controlled landsites" which acted as a barrier to entry in highly-concentrated local markets that gave rise to an AEC. (See paragraphs 7.69-7.113 and 10.9 of the Report.)

51. In light of the foregoing considerations, the Commission identified a number of features of the market for the purposes of subsection 134(1) of the Act as follows:

> "We find that a combination of one or more of the following features of certain local markets for the supply of groceries by larger grocery stores prevent, restrict or distort competition in connection with the supply of groceries by larger grocery stores in those markets:
>
> (a) A significant number of local markets have high levels of concentration, and these high levels of concentration have in many cases persisted over a number of years.
>
> (b) The planning regime (in particular, PPS6 in England, SPP8 in Scotland, PPS5 in Northern Ireland and MIPPS 02/2005 in Wales) and its application by Local Planning Authorities in accordance with the policy objectives of the planning regime necessarily act as a barrier to entry or expansion in a significant number of local markets:
>
> (i) by limiting construction of new larger grocery stores; and
>
> (ii) by imposing costs and risks on smaller retailers and entrants without pre-existing grocery retail operations in the UK that are not borne to the same extent by existing large grocery retailers.
>
> (c) The control of land by incumbent retailers through land bank sites, restrictive covenants, exclusivity arrangements, and landsites that are leased or sub-leased to third parties in highly-concentrated local markets acts as a barrier to entry, by limiting entrants' access to potential sites for new larger grocery stores."
>
> (See paragraph 10.9 of the Report.)

52. The detrimental effects on customers for the purposes of subsection 134(5) arising from these features of the market mainly took the form of a poorer retail offer for consumers at mid-sized and larger grocery stores. The Commission estimated the nature or scale of this consumer detriment indirectly using as a proxy the additional profit which it considered that large grocery retailers earned as a result of weak local competition (see paragraph [43] above).

53. In the Commission's view these detrimental effects on customers were sufficient to justify remedial action. (See paragraphs 10.13-10.17 of the Report.)

Remedies

54. Given its finding of an AEC and resulting detrimental effects on customers, the Commission was required by section 134(4) of the Act to decide the additional questions referred to in that subsection, namely whether the Commission should take, or recommend that others take, action to remedy, mitigate or prevent the AEC or any detrimental effects on customers which have been caused or are likely to be caused by the AEC, and if so what action should be taken to remedy what effect. In reaching its conclusions under subsection 134(4) of the Act, the Commission was obliged by subsection 134(6) "in particular [to] have regard to the need to achieve as comprehensive a solution as is reasonable and practicable" to the AEC and detrimental effects, and to comply with the requirements of section 138. The latter section applies to action which the Commission has decided to take itself, as distinct from action which it recommends should be taken by others. (The text of the relevant provisions is set out earlier in this Judgment.)

55. The Report draws attention to the statement in the Commission's Guidelines (Market Investigation References: Competition Commission Guidelines (CC3 June 2003) ("the Commission Guidelines")) that it is unlikely that, having decided that there is an AEC, the Commission would decide that there was no case for remedial action (paragraph 11.10).

56. During the hearing there was some discussion as to the interrelationship between what was referred to as the binary nature of the questions in subsections 134(4)(a) and (b) (i.e. whether or not action should be taken/recommended by the

Commission), and the apparently mandatory terms in which subsection 138(2) is expressed. Mr Green submitted that in making its decision under section 134(4) there is no presumption for or against remedial action, although he accepted such action will be possible in the vast majority of cases. Mr Roth QC, who appeared for the Commission, whilst accepting the existence of a discretion, submitted that the legislation exerted a strong impulsion on the Commission to take action to remedy the AEC and any detrimental effects on customers, other than in cases when it would be unreasonable or impracticable to do so. There was also some discussion about the precise nature of the obligation enshrined in subsection 134(6).

57. In the end nothing appeared to turn on this debate. In those circumstances it may be best if we say very little about it. It seems to us that it is likely to be a relatively rare case in which the Commission, having identified an AEC and detrimental effects, will exercise its discretion to take no remedial action under subsection 134(4)(a) or (b) of the Act. The Act refers to a "need" to achieve an appropriate remedy for the AEC and for any resultant adverse effects on customers, and requires the Commission to "have regard" to this need when answering the subsection 134(4) questions and making the subsection 138(2) decision. If any tension exists between the discretion in relation to the former and the obligation in the latter, it makes no difference in the present case and therefore does not need to be resolved here.

The competition test

58. The Commission's detailed assessment of the measures which would be used to address the AEC in relation to local market concentration in grocery retailing where barriers to entry arise from the planning system are set out at paragraphs 11.12 to 11.135 of the Report. As one of these measures, the Commission decided to recommend that a "competition test" be established within the planning system. We summarise the thrust of the Commission's reasoning for choosing, designing and implementing the suggested test below.

59. In his witness statement, Mr Freeman explains the development of the competition test remedy during the Commission's market investigation. The idea of a competition test was first raised by some parties, notably Waitrose, Asda and Sainsbury's, very early on in the market investigation in October 2006. As

mentioned above (paragraph [16]), the idea was not a new one: a similar remedy had first been proposed by the Commission following its Supermarkets Inquiry in 2000. The test was the subject of various parties' submissions in response to the Commission's Emerging Thinking (23 January 2007) and Provisional Findings Report (31 October 2007). Mr Freeman explains that as the 2006 market investigation progressed, a difference in approach between Tesco and the other retailers became clear. Whereas other retailers were mostly in favour of introducing a competition test, Tesco was opposed. In the Report the Commission notes that Tesco objected to the adoption of such a test on a number of grounds (set out in paragraphs 11.18-11.19 of the Report). Not only did Tesco call into question the need for a competition test in the first place, it also emphasised that such a mechanistic test would be anti-competitive and wrong in principle.

60. According to Mr Freeman, on 10 January 2008 the Group decided that a competition test was a necessary part of the remedies package designed to address the AEC in relation to local market concentration. In the Commission's view:

> "… a competition test is necessary to prevent the emergence or strengthening of a strong local market position held by a particular large grocery retailer in respect of larger stores in a local market. To the extent that this represents a 'cap on growth', we believe this to be necessary to prevent retailers' positions in local markets becoming unacceptably strong. In our view, the planning regime either as it currently exists or, in the case of England, if changed along the lines of current proposals would not be sufficient to prevent the emergence of highly-concentrated local markets or the strengthening of strong local market positions held by particular retailers. In particular, the identity of the retailer that will operate from the proposed grocery floorspace and the effect that this would have on the degree of concentration in a local market must be taken into account in determining whether to grant permission." (paragraph 11.26 of the Report)

61. The Commission concluded that the competition test should operate within the planning system since in exceptional cases this would enable the LPAs to offset the results of the competition test against other planning issues (paragraphs 11.47-11.49 of the Report). In the event that the competition test was not incorporated into the planning system by the Government and devolved administrations, the Commission recommended that the Department for Business Enterprise and Regulatory Reform should take such steps as are necessary to implement the competition test outside the planning system.

62. While retailers were divided over whether the competition test should be applied by the LPA or by the OFT as statutory consultee, the Commission decided that "as an expert competition authority, the OFT would be better placed to apply the test in a consistent manner than each LPA" (paragraph 11.50 of the Report). Nonetheless the Commission recognised that an LPA should be able to determine a planning application in a manner inconsistent with the OFT's advice in exceptional cases. While the Commission was keen that the LPAs should take the OFT's advice on the application of the competition test very seriously, it considered that an LPA should be able to override the OFT's advice if it is satisfied that: (a) the particular development would produce identified benefits for the local area that would clearly outweigh the detriment to local people from the area becoming or remaining highly concentrated in terms of grocery retailing; and (b) the development, or any similar development, would not take place without the involvement of a large grocery retailer that had failed the competition test (paragraphs 11.53-11.58 of the Report). The Commission emphasised that it is important that an LPA should be able to override the OFT's advice only when it has demonstrated on the basis of clear and sound evidence that both of the criteria (a) and (b) have been satisfied. The LPA must set out publicly its reasons and evidence for overriding the OFT's advice. As an example the Report refers to a situation where an LPA is instrumental in bringing forward a store development, and insists that there must be a convincing case – for example, by market testing – why another retailer, or retailer/developer partnership, would not be prepared to take on the development.

The substance of the competition test

63. The Commission decided that a planning application should be subject to the competition test if it is for a new grocery store over 1,000 square metres or for development of an existing store which would result in the store having over 1,000 square metres. The test would apply to any store that is, or after the store development will be, in the larger grocery store market. For this purpose, a 'grocery store' would be any retail store, a significant proportion of which is devoted to the sale of groceries (paragraphs 11.78-11.81 of the Report) and the 'area' across which local concentration is to be assessed is based on a drive-time of 10 minutes (paragraphs 11.89-11.91 of the Report).

64. The Commission rejected an argument put by Sainsbury's that extensions should not be subject to a competition test. The Commission's view was that extensions could be used to absorb consumer demand and reduce the likelihood of entry, and so should be subject to the competition test in the same way as opening a new store (paragraph 11.84 of the Report).

