Response to submissions

1. The Spar Group Limited (Spar) has reviewed the various stakeholders’ submissions on the subject matter of the grocery retail sector market inquiry (the Inquiry), which have been published on the Commission’s website. Spar wishes to respond to certain of the issues raised in the stakeholders’ submissions by way of the comments set out below. This response constitutes a supplementary submission that is to be read with Spar’s initial submission dated 19 August 2016 (the Initial Submission).

2. Given the short time that it has had to consider the other stakeholders’ submissions, this response is by no means exhaustive and Spar reserves the right to respond more fully at a later stage.

Exclusive lease agreements

3. A number of the stakeholders’ submissions address the issue of exclusivity clauses in leases, which falls under the second objective identified by the Panel in the Statement of Issues.¹

4. The Initial Submission addresses the role of exclusive lease agreements in the context of Spar’s operations, and also presents Spar’s view on the effect of such arrangements.²

5. To the extent that the other stakeholders’ submissions differ from the views expressed by Spar in the Initial Submission, Spar wishes to re-iterate these views.

6. Spar believes that exclusive lease agreements are only likely to be problematic where the party in whose favour exclusivity is granted is dominant and where barriers to entry are high. Even in these instances, the impact of the particular exclusivity arrangement should be assessed to ascertain whether it substantially prevents or lessens competition.

Restriction on time period

7. Certain stakeholders have proposed the implementation of a time restriction on exclusivity clauses in lease agreements, in order to counteract the barrier that these arrangements are perceived to present

¹ See for example the Woolworths submission at para 5.2.2.2, the Massmart submission at para 4 and the Das Naar submission at page 2.
² Initial Submission para 36.
to new entrants.\footnote{Woolworths submission at 5.2.2.2; Das Nair at page 2.} The proposals recommend that a maximum duration of, for example, five years be prescribed.

8. In its submission, Woolworths states the following:

8.1 "Exclusivity clauses should therefore only endure for as long as is necessary to recover a retailer’s initial investment and for no longer than five years. However, such time limits should not apply to the period of a lease (including renewals), as well as usage and tenant mix clauses, since these do not constitute an outright restriction on entry or expansion."\footnote{Woolworths submission para 5.2.2.2.}

9. As explained in the Initial Submission, Spar is a wholesaler and distributor of groceries. The stores that bear the Spar brand are retailers that in the vast majority of cases are independently owned and operated. As a result, many of the leases for the stores are held independently rather than by Spar.\footnote{Initial Submission para 51.} It is these independent parties – who operate their own stores and hold their own leases – that are required to make an initial investment (generally between R5 million and R20 million) in order to establish a store.

10. For these independent retailers, the initial investment is significant and their livelihoods depend on being able not only to recoup the initial capital amount, but also to continue to earn a sustainable return from that store.\footnote{Initial Submission para 4, 56.} This is particularly so when the independent retailer (i) holds a long term lease agreement (commonly ten years) with an obligation to pay rental whether or not the store is profitable; and (ii) has little prospect of selling the business if the store is not profitable. This stands in contrast to the operating models of the large retail chains (such as Woolworths, Pick n Pay, Shoprite and Massmart), who predominantly own and operate corporate stores. The initial investment in setting up a corporate store is made by the group and the risk therefore resides at a group level. Large retail chains are able to absorb this risk by taking advantage of diverse income streams and cross-subsidizing stores that may be operating at a loss for a period of time.\footnote{Initial Submission para 56.2.}

11. Were it to be accepted that a time limit on exclusivity clauses as suggested by Woolworths should be imposed (which Spar submits should not be the case), it would in any event only be appropriate to apply such a limit to corporate stores owned and operated by the large retail chains. It would not be appropriate to apply such a limit to stores that are independently owned and operated, including those within the context of a voluntary trading association, such as Spar. Indeed, a restriction on exclusivity clauses in respect of these stores would itself act as a barrier to entry for independent retailers.\footnote{Initial Submission para 57.}

12. Support for the above position may be drawn from the approach taken to exclusivity clauses in other jurisdictions (to which certain stakeholders have referred).\footnote{Das Nair at page 2.} In the United Kingdom, for example, restrictions on exclusivity arrangements apply only to specified exclusivity arrangements in respect of corporate stores that are controlled by certain identified large retail chains.\footnote{The Groceries Market Investigation (Controlled Land) Order 2010.}
Impact in rural areas

13. Das Nair submits in her submission that exclusive leases have a particularly negative effect on entrants into shopping centres in rural areas.\(^{11}\) No evidence is provided in support of this conclusion. Furthermore, this is contrary to Spar’s experience of the market, given, \textit{inter alia}, the availability of land in rural areas on which alternative malls and/or stores could be established.\(^{12}\)

Status of Massmart litigation

14. Paragraph 4 of the submission by Massmart deals with exclusivity clauses in lease agreements. Massmart records developments with regard to its complaints about exclusivity clauses in leases. In summary the position is as follows:

14.1 on 31 October 2014 Massmart lodged a complaint with the Commission against Shoprite, Pick n Pay and Spar;

14.2 on 12 May 2015 the Commission issued a Notice of Non-referral of Complaint which stated that having completed its investigation the Commission gave notice that it would not refer any part of the complaint to the Competition Tribunal (the\textit{ Tribunal});

14.3 on 9 June 2015 Massmart referred its complaint directly to the Tribunal in terms of section 51(1) of the Competition Act, 89 of 1998 (the\textit{ Act});\(^{13}\)

14.4 after the self-referral was filed all three of the respondents filed exceptions and Spar filed a stay application (which was supported by Shoprite),

14.5 the exceptions and the stay application were opposed by Massmart; and

14.6 argument was heard by the Tribunal in respect of the exception and stay applications on 26 and 27 July 2016.

15. At the stage that Massmart made its submission (apparently on 29 August 2016) the Tribunal had not yet handed down its decision and order. The Tribunal has now done so. The Reasons for Decision were issued on 1 September 2016.\(^{14}\)

16. Spar had filed the stay application to stay Massmart’s self-referral for a temporary period pending the finalisation of the Inquiry which will investigate the issue which is central to Massmart’s self-referral. Spar is of the view that Massmart’s self-referral overlaps with the Inquiry and it would have been in the interests of justice to stay Massmart’s self-referral.

17. The Tribunal dismissed the stay application. The Tribunal noted that by implication the Commission was content to allow Massmart’s self-referral to unfold at the same time as the Inquiry. The Tribunal referred to its test which has three requirements, namely: (i) whether the applicant has reasonable prospects of

\(^{11}\) Das Nair at page 2.
\(^{12}\) Initial Submission para 59.
\(^{13}\) A copy of the self-referral is attached to Massmart’s submission as Annexure “H”.
\(^{14}\) The Reasons for Decision are available on the Tribunal’s website on the Decisions / Procedures page.
success in the parallel proceedings, (ii) whether it is in the interests of justice to stay the proceedings, and (iii) where the balance of convenience lies.»

18. The Tribunal applied this test and determined that:

18.1 as the outcome in the Inquiry is recommendatory in nature, and as the issues in Massmart’s self-referral and the Inquiry are not the same, nothing decided by the Inquiry would be definitive of the issues raised in Massmart’s self-referral, and accordingly the Tribunal found that Spar had failed to meet the “prospects of success” requirement;

18.2 as the two processes are different, the Inquiry providing recommendations and the Tribunal having adjudicative powers over complaint proceedings, there is no danger of conflicting findings and institutional comity does not arise (and accordingly it was apparently not “in the interests of justice” to stay the proceedings);

18.3 as the issues to be determined by the Inquiry and the Tribunal are not the same there will be no duplication of efforts and accordingly the “balance of convenience” did not support a stay application.

19. The Tribunal partially upheld the exception applications. The Tribunal found that it was not necessary to definitively make a finding on some of the grounds of exception due to the fact that Massmart would have to revise its self-referral (as a result of the upheld grounds of exception) and in that process the grounds of exception on which it did not make a finding may be removed.

20. At a high level the Tribunal considered the exceptions as applying to Massmart’s self-referral in so far as it relates to sections 8 and 5 of the Act. In the Reasons for Decision the Tribunal noted that Massmart had on the second day of the hearing of the matter on 27 July 2016 abandoned its opposition to the exceptions in so far as they related to Massmart’s self-referral based on section 8 of the Act. In other words, Massmart conceded that the self-referral did not make out a proper case to establish that:

20.1 Spar, Shoprite and Pick n Pay were dominant; and

20.2 in regard to exclusivity clauses in leases, Spar, Shoprite and Pick n Pay had engaged in an abuse of dominance.

21. As a result of Massmart’s concession, and certain exceptions not being pursued, the Tribunal was left to consider the exceptions in so far as they related to the part of the self-referral based on section 5 of the Act. The Tribunal noted that the essence of the objections concerned the manner in which the market had been defined by Massmart in its self-referral. The Tribunal noted that during the hearing Massmart set out a particular definition of the market, but the question was whether that market definition was to be found in Massmart’s self-referral, and if it was, did the use of that market definition found a proper complaint. The Tribunal found that the criticism that Massmart’s self-referral was vague and embarrassing had substance.

22. The Tribunal partially upheld the applications for exception, gave Massmart leave to amend its referral affidavit within 40 business days, and ordered that Massmart pay Spar, Shoprite and Pick n Pay’s costs.

» Novartis SA (Pty) Ltd v Main Street Ltd (2) 22/CR/B/June01.
The 40 business day time period expires on 27 October 2016 and Massmart's revised self-referral is expected by that date.

23. Spar will only be in a position to substantively respond to Massmart's complaint relating to exclusivity clauses in leases once Massmart has properly referred a complaint to the Tribunal.

