THE UK EXPERIENCE: THE GROCERY SUPPLY CODE OF PRACTICE*

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Abstract: *This paper deals with one aspect of competition in the supply of grocery products, namely the relationship between grocery retailers and their suppliers, and focuses in particular on the new UK Grocery Supply Code of Practice, known as the "GSCOP".*[1]

Summary: 1. Background. 2. Suppliers and Retailers – what was the issue? 3. What the CC found. 4. The CC's Conclusion. 5. The GSCOP. 6. The Ombudsman/Adjudicator. 7. What happened then. 8. Why not use 'ordinary' competition law? 8. Conclusion.

1. BACKGROUND

One of the central functions of all economies is the task of ensuring the purchase or production of foodstuffs, their processing, distribution and sale to consumers.

In the UK, which has a well-developed agricultural sector but which also imports a significant proportion of its food,[2] the retail sector is also highly

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1 The Groceries (Supply Chain Practices) Market Investigation Order 2009.

2 UK imports of food, feed and drink in 2008 were £31.6 billion compared with exports of £13.2 billion. The UK is 59% self-sufficient in food. Source: DEFRA.

developed.[1] The focus of the UK competition authorities' interest in the groceries sector has over the past decade been on retailing, but supplier/retailer relationships have also been a concern.[2]

A recent major intervention was the market investigation conducted by the UK Competition Commission (CC) into Grocery Retailing.[3] This was made at the instigation of the UK Office of Fair Trading (OFT). It lasted more than two years and covered a wide range of retail competition issues, including planning and zoning restrictions, possible discriminatory or predatory pricing activity, competition at local level and the problem of highly concentrated local markets.

But one important strand of the inquiry was the supply chain. On one view, this should be an irrelevant issue for a competition inquiry – the main question was competition between retailers and how each retailer dealt with its suppliers was not important provided retail competition was effective. If a retailer obtained favourable supply terms, consumers would benefit and suppliers would become more efficient. It could not be in a retailer's economic interest to damage its own supply chain irretrievably.

The CC was very conscious of this view but decided to look at the issues in rather more depth.

2. SUPPLIERS AND RETAILERS – WHAT WAS THE ISSUE?

It was argued strongly by producers and suppliers, both domestic and foreign, that major retailers exercised their buyer power in a way that did damage the supply chain; this created uncertainty, if not outright harm, to producers and suppliers, particularly smaller ones. Smaller retailers and wholesalers claimed that it placed them at a competitive disadvantage.

There was said to be a 'climate of fear' under which suppliers, particularly smaller ones, declined to raise complaints against major retailers for fear of being punished commercially or, in an extreme case, being 'delisted' (i.e. excluded from supply) altogether.

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1 In 2007 large grocery retailers accounted for some 85% of total grocery sales and the four largest retailers accounted for just over 65% (up from 57% in 2002).

2 See for example the CC investigations into Supermarkets (2000), Safeway plc (2003), Somerfield/Morrison Supermarkets (2005).

3 CC Report April 2008, available on the CC website: www.competition-commission.org.uk.

The kinds of practice complained of included demands for payment for marketing campaigns, promotions or product placings; transfer of liability for loss or theft of goods; imposition of retrospective discounts and price changes; changes in credit terms and a host of others.

It was also claimed that not all the benefits obtained by retailers from suppliers were passed on to the consumer and were instead retained by the retailers.

The larger retailers' general response was that these complaints were ill-founded; they treated suppliers well and efficient suppliers would always prosper. Suppliers were rarely delisted, the 'climate of fear' was an exaggeration and any benefits were passed on to consumers.

3. WHAT THE CC FOUND

The CC found these issues to be complex and difficult. On the one hand there was some merit in the retailers' argument that some of these complaints simply reflected suppliers' inability or unwillingness to operate efficiently, and that the retailers were passing on price reductions to consumers.

On the other hand the volume of evidence of particular practices suggested there was some mis-match between the intentions and interests of the supermarket buyers, which were on the whole short term, and the longer term effect on consumers.

The CC received much evidence from retailers, from suppliers both large and small and from representative organisations including those representing primary producers overseas. It assessed data on entry and exit at producer level and the various data series on innovation. It held hearings with interested parties throughout the UK. To reflect the 'climate of fear' one set of witnesses offered to enter the building by a side door and in disguise.