65. The substantive criteria of the competition test would be based on both a fascia count (i.e. a count of large grocery retail fascias with stores over 1,000 square metres within the 10 minute drive time) and a market share assessment. The Commission recognised that a test using a fascia count would measure consumer choice and would be simpler to operate, but that such a test would not take account of the differences between large and small stores nor increases in concentration as a result of development of extensions or mezzanines. The Commission decided that only store developments in local areas where there are three or fewer large grocery retail fascias should be subject to a market share criterion in addition (paragraphs 11.92 to 11.96 of the Report). The Commission considered that where there are large grocery stores of four or more large grocery retailers present in a local market it would not be necessary to consider market shares, as it would be unlikely that any store development would lead to the emergence or strengthening of a highly concentrated local market.

66. As regards the market share assessment, the Commission found that, in line with its approach to market definition and the fascia count, it should take account of all stores in the 10 minute drive-time that are in excess of 1,000 square metres and operated by any of the eight larger grocery retailers (paragraph 11.107 of the Report). The Commission decided that it should be more cautious in choosing an appropriate market share threshold for applying the competition test since it would be a remedy that would have the effect of limiting store development. Accordingly, the Commission adopted a "conservative" approach in recommending (by a majority of four members to two) a 60 per cent market share of grocery sales area, at or above which a grocery retailer would fail the competition test. Two members of the panel favoured a maximum of 50 per cent for the threshold, but the majority were concerned that that threshold would be over-inclusive and might prohibit store

development altogether in some local markets. The Commission went on to say, in a passage which is relied on by both Tesco and the Commission:

> "11.103 The same four of us also thought it more appropriate, on balance, to adopt a conservative threshold for what will be a mechanistic test to reduce the risk that welfare-enhancing store developments were prohibited by the test. In doing so, we accept that there may be some cases where a more detailed competition assessment may have failed a development that would have passed the competition test."

67. The market share assessment is to be based on the actual groceries sales area of those stores included in the assessment. (The 1,000 square metres threshold used in determining which planning applications are subject to the test, and the 1,000 square metres threshold used in determining which grocery stores are taken into account in assessing concentration are based on net sales area (paragraphs 11.110-11.111 of the Report)).

68. Thus it is envisaged that the OFT's advice to the LPA on each relevant planning application will set out: the precise location around which it has centred the isochrone (i.e. a line joining points of equal travel time to a store or population centre); which fascia(s) it has assessed as a possible operator of the grocery store in question; which fascias and stores it has taken into account in assessing whether there are four or more fascias in the isochrone; which fascias and stores it has taken into account in any market share assessments and the grocery floorspace figures it has used in that assessment; whether each fascia it has assessed as a possible operator of the grocery store has passed or failed the competition test. In the event of a failure, the OFT may advise the maximum grocery floorspace that the applicant retailer could develop and pass the test.

69. If the recommended competition test were to be implemented, the Commission found that there would be little need for additional monitoring and enforcement arrangements. The publication of OFT decisions on the application of the competition test would, in the Commission's view, gradually engender greater understanding among retailers of the way in which the competition test is applied and would lead to self-enforcement (paragraph 11.125 of the Report).

70. The Commission sees the competition test as an important complement to its other remedies which include a prohibition on grocery retailers from imposing, entering into or enforcing restrictive covenants in relation to sales or acquisitions of land that reduce the likelihood of the land being used for a competing grocery store; and an obligation not to enforce any of the exclusivity arrangements in respect of 30 identified landsites beyond a period of five years from the date of the Report. (The other proposed remedies are listed at paragraphs 11.442 to 11.444.) In addition, as a complement to the competition test, large grocery retailers will be required to notify to the OFT all acquisitions of existing stores of more than 1,000 square metres (see paragraphs 11.16 and 11.123 of the Report).

71. The Commission decided not to recommend any specific changes to the planning system (beyond the competition test). The Commission was concerned that there could be:

> "a risk of unintended consequences that could arise from interfering more than is necessary with an area of policy that has specific and well-defined social objectives and which is itself subject to a process of public consultation and reform." (paragraph 11.135 of the Report.)

72. In assessing the proportionality of its chosen remedies, including the competition test, the Commission reviewed the following factors:

(a) The scale of adverse effect of the AEC: as referred to earlier, the Commission estimated that the cumulative effect of weak local competition on store-level profit margins allows large grocery retailers in existing highly-concentrated local markets to earn an additional £105-125 million in profits per year. The Commission also considered that the scale of the impact on national price levels arising from weak local competition, while difficult to measure, is potentially very substantial (paragraph 11.380 of the Report).

(b) Balanced against that were the likely costs associated with the competition test: based on information provided by the OFT and Tesco, the Commission estimated the annual cost of the competition test to be around £6-8 million:

comprising the OFT's implementation costs of £1-2 million and costs to retailers of £5-6 million (see paragraphs 11.382-11.393 of the Report).

(c) The scope of the remedy: the Commission was satisfied that the competition test did not go further than is necessary to address, in conjunction with the other remedies, the AEC that it had identified in certain highly-concentrated local markets (paragraph 11.394 of the Report).

73. In light of the factors above, the Commission was satisfied that each of the remedies it had chosen to address the AEC in relation to highly-concentrated local markets represented the least-cost, least-intrusive package that would be effective.

Summary of the competition test

74. For convenience the criteria for the application of the competition test are summarised at Annex 1 to this Judgment.

III. GROUNDS OF REVIEW

Preliminary observations

75. As we noted in the Introduction, Tesco has not challenged the facts found by the Commission, including its conclusion that certain features of the groceries market give rise to an AEC with detrimental effects on consumers. On the contrary, it relies on the Commission's findings, and Mr Green indicated that his submissions would be based virtually entirely on the Report and its conclusions. The challenge to the Report is a narrow one which focuses upon one of the proposed remedies, namely the competition test. No issue is taken with any of the other proposed remedies.

76. It is common ground that a recommendation of the Commission under this legislation is reviewable by the Tribunal pursuant to section 179 of the Act, and that in carrying out such a review the Tribunal must apply the same principles which a court would apply on an application for judicial review.

77. The grounds of judicial review are well-established. They frequently overlap with each other. It is not uncommon for a particular flaw in a decision or a decision-making process to fall within more than one ground. Failure of a decision-maker properly to take account of a relevant consideration in reaching its decision is among the grounds most frequently relied upon in judicial review. It is sometimes considered under the broad label of irrationality, but is also (and perhaps more appropriately in the present case) treated in its own right as a ground of challenge to the validity of a decision. This ground, and its converse ground of taking account of an irrelevant consideration, clearly reflect the fact that judicial review is in general about legality and the decision-making process rather than the merits of a decision.

78. Nor will a court necessarily quash every decision in respect of which it is established that a relevant consideration was left out of account: the reviewing court will normally consider whether the factor could have been material to the challenged decision. If the factor, though strictly speaking relevant, is too insignificant to have affected the decision, then its validity may be unaffected.

79. It is also common ground that when considering Tesco's challenge the Report should be read as a whole and should not be analysed as if it were a statute. In its Defence the Commission referred to *R v MMC ex parte National House Building Council* [1993] E.C.C. 388 in which Auld J (as he then was) (upheld on appeal: [1995] E.C.C. 89) after confirming the fact that reports prepared by the former Monopolies and Mergers Commission are susceptible of judicial review, held:

> "…the Court in the exercise of this jurisdiction, as in its exercise in other contexts, must take care not to subject the [Commission's] Report to fine textual or legal analysis as if it were a statute or other legal document. I respectfully adopt the words of Hodgson J about this in *R v MMC ex parte Visa International Service* [1991] ECC 291 … "…the Report must not be read as if it were a statute or a judgment … It should be read in a generous not restrictive way and the Court should be slow to disable the MMC from recommending action considered to be in the public interest or to prevent the [Secretary of State] from acting thereon unless perceived errors of law are both material and substantial"" (at p.398).

80. Whilst the Act sets up a different legal framework from that which existed under the Fair Trading Act 1973 (the Commission is here required to answer specific questions pursuant to a structured statutory scheme, and expressly to decide,

amongst other matters, whether to take or to recommend remedial action in respect of any AEC identified) we agree with the Commission that those observations are also applicable to a case such as the present. As the Commission said in the Defence "applying the forensic magnifying glass only to particular parts of the analysis fails to do justice to the overall appraisal and assessment made by the Commission" (paragraph 37).

81. In considering Tesco's challenge the Tribunal also has well in mind that in fulfilling its statutory functions of investigating and, if appropriate, making findings and recommendations under the Act, the Commission makes many assessments and decisions which require a significant element of judgment. To this end the Commission must be afforded an appropriate margin of appreciation, such that a Tribunal will not intervene in those assessments or judgments without good reason.

82. Although Tesco's case as set out in the Notice of Application was rather more widely drawn, there are now essentially two main grounds for its challenge, both of which have at their heart an alleged failure by the Commission to take account of relevant considerations. Under the first ground, Tesco submits that the Commission failed properly to take into account that the competition test will itself have detrimental effects on competition and consumers by preventing an incumbent retailer from expanding to meet demand and making developments which would in other respects enhance the welfare of customers. Such effects were also referred to by the parties as "economic" costs. Under the second ground, Tesco contends that the Commission failed properly to take account of relevant considerations when considering whether it was proportionate to recommend the adoption of the competition test. In particular the Commission failed properly to consider how, when or to what extent the test would address the existing AEC which it had identified. As will be explained later in the judgment, these two grounds are inter-related.