Exclusivity clauses and the Massmart Supplier Development Programme (SDP)

24. In its submission, Massmart cites exclusivity clauses as a factor contributing to the lack of progress that it has had in developing its local farmers and other members of the supply chain through the SDP.\(^\text{12}\)

25. Spar understands that the lack of success of Massmart's direct farming initiative is the consequence of the trading conditions that were imposed by Massmart on local farmers, who attempted to participate in the fund. For example, farmers supplying Massmart have been required to sell produce at a price that is below the average price prevailing in the market. Conditions such as these, imposed by the retailer itself, create a trading environment that is not sustainable for farmers and appear to be the true cause of the lack of progress (rather than exclusivity clauses in lease agreements).

Buyer power

26. Spar's Initial Submission also addresses the issue of buyer power.\(^\text{13}\) Spar re-iterates the points made in the Initial Submission, which are supplemented as set out below.

Spar differentiated from large retail chains

27. As has been canvassed both in the Initial Submission and in this response, Spar operates using a different model from the other large retail chains.\(^\text{14}\) Spar itself is a wholesaler and distributor, with each of its distribution centres able to negotiate its own terms with suppliers.\(^\text{15}\) In addition, the vast majority of Spar stores are owned by independent retailers. There may be material differences in how these stores are run, including in their relationships with suppliers.

28. Therefore, neither Spar as a group nor its stores operate vis-a-vis suppliers in the same way as the large retail chains.

Spar's own supplier relationships

29. Spar does not believe that it has the ability or incentive to either exclude its grocery retail rivals or impose unfair conditions on suppliers.

30. Spar also does not co-operate with other retailers in order to achieve these outcomes. It is, therefore, incorrect to consider the "big 5" as a block that exerts power as one in order to influence suppliers.\(^\text{16}\)

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\(^{12}\) Massmart submission para 5.1.9.

\(^{13}\) Initial Submission para 83.

\(^{14}\) Initial Submission para 9, B4.

\(^{15}\) Initial Submission para 84.

\(^{16}\) As is submitted by UMS in its submission at page 7.
31. None of Spars distribution centres has exclusive agreements with suppliers, including in relation to Spar branded products. The preference is to use small suppliers in respect of Spar branded products.21

32. Furthermore, as mentioned in the Initial Submission, there are legitimate cost advantages that arise from Spars centralised distribution centres that are easily accessible to independent retailers through membership of the Spar voluntary trading association.22 Even as members, independent retailers remain free to procure elsewhere.23

*Buyer power operates as a check on suppliers to the benefit of consumers*

33. As a large buyer of groceries in South Africa, Spar uses its significant buying volumes to seek out the best possible prices for consumers in order for Spar to be able to effectively compete with other grocery retailers. In doing so, Spar (and Spars rivals) are consumers best means of limiting upstream market power among the grocery manufacturers, and indeed the best means of disrupting any co-ordinated conduct that may exist upstream among grocery suppliers.24 25

*Growth of small independent stores*

34. Certain stakeholders submissions (and particularly that of UMS) emphasize the challenges that are faced by smaller, independent retailers.26

35. In this respect, it must be noted first that Spar itself constitutes a network of independent retailers, which is not comparable to a large retail chain operating a number of corporate stores. The position that Spar occupies today is a result of 50 years of growth, during which independent stores established under the Spar name each had to contend with largely similar market conditions to those that prevail today.

36. Second, contrary to the impression created by certain of the stakeholders submissions, the grocery retail industry is currently experiencing much greater growth in independent retail stores than in established networks or large retail chains. This is likely due to the market for large retail chain stores becoming comparatively saturated, whereas there is greater scope for growth in areas that are suited to independent retailers. In any event, this growth is a strong indicator that the perceived restrictions on independent retailers supposedly created by the practices of the large retail chains, are not in fact inhibiting the entry and growth of these independent retailers in the market.

37. Spars top suppliers (including the likes of [REDACTED]) currently subscribe to a survey called ASK'D where each supplier submits its outbound sales to each wholesaler or retailer on a monthly basis. A supplier recently provided Spar with the overview from August and September 2016, extracts of which are attached hereto marked Annexure A. This data demonstrates that independent players, such as UMS and Choppies, are showing strong growth (stronger than that of Spar) over 12 months and over 3 months. In particular:

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21 Initial Submission para 84.
22 Initial Submission para 17.
23 Initial Submission para 17.
24 Upstream market power and co-ordination among grocery manufacturers has been identified in a number of cases that have come before the competition authorities, including among bread manufacturers.
26 UMS submission page 7.
37.1 UMS has experienced “basket growth” of [x] over the 12 months up to August 2016, and [y] over the 3 months up to August 2016. By contrast, Spar experienced growth of [z] and [w] during the same periods respectively.

37.2 This growth is even greater for the 12 and 3 month periods up to September 2016, during which UMS experienced growth of [a] and [b] respectively. Spar experienced growth during these same periods of [c] and [d] respectively.