



A body to monitor and enforce GSCOP

Response to BIS consultation, February 2010

SUMMARY

The British Brands Group strongly supports the setting up of a body to monitor and enforce the GSCOP as defined and set out by the Competition Commission (CC). This remedy resulted from an extensive two-year market investigation and is evidence-based. It balances the adverse effects on consumers of abuses of buyer power with the positive effects in relation to consumer prices.

- 1 The British Brands Group welcomes the opportunity to comment on the establishment of a body to monitor and enforce the groceries supply code of practice (GSCOP).
- 2 The British Brands Group is a trade organisation that provides the voice for brand manufacturers in the UK. Our members range in size and supply a variety of branded goods in a wide range of product categories. Many supply groceries (as defined by the CC) to supermarkets and rely on them for the efficient delivery of their products to consumers. The GSCOP and the way it is monitored and enforced is therefore directly relevant to our members.
- 3 The consultation document has been forwarded to members with an invitation to comment on the questions posed. A draft paper was then prepared and circulated to members for further comment, from which this response has been developed. This paper therefore represents the views of the British Brands Group.
- 4 The British Brands Group is a member of the Grocery Market Action Group, chaired by Andrew George MP, and we fully endorse the submission it has made to BIS.

5 INTRODUCTION

In responding to the questions posed, we adhere to the principle that the CC's remedy to the adverse effect on competition (AEC) it found is a strengthened code of practice monitored and enforced by an ombudsman. The CC assessed both the need for the remedy and its form, following an extensive two-year market investigation underpinned by evidence. We know of no further evidence that warrants a remedy that goes beyond, or falls short of, that considered by the CC.

- 6 We echo the Chairman of the CC's call for BIS to appoint an ombudsman as the CC envisaged as soon as practicable and are encouraged to see that all the main political party manifestos commit to the appointment of such a body.
- 7 We believe that to do so is firmly in the interests of consumers, for the reasons outlined by the CC (ie. providing greater levels of choice, quality, diversity and innovation). While we are encouraged by the Minister's view in the Foreword that he believes suppliers deserve a fair deal, this is not the purpose of the remedy. As we see it, the role of suppliers in the context of the GSCOP is to help the ombudsman (hereinafter "the body") ensure compliance with the GSCOP and thereby ensure this market works well for consumers, via the bringing of disputes, anonymous complaints and information.

8 **1. Should the body monitoring and enforcing compliance with the GSCOP be given all these duties and powers?**

Yes, as this is what the CC envisaged as the remedy.

9 **2. Are some of the activities more important than others, if so what are they?**

The activities which we consider particularly important to an effective remedy are:

- (1) the ability to receive complaints, in particular anonymously. We see this as crucial as we do not foresee the body being called upon to adjudicate many disputes;
- (2) conducting proactive investigations into GSCOP compliance, on the basis of complaints and information received from a wide range of sources;
- (3) making both specific and general recommendations to retailers on how to comply with the GSCOP and the remedial action required where non-compliance is found;
- (4) publishing guidance to grocery suppliers and retailers on all matters relating to the GSCOP and its effective functioning; and
- (5) issuing binding decisions, although we envisage this being in the last resort.

10 **3. Are there additional activities that should be considered, if so what are they?**

No. We believe that BIS should implement this aspect of the remedy as the CC envisaged.

11 **4. Are there some proposed activities that should be rejected, if so what are they?**

No. We believe that BIS should implement this aspect of the remedy as the CC envisaged.

12 **5. The body monitoring and enforcing compliance with the GSCOP will require information gathering powers to perform effective investigations. How general or specific should these powers be?**

Paragraph 11.364 of the CC's Final Report addresses this, stating that "retailers should be under a requirement promptly to provide such information to the Ombudsman as it requires for the performance of its functions". We support this scope for the body's information gathering powers and we further expect information to be provided from many other sources as well, including all suppliers and trade associations.

13 The body should have powers similar to those now exercised by the OFT in relation to suspected competition law infringements, including the power to formally demand documents and gather other written and oral evidence. Where requested evidence is not forthcoming or the body fears that evidence may be destroyed, it may also be appropriate for it to have powers to carry out on-the-spot investigations. Without the full remit of powers, there is a significant risk that the body will essentially be toothless.