83. It should be recorded that in the Notice of Application Tesco had raised a further ground of review, namely that the competition test is not sufficiently related to any AEC identified in the Report, and is for that reason *ultra vires*. Tesco argued that the AEC to which the competition test is addressed is the combined effect of high

concentration in local markets and barriers to entry arising out of the planning system. In seeking to focus on one feature of the market giving rise to the AEC (highly-concentrated local markets) but not the other (the barriers to entry created by the planning regime) the competition test was *ultra vires*. In other words, the Commission did not have the power to recommend the competition test to prevent the creation of highly-concentrated local markets unless it also took steps to address the barriers to entry to which the planning system gives rise. However, this ground was not mentioned by Tesco either in its skeleton argument or at the hearing. At both those stages Tesco pursued only the two grounds referred to above. In its skeleton argument the Commission (which had responded to the *ultra vires* ground in its Defence) interpreted this omission as in effect an abandonment by Tesco of that argument (see paragraph 9 of the Commission's skeleton argument). At no stage did Mr Green demur from the Commission's interpretation, and no further mention has been made of this point. Whether the argument has been abandoned or simply reformulated and folded into the remaining two grounds probably does not matter. In either case it is not necessary for the Tribunal to deal with it as a distinct ground.

Ground 1: Failure to take into account the "economic" costs of the competition test

84. Under this ground of challenge Tesco argues that the Commission failed properly to take account and to evaluate certain detrimental effects which would result from the application of the competition test, no matter what benefits would also ensue. (It is to be noted that the same arguments are repeated by Tesco under Ground 2 in the context of proportionality issues.)

85. Tesco points first to the Commission's finding that the test would prevent 24 per cent of existing larger grocery stores in the UK from extending (Report, footnote 334), and then to the Report's recognition that "New store construction involves entry and the creation of extra capacity, which can in turn bring consumer benefits" (see Appendix 2.1, paragraph 9(b) of the Report). Tesco goes on to argue that the test would therefore reduce capacity, artificially limit competition and deprive customers of the benefits which such expansion would bring in terms of, for example, more space, better choice of products, and more modern facilities at what

may be the customers' preferred retailer. The test is a "cap on growth". It will apply to companies who have achieved their market position lawfully by fair competition. In addition it will operate mechanistically and result in anomalies and unintended consequences. In view of its admitted potential to affect 24 per cent of existing larger stores these adverse consequences are capable of being significant for both consumers and the companies affected. The test represents an intrusive and unusual remedy which itself distorts the normal competitive process.

86. The competition test would in particular prevent an incumbent grocery retailer from opening a new store or expanding an existing store to meet specific consumer demand for its offering, thereby resulting in what has been termed by Tesco "unmet demand". In support of that contention Tesco refers to the Commission's survey indicating that 62 per cent of LPAs had quantified a "need" for additional floor space for the retailing of convenience goods (which include groceries) in their local development plan (see paragraph 7.41 and Figure 7.1 of the Report). Tesco argues that the concept of "need" used in the planning regime is a reasonable proxy for unmet demand (see Appendix 7.2, paragraphs 12-14). Tesco also draws attention to the Commission's finding that 79 per cent of long-standing monopoly and duopoly stores with a net sales area greater than 1,400 square metres are located in areas which appear capable of supporting an additional store on the basis of their population levels (paragraph 10 of Appendix 7.1 to the Report). So there is significant and persistent unmet demand already existing in highly-concentrated local markets, and the application of the competition test would, Tesco submits, make it more difficult to satisfy that unmet demand and would also create more.

87. One example given by Tesco of the possible effect of the test in preventing expansion regardless of demand is of a "duopoly" local market where each of two retailers has a 50 per cent share and no land is available for a third store to be created by a new entrant. (It is to be noted that the Commission found that in 2006 160 stores had persisted as monopolies or duopolies since at least 2000: see Report Appendix 7.1, paragraph 6.) By virtue of the competition test neither of the two retailers would be able to add materially to its grocery floor space, whether or not there is sufficient demand or other reasons to do so. Tesco states that this, and the other hypothetical examples given in its skeleton argument, are not intended to be

exhaustive of the anomalies and detrimental effects which would result from the application of the test, but are simply to show that the application of a mechanistic test such as this poses a risk of consumer harm and detriment to competition which the Commission ought to have investigated and taken into account.

88. Tesco submits that the Commission itself acknowledges the risk of such adverse consequences, relying in this regard upon the following statements in the Report:

> "We take the view that the other points raised by the retailers in opposition to the competition test (for example, in relation to the effect on investment, strategic behaviour, regulatory burden, uncertainty, perverse effects and regulatory 'gridlock') are best dealt with in the design of the test, which is discussed below."
>
> (paragraph 11.35)
>
> "The same four of us also thought it more appropriate, on balance, to adopt a conservative [market share] threshold for what will be a mechanistic test *to reduce the risk that welfare-enhancing store developments were prohibited by the test*."
>
> (paragraph 11.103) (Emphasis added)

89. In spite of its acceptance that such a risk exists and could potentially affect a very significant number (24 per cent) of the country's relevant grocery stores, the Commission, argues Tesco, entirely failed to consider these adverse consequences. They are not referred to anywhere in the Report other than in the statements quoted above, and no attempt whatsoever is made to quantify or otherwise assess the extent or nature of the risk which they pose. According to Tesco, this was a fatal omission since the risk of significant economic costs of this kind was clearly a relevant consideration when the Commission was deciding whether to recommend the competition test.

90. The Commission, supported by the interveners, rejects Tesco's allegation that it ignored the economic and welfare costs to consumers which might arise where the competition test prevents welfare enhancing expansion or developments to meet unsatisfied consumer demand. The Commission submits that none of Tesco's arguments show that it failed properly to apply the relevant statutory provisions or acted irrationally. The decision of the Commission on the adoption of the competition test was plainly one which it was entitled to reach.

91. The Commission does not dispute that it is necessary for it to take account of the costs associated with its chosen remedies. It points to the fact that it expressly took into account the likely administrative costs to which the application of the competition test would give rise, estimated to be around £6-8 million per year (paragraphs 11.382-11.393). As regards the costs arising from the retailers' inability to expand on sites which would have obtained planning permission but for the competition test, the Commission asserts that such costs are the monopoly rents which are transferred to customers. In the Commission's view that is precisely the result the competition test is designed to achieve. As for other costs to retailers, in particular Tesco's submissions during the investigation that the competition test would cost between £138 million and £183 million per year, the Commission found no basis for the assumption underlying Tesco's calculations, namely that the competition test would significantly increase the time taken for planning applications to be determined (see paragraphs 11.385-11.389).

92. As to Tesco's argument that it had failed properly to take account of the economic costs, namely the prevention of welfare-enhancing developments, and in particular the risk of further unmet demand, the Commission submits as follows. It accepts that the test will block certain incumbent retailers from expanding their stores to meet demand or will place a limit on possible expansion. But where the test has that effect "it should be expected that another will come forward to develop a replacement." (See Mr Freeman's witness statement at paragraph 72. See also, for example, paragraph 55 of the Commission's skeleton argument.) Thus the Commission's response is that no such economic costs will in fact be caused by the test because the very application (or threat of application) of the test so as to block or deter development by an incumbent will itself (in combination with the other remedies) result in corresponding entry or expansion by another retailer into the local market in question, thereby taking up any slack. The interveners endorse the Commission's answer. They contend that Tesco's assertions about the putative "economic" costs associated with the test are divorced from commercial reality. M&S's Statement of Intervention was supported by concrete examples of its willingness to enter a number of highly concentrated local areas. Similarly Waitrose and Asda submit that they too are seeking to expand and have publicly announced plans to do so.

93. Tesco takes issue with the Commission's answer on a number of levels, and much of the argument before the Tribunal revolved around the validity and implications of that answer. Moreover, the point has a bearing not just upon Tesco's first ground of review but also upon the second ground, relating to the effectiveness of the competition test; this is because the expected new entry, which will in the Commission's view remove or reduce the risk of economic costs resulting from the blocking of an incumbent's development, is obviously related to the new entry which the Commission considers will "address" the AEC in existing highly-concentrated local markets, and which is for that reason said to be part of the benefit of the test. It is therefore necessary to set out the rival positions of the parties on this issue in a little more detail.

94. Tesco submits that the Commission has simply assumed without any consideration or analysis at all, that where the test blocks an incumbent's expansion another retailer's development would fill the void, and would do so within the same timescale, so that there would in fact be no material damage to consumer welfare or unmet demand. Tesco goes on to argue that this assumption is nowhere mentioned let alone analysed and substantiated in the Report, and that it makes its first real appearance in the Defence and the accompanying witness statement of Mr Peter Freeman. As such it amounts to new reasoning and cannot be relied upon at this stage to justify the competition test. (In this regard Tesco cited *Somerfield v Competition Commission* [2006] CAT 4, paragraph [67] and *R v Westminster City Council ex parte Ermakov* [1992] 2 All ER 302, at 315h.)

95. Tesco also submits that the very fact that this factor is now said to be a key attribute of the remedy demonstrates that in the Report the Commission failed to take account of a relevant consideration. Alternatively, if the Commission did take account of it, then it acted unfairly by failing to raise the issue with Tesco and the other interested parties in the course of the investigation.

96. Furthermore, Tesco argues that the validity of the assumption is very far from being self-evident, and that the Commission's own findings in the Report point the other way. That being so, the assumption cannot justify the Commission's position on

the economic costs of the test, without full and proper consideration and analysis of the evidence, and the making of relevant findings by the Commission.