Towards the end of the investigation two major retailers began a 'price war' claiming that they would bear the cost of the price reductions. To validate this claim the CC examined a large number of emails between the retailers and their suppliers sent over a six-week period. This provided an interesting insight into the day-to-day retailer/supplier interaction.

Another part of the retailers' argument was that the existing Code of Practice, which was observed by the four major retailers, was working satisfactorily and there were few complaints under it. This Code had been established following an earlier CC investigation, but had only been in place

a few years. The CC examined carefully the extent to which it was affecting supplier/retailer behaviour.

4. THE CC'S CONCLUSION

The CC concluded that whilst the existing Code of Practice was having some effect, a large number of the practices identified in its 2000 Report were still going on. The main concerns were in relation to unexpected, retrospective changes to price terms that were already in place and the inappropriate placing of risk on to suppliers by retailers.

An example of the former was the retailer's practice of cutting the price to the supplier after the event if the retailer could not sell the produce it had bought – leaving the supplier with an unexpected liability. An example of the latter was a retailer requiring the supplier to bear the cost of loss or theft of products (known as 'shrinkage') from the retailer's premises, over which the supplier had little control.

The CC did not find evidence of current and immediate harm to consumers from these practices. But it did find that if they went on unchecked they would lead to increased uncertainty, reduced investment and damage to the viability of UK food supply and detriment to consumers. The CC concluded that a new, strengthened Code of Practice was needed, to apply to more retailers, with a proper enforcement mechanism and oversight by a dedicated officer – i.e. an Ombudsman.

These conclusions were not uncontroversial. It was argued by major retailers that controlling the supplier/retailer relationship was futile and possibly harmful; that consumers would pay higher prices as a result; and , somewhat contrarily, that the existing Code of Practice worked well and did not need strengthening. Despite these objections to the CC's conclusions, no appeal was brought against them.

5. THE GSCOP

The UK System gives the CC direct competence to enact on its own authority measures to correct the adverse effects on competition that it has found. So the CC, after consultation, made an Order to provide for a new Code of Practice – the GSCOP.[4]

4 The CC consulted on drafts of the GSCOP Order on 26th February 2009 and 29th June 2009 and issued a final version of the Order on 4th August 2009, to take effect six months later, on 4th February 2010.

The essential outline of the GSCOP is as follows: the main thrust of the new Code is to cover more ground than before, to be more specific in its terms and to apply to more retailers. 'Designated Retailers' are those whose grocery annual turnover exceeds £1 billion and now covers some dozen companies rather than four.

The Order provides for compliance and training obligations and for the provision of information both to suppliers and to the OFT. At its core is the obligation on retailers to incorporate the Code of Practice into their supply agreements, which is the mechanism by which the Code is to be applied.

The specific terms of the Code provide:

1. A general obligation of fair dealing (not provided by UK common law);
2. A ban on retrospective variations of supply terms;
3. Limitations on changes to supply procedures;
4. Prompt payment of supplier invoices;
5. Limitations on suppliers' contributions to retailers' costs;
6. A ban on supplier payments for 'shrinkage' (i.e. theft or loss of food, at the retailer's store);
7. A ban on supplier payments for 'wastage' (goods being unfit for sale) unless specifically due to the supplier's negligence or fault;
8. Limitations on payments for stocking;
9. Compensation for retailer forecasting errors;
10. Limitations on arrangements involving third parties;
11. Limitations on supplier payments for promotions;
12. No unjustified supplier contributions to resolving consumer complaints;
13. A transparent procedure governing the de-listing of a supplier should that be justified.

This is a detailed package of measures with far fewer qualifications and 'let-outs' than the previous Code. But the question was, how could it be enforced? If the 'climate of fear' was indeed as claimed, then these provisions, as with the previous version, risked being a dead letter.

6. THE OMBUDSMAN / ADJUDICATOR

The CC concluded that private enforcement of the GSCOP was better than nothing, but that oversight and a mechanism for enforcement were needed. It therefore proposed the establishment of an 'Ombudsman' to receive complaints and follow them up in a way that would not expose the complainant

to retaliation, and who could enforce complaints with the GSCOP if a breach was established.

The CC is not a tax-raising authority and such a mechanism would require legislation – indeed, primary legislation approved by Parliament – if the voluntary agreement of retailers was not forthcoming.