97. In support of this submission Tesco points out that there is a range of reasons why a grocery retailer might not enter a local area: the level of unmet demand might not be such as to render new entry economically feasible; there might not be a suitable site available or in the right location; or the retailer may simply consider that its retail offer is not well-suited to local consumer demographics. (See for example paragraphs 19ff of Tesco's skeleton argument.) In one hypothetical example Tesco postulates that in a particular local market retailer A has 50 per cent (2000 square metres) and retailers B and C each have 25 per cent (1000 square metres). A concludes that there is sufficient customer demand for an extension of 2000 square metres. But as this would give A 67 per cent of the local market A must settle for an extension of less than 1000 square metres. Tesco argues that it is far from clear that B or C or a new entrant would regard it as economically worthwhile to extend or build a new store so as to take up the remaining 1000 square metres, even assuming that they had the available space on their existing sites or could find a suitable site elsewhere within that local market.

98. Particular reliance was placed by Tesco on the Commission's own findings, following a detailed analysis, that of 186 stores belonging to Asda, Morrisons, Safeway, Sainsbury's and Tesco which were in monopoly or duopoly situations in 2000, 160 stores (86 per cent) continued to face no or only one competitor in 2006 notwithstanding that the weakness of competition and resulting profitability in those highly concentrated markets would normally tend to attract new entry. (See paragraphs 7.9-7.11 of the Report.) Reliance was also placed on the Commission's finding that 79 per cent of persisting monopoly and duopoly stores with a net sales area greater than 1,400 square metres are located in areas which appear capable of supporting an additional store on the basis of their population levels (paragraph 10 of Appendix 7.1 to the Report). The Commission's conclusion was that the persistence of highly concentrated local markets indicated barriers to entry into those markets.

99. Tesco also drew attention to paragraph 102 of the Defence, which addresses Tesco's second ground of review. The paragraph states:

> "Tesco's assertion that the Commission had, or could have had, the data to calculate the economic benefit accruing from the future operation of the test is wrong and simplistic. It is not feasible to ascribe a meaningful ex ante value to the benefit accruing from the future application of the test. Attempting to calculate the future economic benefit would have required the Commission to make highly speculative assumptions about the number of larger grocery stores that would be developed in the future, as well as the timing, precise location and sequence of proposed store developments by retailer and by local area. The degree of speculation required would render the calculation highly unreliable."

100. On the basis of that statement Tesco submitted that if the Commission is unable to predict the timing, number and location of larger grocery stores that would be developed in the future, then how can it assume that timely replacement entry or expansion will be likely to occur in areas where incumbent store development is blocked by the test. Tesco adds that the Commission has made no attempt to estimate even an approximate time frame in which new entry is likely to occur.

101. Given the Commission's findings and statements, and given that the competition test admittedly does not remove or mitigate any of the effects of the planning regime which the Commission had identified as barriers to entry, Tesco argues that it cannot simply be assumed that the application of the competition test to block an incumbent's development would result in replacement entry or competitor expansion in the highly-concentrated markets in question. Therefore the issue of economic costs resulting from the test has not been addressed by the Commission, thus invalidating its decision to recommend the test.

102. The Commission accepts that:

(a) The competition test cannot, in and of itself, produce new entry or expansion.

(b) The competition test does not remove or mitigate any of the constraining effects of the planning regime which it had identified as the main barrier to entry into the markets in question.

(c) The competition test will not, of itself, reduce existing concentration.

(d) There is a range of reasons why any particular retailer might not enter a local market.

(See paragraphs 79-80, and 93 of the Commission's skeleton argument.)

103. Nevertheless, according to the Commission the test will facilitate new entry. Mr Freeman explains that "the key thrust of the competition test is that it is intended to provide opportunities rather than create new entrants". By creating a barrier to expansion by the incumbent, the Commission expects that the test will create opportunities for entry by other grocery retailers. (See paragraphs 68-69 of the witness statement.) The Commission does not accept Tesco's claim that the competition test will mostly apply to extensions by incumbent retailers which are unlikely to discourage entry. On the contrary, the Commission found that an "incumbent grocery retailer, by extending its store, will make new larger grocery store entry by a rival grocery retailer more difficult" (paragraph 7.67 of the Report). By increasing market share, extensions can give rise to or exacerbate the potential effects on competition associated with high levels of concentration. Therefore in general, it is likely that where an existing larger grocery retailer is prevented from developing a new store because it fails the competition test, at least one of the rival retailers would seek to meet any unmet demand. In support of this proposition, the Commission refers to paragraph 10.1 in the Report where it found that, in general, the UK grocery industry is highly competitive. It is fanciful for Tesco to contend that only the incumbent with an existing 60 per cent market share is likely to seek to meet that demand. The Commission relies on the evidence of the other large grocery retailers (see paragraph [92] above).

104. The Commission does not accept the validity of Tesco's argument that findings as to the competitive nature of the market overall cannot support the Commission's assumption that new entry will occur in persistently highly concentrated markets where, by definition, competition is weaker. The Commission responds that there is no reason why the process of rivalry and store development that is observed nationally should not be true of such markets. The Commission notes that at no point during the groceries market investigation did Tesco suggest that either it or its

competitors are less keen to enter highly concentrated local markets. Indeed, it would be very strange if a grocery retailer were less keen to enter such markets. The Commission was strongly supported by the interveners on this point. Even in situations where an existing grocery retailer is prevented by the test from expanding, and where it would not be economically viable for a new entrant to build a new larger grocery store, Waitrose claimed that mid-sized stores (i.e. less than 1,000 square metres) may be built instead.

105. The Commission further submits that the analysis of the persistence of local concentration in Appendix 7.1 to the Report does not undermine its view that any unmet consumer demand would be satisfied by new entry in areas where the competition test applies. The persistence of highly-concentrated local markets informed the Commission's analysis of barriers to entry in local markets: assessing the extent to which those local markets identified as being highly-concentrated in its 2000 Supermarkets Inquiry continued to be highly-concentrated in 2006 (above). It was the Commission's view, on the available evidence, that the competition test and the controlled land remedies would address the AEC in relation to highly-concentrated local markets that have persisted over a number of years. Thus, Tesco's reliance on the persistence of such markets fails to take account of the "new world" in which grocery retailers will operate, with the benefit of the competition test and the controlled land remedy.

106. Further, the Commission denies that this "facilitative" effect of the competition test amounts to a new justification for adopting it. When the Report is read as a whole, as it must be, the purpose of the test is clearly stated. Referring in particular to paragraphs 11.78, 11.266 and 11.268 the Commission submits that it is "self-evident" from those passages that the reason why the competition test, along with the removal of the barrier to entry resulting from controlled land, will be sufficient "over time" to address the AEC of highly concentrated local markets is that in general a large retailer other than the incumbent blocked by the competition test is likely to develop large grocery stores in the highly-concentrated markets in question. Moreover, Tesco clearly understood the way in which the Commission envisaged the test would operate, since Tesco's response to the provisional remedies decision stated:

> "The very purpose of the competition [test] is to limit growth. … The remedy presupposes that there is a shortage of sites and that if one retailer is prevented from developing a site another retailer will step in."

107. The Commission rejects the relevance of paragraph 102 of the Defence to the question whether it is in a position to estimate the time of entry. That paragraph is dealing with a different issue. It is addressing the inability of the Commission to measure the benefit of introducing the competition test in order to prevent the emergence of highly-concentrated local markets in the future. That reasoning sheds no light on whether a new entrant is likely to enter an existing highly-concentrated local market following the blocking of a store development by an incumbent retailer. Further, and in any event, the Commission submits that the time in which a remedy will take effect is a matter of judgment falling within its margin of appreciation.

108. The Commission submits that the hypothetical scenarios put forward by Tesco to show that the competition test will distort the competitive process and produce economic costs are mistaken. For example, the Commission counters Tesco's hypothesis of a local duopoly with each retailer having 50 per cent of the market and no site available for a new store but unmet demand, by suggesting the following. If each of the two stores was 1000 square metres in size retailer A could expand its store by 490 square metres. This would give A just less than 60 per cent of the market and would open the way to B (who would now have only 40 per cent) to expand its own store by up to a further 1000 square metres before hitting the prohibited 60 per cent market share. In the Commission's view this demonstrates how dynamic competition could continue to meet consumer demand in such a situation. (See paragraph 14 of the Commission's skeleton argument and Appendices A and B thereto, in which the Commission responds to Tesco's various scenarios.)

109. Thus, in short, where the competition test prevents an existing retailer from expanding, the Commission expects another retailer will enter the market to satisfy demand. In those circumstances, consumers may shop at the existing grocery store but also benefit from a new store from another retailer and/or a lessening in concentration. Waitrose and Asda add that there is unlikely to be any cost to

consumers arising from a time lag between the incumbent being denied planning permission and the response of rival retailers. Competitors will already have taken into account the likely result of the competition test and readily adapted their plans for expansion.

110. The risk that by placing a cap on market share the competition test could prohibit beneficial store development, is addressed by limiting the application of the test to larger grocery stores with a market share of 60 per cent rather than 50 per cent (see paragraphs 11.99-11.103 of the Report). In cases where the test would block a development which produces benefits for the local area which outweigh the detriment from high concentration, and where the same or a similar development would not otherwise take place, the LPA can override the result of the competition test. The "LPA override" will however only apply in exceptional circumstances - in the great majority of cases the Commission maintains that another retailer would open a store (or extend an existing store) in lieu of the one blocked by the competition test.

Ground 1: The Tribunal's discussion and conclusions

111. Bearing well in mind the cautionary words of Auld J (paragraph [79] above), it is nevertheless our view that Tesco is correct in submitting that there is a significant gap in the Commission's analysis in relation to the "costs" of the competition test. The Report does not fully and properly assess and take account of the risk that the application of the test might have adverse effects for consumers as a result of their being denied the benefit of developments which would enhance their welfare, including by leaving demand "unmet". Moreover, as will be explained later, the problem is not cured by the view which the Commission has expressed in the course of these proceedings that the risk does not need further consideration because any development which is blocked by the test is likely to be replaced within the same time scale by another retailer already in the local market or by a new entrant.

112. Although the Commission did not accept the force of the hypothetical scenarios used by Tesco to illustrate the possible perverse consequences of the test, it acknowledges in the Report that because the test is "mechanistic" there is a risk that

welfare-enhancing store developments could be prevented by its application, and also that there may be other unintended adverse effects (see paragraphs [66], [85] and [88] above). As can be seen from the passages quoted in paragraph [88], the Commission's approach to this risk was that it should be dealt with in the design of the test, and in particular that the risk would be "reduced" if a "conservative" market share threshold were adopted, namely 60 per cent. There appears to be no other reference in the Report or in its appendices to these possible adverse effects of the competition test. There is no attempt to assess the degree of risk either generally or in any particular local market or markets. Nor does the Report explain by how much the risk is to be reduced by reference to the market share criterion selected.

113. The Commission does however, in a different context, calculate that at the threshold of 60 per cent the test would prevent store developments in 24 per cent of relevant UK stores. This is obviously not an assessment by the Commission of the degree of risk of economic or welfare costs resulting from the application of the test, but it does in our view show that the potential for such costs to materialise is by no means insignificant, and that the risk cannot therefore be dismissed as trivial and not requiring full and proper consideration. Yet there is no mention of such assessment in the Report, not even when the Commission is dealing with the proportionality of the competition test. Mr Freeman states that:

> "The Group was particularly concerned to ensure the full implications of the test were appreciated and that it would not have arbitrary or unintended consequences or an excessive effect." (Paragraph 50 of his witness statement.)

We do not doubt this for one moment, but if, as one must assume, the upshot of the Group's discussions and consideration is reflected in the Report's treatment of this issue, then the apparent deficiency remains.

114. The Commission's explanation for the absence from the Report of any assessment of the risk of economic costs is based, not just on the "conservative" market share threshold adopted in the test, but more on the Commission's expectation that any development blocked by the test would be replaced by another retailer's development. However, this explanation is itself absent from the Report, in the sense that the Commission does not in terms explain that it is for this reason that no

assessment of the risk of economic costs of the test is necessary. The Commission, however, contends that the "facilitative" effect of the test (i.e. its alleged purpose and effect of encouraging new entry into existing highly-concentrated local markets) was made clear in the Report, and was in any event self-evident.

115. It may therefore be helpful to consider how the Report describes the aims of the competition test. To this end we have set out in Annex 2 to this Judgment the passages which both parties have drawn to our attention in this connection, together with certain other passages which appear to us to have a bearing on this. Again we remind ourselves that the Report must be read as a whole and that one must be cautious about placing too much reliance upon specific passages or treating the text as if it were a statute.

116. It is clear in the light of the extracts cited in Annex 2 that in the Report the Commission draws a distinction between the aims of the competition test and those of the remedies in respect of controlled landsites. In several places the Report emphasises that the competition test is intended to prevent the emergence of new highly-concentrated local markets and the strengthening of existing strong market positions. In other words it looks to the future and is essentially preventative, in that it is aimed at achieving a "standstill" so far as the concentration of local markets is concerned. On the other hand the role of the controlled land remedies is to deal with certain barriers to entry which need to be broken down in order to remedy existing highly-concentrated markets.

117. This distinction (and the complementarity of the two sets of remedies) is perhaps most clearly expressed in the following paragraphs:

> "11.27 We see the competition test remedy as an important complement to our remedies in relation to controlled land and multiple stores (see paragraphs 11.136 to 11.268). While those remedies address barriers to entry in existing highly-concentrated local markets, the competition test will prevent the emergence of areas of highly-concentrated local markets or the strengthening of strong local market positions in the future."
>
> "11.97 In our view, the competition test should broadly reflect the same principles that we applied to our analysis of highly-concentrated local markets and controlled land (see Section 7). The objectives of the two are, however, different. The competition test is essentially forward looking, whereas our analysis of controlled land sought to identify existing barriers to entry in areas of high concentration."

118. It is true that there is reference in several places to the Commission's desire to encourage new entry and competitive development in existing highly-concentrated local markets (see for example paragraphs 11.25 and 11.78; see also paragraph 11.268). In addition the Commission made a finding that by extending its store an incumbent grocery retailer makes new larger grocery store entry by a rival grocery retailer more difficult, presumably by utilising some of the finite "need" identified by the LPA for the area in question (paragraph 7.67 of the Report). It would follow from this that blocking an incumbent's extension plan could be said indirectly to assist a rival application for planning permission.

119. Thus, although a "facilitating" role for the test was not clearly identified in the Report, the Commission may well have envisaged that it would serve this purpose as well as fulfilling its primary preventative role. Nor would it be implausible to suggest that the test, in combination with the Commission's other proposed remedies, could have some effect in encouraging the breakdown of existing highly-concentrated local markets. On the other hand in our view it cannot be derived from the Report that developments blocked by the test would in all likelihood be replaced in a timely way by corresponding competitive developments, so as to protect customers from welfare losses which might otherwise occur. Nowhere is this stated, and the Report does not claim that more has been done than to "reduce" the risk that such losses will be caused by the test.

120. It was not until the Defence was filed that the expectation of a replacement effect was clearly articulated by the Commission (see paragraphs 80(i), 80(v), 93 and 110 of the Defence). In paragraph 110 of the Defence the Commission gives a certain prominence to it:

> "The expectation *underpinning the test* is that where one retailer is prevented from expanding to meet demand, another retailer is likely to step in to meet that demand."
>
> (Emphasis added. See also, to like effect, paragraph 72 of Mr Freeman's witness statement.)

121. Perhaps even more importantly the expected effect is not at all self-evident, in the light of the findings in the Report and generally. There are evidential factors going both ways. For example in support of it there is the Commission's finding in

paragraph 10.1 of the Report that, in general, the UK grocery industry is highly competitive, together with the evidence of the interveners and other large grocery retailers to the effect that they are actively seeking to expand and open new stores and believe that the introduction of the competition test will help them in that regard. However, arguably putting the assumption in doubt is the detailed finding in the Report that significant numbers of highly-concentrated local markets have persisted for at least six years (and possibly a good deal longer) notwithstanding the competitive and expansionary environment referred to, and in spite of the fact that in many of those markets the population had been sufficient to support another large grocery store. Similarly, the Commission accepts that the competition test does not reduce or remove the main barrier to entry, namely the planning regime, which is to be left in place (see paragraph 13(b) of the Commission's skeleton argument). This, too, may also call into question how quickly a replacement development would materialise.

122. Further, whilst it was the Commission's view that its package of remedies would "address" the AEC in relation to highly-concentrated local markets "over time", neither in the Report nor in the later statements made in the course of these proceedings was the Commission able to state any expected time-frame for replacement. The nearest was the statement at paragraph 52 of the Commission's skeleton argument:

> "Nor is there any reason why new store development should not occur as quickly under a competition test regime as under the existing arrangements."

123. That statement, with respect, seems to us to be very much open to question: there are a good many reasons why, if one retailer is blocked from developing a store, a replacement development by a different retailer may not occur for some considerable time or at all, notwithstanding the "new world" of the competition test and the controlled land remedies. Some of these potential reasons are set out at paragraph 47 of Tesco's skeleton argument, and the Commission itself has stated as much. (See the Defence at paragraph 80(v); there the Commission accepted there might be a range of reasons why a particular retailer might not enter a local market, but took issue with a different proposition, namely that the test would be likely to result in unmet demand.)

124. In the context of a judicial review it is not for the reviewing court to resolve such evidential issues, which are ultimately a matter for the decision-maker. The important point is that an assumption, which the Commission now says underpinned its recommendation of the competition test (see paragraph 110 of the Defence), but which is by no means self-evidently correct, has not been articulated let alone properly analysed and considered in the Report itself, whether generally or as a reason why the risk of welfare losses for consumers could safely be discounted without further consideration. One of the Commission's responses in the course of the hearing was that it was fanciful for Tesco to contend that only the incumbent with an existing 60 per cent market share is likely to seek to meet any demand which may exist in a highly concentrated market. With respect that seems to us to misunderstand the point which Tesco was making: Tesco was not, as we understand it, contending that any such demand could only ever be met by the 60 per cent incumbent; rather it was submitting that, particularly in the light of certain findings in the Report, it was impermissible for the Commission to assume without proper investigation and consideration of the issue, that no unmet demand or other welfare costs would arise because wherever the test blocked an incumbent's development a rival's would fill the void without significant delay. With that submission we agree.