Again the CC consulted extensively: but the retailers involved would not agree.[5] Equally, supplier organisations were concerned that concessions offered to retailers to make them agree would make the Ombudsman ineffective. So in August 2009, the CC made a formal recommendation to the Government to enact legislation to establish an Ombudsman to oversee and enforce the GSCOP.

7. WHAT HAPPENED THEN

The Government is committed to responding to CC recommendations. In this case, the approach of a general election was a complication but in January 2010 the then Government accepted the recommendation in principle and consulted on aspects of its implementation. This included a) whether the new body should be part of or outside the OFT and b) whether it should have the power to impose penalties.[6]

The general election produced a new coalition government which, after some delay, again endorsed the recommendation (although the 'Ombudsman' had become the 'Adjudicator') and tabled a draft bill in May 2011.[7] Its terms were examined by the appropriate Select Committee over the summer and the Committee recommended recently that the Bill should proceed, with a few variations.[8] These are essentially that the Adjudicator should be able to have greater access to trade associations and employee whistle-blowers, and that the cost of the Adjudicator should be paid for by a flat-rate imposition on the retailers affected.

5 A draft set of undertakings was published on 28th April 2009.

6 The Government Response: January 2010 URN 10/519. Consultation: February 2010 URN 10/577.

7 Draft Groceries code Adjudicator Bill Cm 8080 May 2011.

8 See House of Commons, Business, Innovation and Skills Committee Announcement no73 and Ninth Report of Session 2010-12 'Time to bring on the referee?' 28th July 2011 HC 1224-1.

8. WHY NOT USE 'ORDINARY' COMPETITION LAW?

The question arises, why does the situation require a Code of Practice? If, as we have argued, inappropriate treatment of suppliers by retailers is a competition issue with potential adverse effects on consumers, then why do not Articles 101 and 102 apply to control the practices that are unacceptable?

The answer to this is that of course they do apply, but they are a blunt and rather ineffective instrument in this particular situation.

There have of course been allegations of cartel behaviour by retailers extending to their relationships with suppliers. The OFT began an investigation into these allegations – possibly arising from the CC's own investigation – in April 2008 but did not in the end pursue the case.[9] One problem is that it is not necessarily collective or co-ordinated activity which is the issue but rather the practices of individual retailers towards their suppliers. Where the activity is collective it tends to involve suppliers as well as retailers.

In relation to Article 102, such practices fall under the general heading of abuse of buyer power. But whilst it may be possible to show a retailer holding a dominant position in a particular instance, it is harder to establish any general position of dominance (given that in the UK there are four major retailers and many smaller) and equally hard to establish reliably what is or is not an abuse.

Given these limitations, the more general view possible under the UK market investigation regime is particularly appropriate for cases of this kind.

9. CONCLUSION

So that is the UK experience which has led to the GSCOP and may be expected to lead to the establishment of an Adjudicator's office to oversee it. The conclusions I would draw from this exercise are these:

1. The view that competition law should not apply to retailer/supplier relationships is doctrinaire and misplaced. It is true that the UK market investigation regime is particularly flexible in regard to possible measures, but the essential basis for the UK's measures is effect on competition and effect on consumers.
2. That said, deciding what to do in cases like this is fraught with difficulty as any measures, to be effective, have to control the operation of the

9 See OFT case closure summary 9th November 2010.

buyer/seller relationship in a variety of market situations. For that reason, any Code of Practice has to be carefully crafted and evidence-based i.e. to control specific practices that have been identified as harmful.

3. Although the terms of any Code are important (bland or general provisions are largely worthless) it is the enforcement mechanism that really matters. It must be seen as credible, and suppliers, particularly smaller ones, must be willing to come forward. Providing a means of investigating complaints whilst preserving a sufficient degree of anonymity is the key to the success of these measures.
4. Any measure that requires political agreement takes time to enact, and requires great persistence. Even now, some retailers argued to the Business Select Committee that the CC's 2008 Report was out of date and the issue needed to be investigated again. The Committee did not agree with this view.
5. Finally it would seem that a Code of Practice is preferable to the use of 'standard' competition prohibitions. This is not generally a situation where anti-cartel law is effective; and the application of Article 102 to the abuse of buyer power is cumbersome and problematic. But that does *not* mean that this is not a competition matter. It is just a question of what particular legal framework is available to deal with it.