125. Nor in our view does the fact that the Commission (with assistance from the interveners) has sought to substantiate that assumption by means of evidence and submissions in the course of these proceedings satisfy the need for such investigation and consideration. We do not believe that this is an appropriate way of supplementing the Report's consideration and findings in relation to significant issues in a major market investigation of this kind. We agree with Tesco that the Commission's assumption and reasoning in respect of the risk of welfare costs is "new", in the sense that it is not to be found in the Report. Whether there has been procedural unfairness in that Tesco has not had a proper opportunity to deal with it, we do not need to decide. Tesco does appear to have anticipated the argument which the Commission now makes about the timely replacement of developments blocked by the test, and to have made some representations to the Commission about its validity (see paragraph [106] above). However, this does not seem to be a satisfactory way to deal with an assumption which the Commission now says is key to its recommendation of the test.

126. Further, full and proper consideration of the risk of such costs cannot be avoided by reference to what has come to be called the "LPA override". This is the proposed power of the LPA to grant planning permission in certain cases in the face of advice from the OFT that the application had failed the competition test (see paragraph [62] above). If implemented in the terms recommended by the Commission, this power would only be able to be exercised in "truly exceptional" cases and following compliance by the LPA with strict and quite onerous conditions. Such compliance would have to be established by reference to "clear and sound evidence", which must be published by the LPA along with its reasons for overriding the OFT's advice. In certain cases market testing by the LPA is likely to be required to establish that no alternative retailers could take up the development (see paragraph 11.53 of the Report). While the LPA override may in practice mitigate the perceived severity of the competition test in a particular area, it is clear that the Commission intended the power to be exercised in very limited cases. That intention is reflected in the stringent conditions which circumscribe its use – and given that such overrides clearly would not apply in all (or even most) instances where the competition test would block a development (for that would render the test otiose), the power would not neutralise the risk of welfare costs arising in those cases where the power was not exercised.

127. The upshot is that the risk of welfare losses or "economic" costs such as those to which the Commission itself refers in paragraphs 11.35 and 11.103 of the Report, and which is admittedly a relevant consideration for the Commission in fulfilling its statutory role and in particular when dealing with the questions posed by section 134 of the Act, has not been properly addressed by the Commission. Such losses could be significant in view of the Commission's finding that the test would block development in 24 per cent of relevant stores. Nor in our view can the omission be regarded as incapable of affecting the Commission's decision to make the recommendation in question.

128. Tesco repeats its Ground 1 arguments in the context of the proportionality principle. As it is not disputed that the risk of welfare losses/economic costs is a relevant consideration when deciding on an appropriate remedy under this legislation, it may not matter under what specific heading or headings such risk falls to be considered.

In our view the risk of such losses is equally relevant when one comes to consider the proportionality of the test, and our conclusions above therefore mean that the Commission's consideration of proportionality is deficient in this respect. We will return to the consequences of these conclusions once we have dealt with Tesco's Ground 2.

Ground 2: Failure to take account of considerations which are relevant to the proportionality of the competition test

129. Tesco's second ground of challenge relates to the proportionality exercise which the Commission accepts it must carry out when taking or recommending action to remedy, mitigate or prevent an AEC. Tesco argues that the Commission failed to carry out this exercise properly. Essentially Tesco has three complaints. First, the Commission failed to make any assessment of the possible benefit of the competition test. Second, it failed to take account of the economic costs of the test. Third, when examining the proportionality of the test the Commission failed to take account of the fact its assessment of the AEC was not clear cut (see paragraph 97 of Tesco's skeleton).

130. As already noted, the second of the above three complaints overlaps with Tesco's submissions under Ground 1. We have stated our conclusions on that aspect of the case, namely that the Commission has failed to take into account some of the relevant potential adverse effects of the test. One of the elements in the proportionality exercise is to identify and assess the debit side of a proposed measure so that this can be balanced against the benefits or "credit" side.

131. The main complaint under Ground 2 concerns the "credit" side of the balancing exercise. It is not in dispute that the application of the proportionality principles also involves the question whether and to what extent the proposed measure will be effective for its purpose. A measure will be considered not to be proportionate if it is ineffective with respect to its aim, or if its "costs" are disproportionately large in comparison with the mischief at which it is aimed. In the course of the hearing the positive effect of the competition test in achieving its aim was referred to as the "benefit" of the competition test. Much of the argument on this issue concerned the way in which the Commission was required to carry out the proportionality exercise

in the context of the statutory scheme in question, and in particular whether a formal cost/benefit analysis was required, and how if at all the Commission ought to have assessed the benefit of the test.

132. The essence of Tesco's submission is that the Commission failed to address the benefit or effectiveness of the competition test and, consequently, failed to balance the adverse effects of the competition test against any beneficial effects it might have. Tesco submits that if the Commission has failed to carry out a cost-benefit analysis, then it was not in a position to decide the questions contained in section 134 of the Act. In support of this submission Tesco refers to (i) the Commission Guidelines; (ii) the Commission's decisional practice in respect of appeals under the Energy Act 2004; (iii) guidelines published by the Office of Communications ("OFCOM") on "Better Policy Making: Ofcom's approach to Impact Assessment"; and (iv) the HM Treasury publication "Green Book: Appraisal and Evaluation in Central Government". Tesco argues that these sources demonstrate the sort of exercise that the Commission should have undertaken when evaluating proportionality in a case such as the present.

133. Tesco characterises the Commission's claim that it could not quantify the effectiveness of the competition test in breaking down the existing AEC as an "unsustainable counsel of despair". In any event, all the sources referred to above confirm that an inability to quantify the benefit of a proposed measure does not justify simply disregarding the issue. At the very least, the Commission should have attempted an analysis along the lines suggested by the various guidance – for example, broad estimates, sensitivity analyses, scenarios – and then taken a view on what weight to attach to the results. While "spurious accuracy" should be avoided, difficulties of precise quantification did not absolve the Commission from conducting the next best assessment. Tesco submits that the Commission's failure properly to assess the benefits (as well as the economic costs) of the competition test means that its proportionality analysis is flawed.

134. The essential submissions of the parties on these questions are referred to in the Tribunal's discussion and conclusions below. A fuller summary of the submissions is at Annex 3 to this Judgment.

Ground 2: The Tribunal's discussion and conclusions

135. The Commission accepts that any remedies which it recommends or adopts must satisfy proportionality principles (paragraph 4.9 of the Commission Guidelines). We agree with the Commission that consideration of the proportionality of a remedy cannot be divorced from the statutory context and framework under which that remedy is being imposed. The governing legislation must be the starting point. Thus the Commission will consider the proportionality of a particular remedy as part and parcel of answering the statutory questions of whether to recommend (or itself take) a measure to remedy, mitigate or prevent the AEC and its detrimental effects on customers, and if so what measure, having regard to the need to achieve as comprehensive a solution to the AEC and its effects as is reasonable and practicable.

136. A useful summary of the proportionality principles is contained in the following passage from the judgment of the ECJ in Case C-331/88 *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte Fedesa* [1990] ECR I-4023, paragraph [13], to which we were referred by the Commission:

> "By virtue of that principle, the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued".

137. That passage identifies the main aspects of the principles. These are that the measure: (1) must be effective to achieve the legitimate aim in question (appropriate), (2) must be no more onerous than is required to achieve that aim (necessary), (3) must be the least onerous, if there is a choice of equally effective measures, and (4) in any event must not produce adverse effects which are disproportionate to the aim pursued.

138. The first thing to note is that the application of these principles is not an exact science: many questions of judgment and appraisal are likely to arise at each stage of the Commission's consideration of these matters. This is perhaps most obviously the case when it comes to the balancing exercise between the (achievable) aims of

the proposed measure on the one side, and any adverse effects it may produce on the other side. In resolving these questions the Commission clearly has a wide margin of appreciation, with the exercise of which a court will be very slow to interfere in an application for judicial review.

139. That margin of appreciation extends to the methodology which the Commission decides to use in order to investigate and estimate the various factors which fall to be considered in a proportionality analysis (and indeed in its determination of the statutory questions of comprehensiveness, reasonableness and practicability). There is nothing in the governing legislation, or in the general law, which requires the Commission to follow any particular formal procedure or methodology when it comes to consider the effectiveness of a possible remedy, or its relevant costs, adverse effects and benefits. While the Commission is entitled to have regard to, *inter alia*, OFCOM's guidelines on impact assessment and the Treasury's Green Book on appraisal and evaluation, it is not required to do so. It has not been suggested that the Commission's own guidance on market investigations is inadequate for these purposes. The Commission can tailor its investigation of any specific factor to the circumstances of the case and follow such procedures as it considers appropriate. In this regard it may well be sensible for the Commission to apply a "double proportionality" approach: for example, the more important a particular factor seems likely to be in the overall proportionality assessment, or the more intrusive, uncertain in its effect, or wide-reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be. Ultimately the Commission must do what is necessary to put itself into a position properly to decide the statutory questions. As the Commission itself accepts, this includes examining and taking account of relevant considerations, such as the effectiveness of the remedy, the time period within which it will achieve its aim, and the extent of any adverse effects that may flow from its implementation. (See paragraphs 11.5-11.10 of the Report, referring to paragraphs 4.6-4.16 of the Commission Guidelines.)

140. The way in which the Commission states that it applied the proportionality principles is set out at paragraph 90 of the Defence as follows:

> "Although the Commission found that the scale of the AEC is difficult to estimate, its best estimate of that effect indicated that it is substantial. Balanced against that, it found that the cost of applying the competition test would be relatively low and the test goes no further than necessary to achieve an effective remedy. The test (and other remedies) was therefore proportionate to the AEC found in relation to highly-concentrated local markets."

141. Thus, the Commission referred to its best estimate of the "mischief" it had identified i.e. the additional profit earned by larger grocery retailers due to weak competition in existing highly-concentrated local markets, and balanced this against its estimate of the costs of applying the competition test. The latter was found to be relatively low. Having then satisfied itself that the test went "no further than necessary to achieve an effective remedy", the Commission concluded that it was proportionate to the AEC.

142. This approach was criticised by Tesco on the basis that the Commission did not attempt to estimate the actual benefits in terms of increased competition which the test would produce, and instead limited itself to pointing to its estimate of the aggregate annual detriment to consumers caused by existing highly-concentrated markets. In this respect Tesco submits that the Commission has misapplied the proportionality principles.

143. It is worth noting that element (1) of the proportionality principles is closely linked to element (4) (see paragraph [137] above). In other words it is necessary to know what the measure is expected to be able to achieve in terms of an aim, before one can sensibly assess whether that aim is proportionate to any adverse effects of the measure. The proportionality of a measure cannot be assessed by reference to an aim which the measure is not able to achieve.

144. The Commission's use of the estimated consumer detriment resulting from existing highly-concentrated markets as one of the two comparators in the proportionality assessment seems to imply that the test itself, or the test in combination with the other remedies proposed, would be effective in removing (or at least substantially reducing) that existing AEC. Otherwise it would not be an appropriate comparator to balance against the costs of imposing the test. (We are aware, of course, that the Commission's estimate of customer detriment is said to be conservative. We are

also aware that it is said to form the basis for the detriment to customers which could arise as a result of concentrated markets which might emerge in the future.)

145. The Tribunal pointed out earlier in dealing with Ground 1 that the chief function of the competition test, as revealed in the Report, was to bring about a "standstill" by preventing the emergence of new concentrated markets and the strengthening of existing ones. To the extent that a further role was envisaged for the test, namely breaking down existing highly-concentrated local markets by facilitating new entry, the Report itself is rather reticent on the subject. However, this additional role has been strongly promoted by the Commission in its written and oral submissions to the Tribunal. We therefore approach the matter before us on the basis that the purpose of the test is not limited to a preventative role, and that it is also intended to fulfil a role, in conjunction with the landsites remedies, of increasing competition in existing highly-concentrated local markets thereby remedying the AEC and customer detriment which the Commission has found in those markets (of which there are approximately 495).

146. It is in relation to this further role that Tesco's complaints arise. For it is true that in the Report the Commission has made no attempt to estimate the competition test's contribution to the achievement of this aim. Nor does the Report describe the process by which the test is intended to make inroads into those existing concentrations. Further, the timescale over which the breakdown of existing concentrations is to be achieved is not estimated even in approximate terms, or considered at all. The only reference to the time within which the remedies are expected to take effect is in paragraph 11.268 of the Report, which states:

> "…it is our view that removing barriers to entry in highly-concentrated local markets and ensuring that store developments do not exacerbate high concentration will be sufficient over time to address the AEC we have found in relation to highly-concentrated local markets…..We therefore believe that the competition test and controlled land remedies will be more effective remedies over time than would be store divestitures."

147. That passage, which also refers to the test's main "standstill" role in relation to future AEC, is not clearly and unequivocally allocating to the test a proactive role in relation to existing highly-concentrated markets. However assuming that it is intending to do so, the statement is still opaque in two respects. First the word

"address" does not indicate whether the package of remedies, including the test, is expected wholly to remedy the AEC in existing concentrated markets or merely to mitigate it, and if the latter by how much. Second, the words "over time" tell one virtually nothing about the anticipated time frame. In this connection Tesco particularly relies upon the following extracts from the Commission Guidelines:

> "4.16 A third consideration is the timescale within which the effects of any remedial action will occur. Some remedies will have a more or less immediate effect while the effects of others will be delayed. There may be particular uncertainty about the timescale within which results can be expected when the remedy calls for action by some other person, for example a recommendation to government to change regulations. The Commission will tend to favour a remedy that can be expected to show results in a relatively short time period – so long as it is satisfied that the remedy is both reasonable and practicable and has no adverse long-run consequences.
>
> 4.22 In deciding what remedy or remedies would be appropriate, the Commission will first look for a remedy that would be effective in dealing with the adverse effects on competition of the market features rather than seeking to deal with any detrimental effects on customers. Clearly, what type of effective action to increase competition can be taken will depend on the nature of the feature or features concerned. For example, if the feature was a widespread practice of recommending resale prices in a market with plenty of suppliers, it is likely that competition would be stimulated, either between those suppliers or between their (retail) customers, or between both, by a remedy that prohibited the practice.
>
> 4.23 In looking for remedies that would be likely to increase competition in the relevant market(s), the Commission will give attention to the time period within which the remedy can be expected to show results. If the remedy is not likely to have speedy results, the Commission may choose an alternative remedy or implement additional remedies such as those to remedy the detrimental effects on customers during the interim period. Otherwise, not only might there be uncertainty as to whether the effects would ever materialise, but in the meantime customers would continue to suffer from the consequences of the adverse effects on competition."

148. Mr Roth did not shrink from this: whilst the test would have immediate preventative effect to stop new concentrations emerging or the strengthening of existing strong positions, its de-concentrating effect in respect of existing highly-concentrated markets would, he said, be much longer term than, for example, a divestiture remedy. The speed would depend on the dynamism of the market. If economic conditions over the next few years led to more rapid expansion in grocery retailing then the de-concentrating effect of the competition test would work more quickly. If, on the other hand, expansion was slower, the test would work more slowly.

149. Mr Roth accepted that in this regard the Commission was departing from its own Guidelines, in the sense that the Commission Guidelines tended to favour immediate short-term remedies as opposed to longer term ones. However he did not accept that the Commission's approach here was inconsistent with the Commission Guidelines, which incorporated the ability to depart from it where this was considered appropriate. This flexibility was clearly set out in paragraph 1.4 which states:

> "In addressing the questions the Commission must consider in respect of references made under sections 131 and 132, a group will have regard to this guidance and will apply such of the methodology and analysis summarised in it as it considers appropriate. However, the Commission will consider each reference with due regard to the particular circumstances of each case including the information that is available and the time constraints applicable to the case. Accordingly, whilst aiming to use a systematic approach to investigations, the Commission will apply the approach described in this guidance flexibly and may, if it considers it appropriate to do so, depart from that approach." (footnotes omitted)

150. Tesco's complaint is not that the Commission departed from its guidance by selecting a longer term remedy as opposed to a more immediately effective one, but by failing to give any proper consideration to the questions of timescale or indeed effectiveness generally. As we have said, the Report contains none of the specific consideration of these matters which one would have expected to see in a report as detailed and painstaking as this. This is surprising given in particular that the test, if implemented, would in principle be capable of having profound, widespread and indefinite effects on businesses and customers alike in the grocery sector. Yet the Report does little more in this regard than record the Commission's belief that the package of remedies proposed will eventually "address" the AEC.

151. Mr Roth made two main points in response to this criticism.

152. First he submitted that there was no need to attempt to assess or quantify the effectiveness of the test, including the time scale thereof, any more than the Commission had done. This was because the annual cost of imposing the test was only £6-8 million as found by the Commission. Those costs would be exceeded by annual "benefits" once 30 out of the existing 495 highly-concentrated markets had been de-concentrated by new entry. (The mathematics is not controversial and

results from multiplying 30 by £300,000 which is the annual additional profit estimated by the Commission to be earned by a store which faces weak, or no, competition.) Moreover, that did not take into account the customer detriment arising from the national as distinct from the local effect of the AEC, nor any benefit derived from the test's preventative role. Although the speed at which the process of de-concentration took place would depend upon the rate of activity of the large retailers, once the test had bitten in only 30 areas in that way the annual costs would be covered. Given that competition in the grocery sector is generally vigorous, Mr Roth submitted that it would have been unreasonable for the Commission to conclude that the benefits would not outweigh the costs. Mr Roth accepted that had Tesco been able to persuade the Commission that the annual costs of imposing the test were in the order of £180 million, that might have made the Commission reconsider the question of proportionality. But that was not the Commission's conclusion on the extent of the costs.

153. We make the following comments on this submission.

154. First, Mr Roth's reliance on the annual costs of imposing the test being limited to £6-8 million may be called into question by the Tribunal's conclusions in respect of Tesco's Ground 1, namely that the Commission failed to give proper consideration to the risk of "economic costs" or welfare losses to customers. Had this risk been properly considered then additional elements, whether in quantitative or qualitative terms, may have arisen on the debit side of the proportionality balance, and may have led the Commission to feel less confident as to where the balance lay as between cost and benefit, so as to require a detailed investigation of the latter. If (as Mr Roth accepts is a distinct possibility) the test will only be effective in dealing with the existing AEC over a period of several years, the advent of some or all of the anticipated benefits in terms of stronger competition and better retail offering will be delayed, and the welfare "costs" to customers will continue, in that they will have to wait correspondingly longer for store developments to replace the ones blocked by the test.

155. A second problem with the submission is that the Report does not express a view about the ripeness for new entry/de-concentration of even a single highly-

concentrated local market. Why should it then be assumed that 30 such markets would, thanks to the test (in combination with the other remedies), become de-concentrated within a short order or even within a reasonable time? The matter is not discussed in the Report and no relevant findings are made.

156. We do not consider that Mr Roth's first point justifies the absence of any proper assessment or consideration of the effectiveness (including time scale) of the test.

157. Mr Roth's second point in answer to Tesco's criticism is that the Commission could not in any event have estimated, in any useful sense, the benefits flowing from the test. In this regard Mr Roth directed his submissions to both the test's role in reducing the existing AEC and to its preventative role. Mr Green, however, made clear that Tesco's argument related only to the Commission's failure to estimate the test's effectiveness in the former role, as it was to the existing AEC that the main thrust of the Report was directed. As far as concerned the preventative role, Mr Green accepted that the test would have some effect in preserving the status quo.

158. Mr Roth summarised the Commission's objections to attempting to measure the test's effectiveness in either of its roles as follows. The market in question is dynamic: it is changing all the time as existing stores expand and new ones are built; there are store closures and replacements. Such changes alter the isochrone which the Commission used to measure concentration in local markets. A new store means a new isochrone and also changes market share percentages as well. One can get a snapshot of the position at any given time, but it is constantly in flux. Similarly, retailers' store development plans, which could be obtained, are not set in stone: they are subject to revision as economic and market circumstances alter. Thus one cannot tell where a particular retailer would choose to site a new store in the future either with or without the competition test. Historic data cannot form the basis of any sensible estimate of the effect of the test. The test and the other remedies will create a new dynamic. Much of the information which would be needed to determine whether a retailer might be interested in developing a particular site would be confidential. Sampling particular local markets would be possible but would not tell one anything about other local markets. Any numbers arrived at on this basis would be meaningless.

159. As seen, this is strongly disputed by Tesco, which filed evidence suggesting how a useful measure of the effectiveness of the test could have been estimated reasonably straightforwardly on the basis of data published in the Report, together with other information collected by the Commission in the course of its inquiry or easily obtainable. Tesco claimed that some aspects of the benefits could have been assessed quantitatively without difficulty, and other aspects of the Commission's assumptions could have been the subject of qualitative insights or sensitivity tests. It was suggested that these estimates would have been far simpler to complete than many of the other empirical pieces of work carried out by the Commission, such as its margin-concentration analysis. A schedule produced by Tesco during the hearing identified the information in the possession of, or obtainable by, the Commission which would have enabled such an estimate to be made. The information referred to is very detailed on each of the highly-concentrated markets which have resulted in the AEC, and on each of more than 1,300 land sites across the country. The latter data were continually updated with new information and included, in respect of each site, the product of two interviews with each of the four largest grocery retailers to discuss on a case-by-case basis the latest information on the site, its history, future plans for the site and other specific matters.

160. The Commission responded to this evidence in its skeleton argument, and also provided us with a response to Tesco's schedule after the hearing had ended. The essence of the response was that all the information referred to by Tesco was historical and as such could not provide a sound basis for estimating how effective the test would be once the various remedies were imposed. It reiterated the problems and uncertainties of estimating future events in a changed environment, and also made the point that to carry out the kind of exercise envisaged by Tesco would have been difficult within the time constraints, as full consideration of a possible competition test arose only after the Commission reached a provisional view that there was an AEC. Just identifying the markets which were highly concentrated had taken about 9 months with the aid of outside consultants.

161. We do not set out the parties' rival submissions on this issue in full because we do not consider that it is either necessary or appropriate in this case for the Tribunal to decide whether or not the Commission is right in saying that no useful estimate

could be made of the effectiveness of the test, including the time scale within which it could be expected to introduce more competition into concentrated markets. The fact is that none of the Commission's arguments against attempting any real estimate of the likely benefits of the test appear in the Report. They have been produced in a forensic context. As we have said, all the Report contains are bald and general statements of the Commission's belief in the test's eventual effectiveness, such as those in paragraphs 11.268 and 11.377. There is nothing to indicate that in considering proportionality and answering the statutory questions the Commission has taken account of the fact that it has felt itself unable to make even a rough estimate of when and by how much the competition test itself and/or the package of remedies will make an inroad into the existing AEC.

162. If the Commission is right in what it now says about the impossibility of making any kind of estimate, this itself is a factor of which account would need to be taken in the balancing exercise which it carried out. Yet there is nothing in the Report to suggest that the Commission has taken account of it. Instead the Commission seems simply to have based its proportionality assessment on an assumption that the whole of the estimated customer detriment would be remedied by the test, in combination with the other remedies (see paragraph [140] above). There is in the Report no recognition or weighing of the now-acknowledged possibility that the existing AEC might not be satisfactorily remedied or mitigated for many years.

163. Whilst the precise methodology adopted for assessing these matters, and the weight to be attributed to the results of such assessments are (subject to rationality or questions of law) likely to fall within the margin of appreciation of the Commission, the assessments and the weighing must take place.

164. We have considered whether the fact that the competition test is likely to have some immediate effect in achieving its "standstill" aim means that the Commission did not need to examine the test's effectiveness in its de-concentrating role. However we have concluded that this is not an answer to the problem. Although the latter role is not put at the forefront of the Report's exposition of the objectives of the test, and it is the standstill role which is there emphasised, we have already stated that it is possible to read the Report as allocating to the test an additional role in helping to

break down existing concentrations. Further the Commission has in the course of these proceedings unequivocally held out the test as being intended to fulfil an important function in that regard, and has strongly argued that such aim can be identified by reference to the Report. In these circumstances we do not believe that the test's effectiveness in that role can be regarded as incidental or insignificant, and therefore as not demanding appropriate consideration within the statutory framework, including the proportionality analysis.

165. For these reasons we are unanimously of the view that the proportionality analysis in the Report is flawed in this further respect, and that, as with Ground 1, this omission is not of a trivial nature so as to be incapable of affecting the Commission's decision with respect to the proportionality of the test and the statutory questions in section 134(4). Although it does not affect our analysis, we should perhaps also record that the effectiveness of the measure (including the likely time scale) is in our view a material consideration in its own right. In other words, just as the costs involved in implementing the test were relevant to the Commission's decision generally as well as specifically in relation to the proportionality exercise, the same applies to the effectiveness of the test.

166. Tesco's third complaint under Ground 2 was that although it does not challenge the finding of an AEC by way of the margin-concentration study, the Commission's proportionality analysis did not take into account the lack of robustness of the AEC that it had found at the local and national level. In particular Tesco argues that it was clear that, in the light of the conflicting evidence before the Commission, there were material uncertainties as to the existence of the AEC which should have been weighed. Tesco also relied upon the Provisional Decision on remedies: background and overall assessment, where the Commission, at paragraph 22, stated that it did "not consider [store divestitures] to be supported by the strength, *robustness* and scale of the AEC we have found at the local level in the relevant areas." (emphasis added). Tesco submitted that the uncertainties inherent in the Commission's finding of an AEC should have been taken into account, and the alleged benefits of the competition test discounted accordingly.

167. Mr Green did not develop this point at all at the hearing, and indicated that it was a relatively small, legal point which, although Tesco did not abandon it, he was happy to leave it as it stood in his skeleton argument.

168. In the Tribunal's view this aspect of Tesco's challenge is misconceived. The Commission made a clear finding of AEC in the Report, and expressed itself satisfied that the finding was robust (see paragraph 6.55 of the Report, and Appendix 4.4, paragraph 19). That AEC finding is expressly not challenged in these proceedings. Moreover, in the Report the Commission explained in some detail why it had decided to place limited weight on the results of the GfK NOP and Tesco studies (which cast doubt on the AEC), and to rely instead on the margin-concentration analysis. The reference in the Provisional Decision on remedies to "strength, robustness and scale of the AEC" (see paragraph [166] above), does not appear in the Report, which has instead "gravity and prevalence" (see paragraphs 11.267 and 11.268). There is force in the Commission's point that Tesco's argument in this respect amounts to an attempt indirectly to challenge the AEC finding and the margin-concentration analysis on which it is based – indeed some of the economic evidence filed by Tesco was expressly to the effect that the margin-concentration analysis was fundamentally flawed. At any rate, in the light of the unequivocal and unchallenged finding of AEC the point falls away.

IV. EFFECT OF THIS JUDGMENT

169. It is important to set out the scope of our unanimous conclusions.

170. We have *not* concluded that a competition test, whether in the form proposed or in any other form, would be ineffective as a remedy for the AEC which the Commission has identified, nor that such a test would be unreasonable, disproportionate or otherwise inappropriate or unlawful. Our conclusions do not preclude the possibility that the test would ultimately be lawfully recommended by the Commission and implemented.

171. We have concluded that the Commission, in the Report, has failed properly to consider certain matters which are relevant to its recommendation that the

competition test be imposed as part of a package of remedies to address the existing AEC. None of the matters in question can, in our view, be dismissed as incapable of affecting the Commission's recommendation in that regard.

172. These deficiencies in the Report's analysis, although material, are within a narrow compass, and leave the vast majority of the Report and its findings unimpugned.

173. We will invite the parties to address us on the question of specific relief pursuant to subsection 179(5) of the Act once they have had an opportunity of considering this Judgment. We are mindful that the Report will not be the last word on the merits or otherwise of the competition test. The relevant aspects of the Report constitute a recommendation to Government and the devolved administrations. If such a recommendation is to be implemented, it will be subject to further consideration and impact assessment as part of the legislative process.

The President Graham Mather John Pickering

Charles Dhanowa
Registrar Date: 4 March 2009