14 **6. Where the body monitoring and enforcing compliance with the GSCOP takes a decision following arbitration or an investigation, the decision should be open to appeal. Who should hear the appeal?**

The CC in paragraph 11(8) of its Order states that “either party may appeal on the grounds set out in sections 67 to 69 inclusive of the Arbitration Act 1996”. This sets out that decisions may be appealed to the High Court.

15 **7. In considering the general principles that the body monitoring and enforcing compliance with the GSCOP should have regard to in the course of its work, should they last indefinitely?**

Yes, as long as the principles are helping to achieve the main aim of protecting the long-term interests of consumers and addressing the AEC.

16 **8. Are the suggested principles (paragraph 2.17, a-c) to be considered by the body monitoring and enforcing compliance with the GSCOP in carrying out its duties appropriate?**

Yes, they are appropriate and we would emphasise in particular that the Code should not consider other commercial elements of the Supply Agreement (paragraph 2.17(c)).

17 **9. Are the general principles too broad? Should they be made more specific? If so how?**

We consider the principles to be appropriate as drafted.

18 **10. Should the principles be set out in legislation?**

No, we do not consider the principles as worded to be appropriate for legislation, their value lying more in being good working guidelines for the body.

19 We however do see value in the objectives of the body being clearly set out in legislation and we suggest the following:

- ensure fair dealing between retailers and their suppliers;
- promote competition for the benefit of consumers;
- enforce the GSCOP including the investigation and determination of complaints and disputes under the Code;
- fulfil the purposes set out in the Recommendations of the CC to the Minister of State for BIS on 4th August 2009.

20 **11. Is there an existing body that could take on this role? If so who might this be?**

The CC envisaged that “The Ombudsman would ... be independent from the OFT and from all parties involved in any dispute.” (paragraph 11.338). An independent body is therefore the approach we strongly recommend.

- 21 We do not believe there to be an existing body that could take on this role within their current structure. The GSCOP provisions are very specific and require dedicated focus and resource from the body monitoring and enforcing it in order for the remedy as a whole to be effective.
- 22 In particular we do not believe the OFT could take on this role within its current framework. The OFT itself does not see this as desirable (see Memorandum accompanying Peter Freeman's letter to the Secretary of State, paragraph 3.4) and the role would be subject to its overriding prioritisation principles, undermining significantly its resource, focus, authority and effectiveness.
- 23 We do however believe that the body may be structured to fall under the umbrella of the OFT but in all substantial respects to be independent and ring-fenced. A potential model is the CRR Adjudicator which is a ring-fenced unit within OFCOM. Were the body to be such a ring-fenced unit within the OFT, it will be important for its credibility, authority and effectiveness to be as independent as possible. This means having its own premises, budget, working practices, targets, structure, manpower policies and crucially its own independent IT systems which will guarantee confidentiality. This will all help build confidence in the system both with retailers and with suppliers.

24 **12. What are the benefits or downsides of an existing body taking this role?**

The main benefit of an existing organisation taking on this role is one of public presentation, avoiding a new body being set up in the current tough economic climate. There may also be some cost savings through economies of scale although we believe these to be negligible, bearing in mind that the body needs to be essentially independent if it is to be effective.

- 25 The downsides relate to restrictions on the body's freedom to operate to achieve its objectives and the confidence it would engender amongst stakeholders, particularly suppliers. An existing organisation will have its own priorities and resources and will continue to allocate these as it sees fit in order to achieve its own overall objectives. Monitoring and enforcing the GSCOP is unlikely to be a key objective of any existing organisation, yet dedicated focus, resource and specialist expertise is required if the body's functions are to be executed well.

- 26 An organisation which is seen as unresponsive to and/or dismissive of input from suppliers will soon lose their confidence and potentially their co-operation, yet this input is crucial to the effectiveness of this remedy. This was to some extent the problem experienced with the Supermarket Code of Practice (SCOP).

27 **13. Is it important that a brand new body be created and are there strong arguments for or against this?**

We do consider it important that a new independent body be created but we are alert to the political challenge this presents in the current economic climate. A ring-fenced body within an existing organisation is therefore a possible solution, but it must be independent to all practical intents and purposes.

28 **14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?**

The levying of penalties is an essential role of the body as there would then be a demonstrable consequence of breaching the GSCOP, a deterrent and visible indicator of how seriously authorities regard such breaches. It is recognised however that levying penalties may involve more cost as they may give rise to appeals (although these are expected to be few and far between – see below – and would be defrayed by penalties) and operational complexity (with retailers disputing every point).

29 **15. If important, how should the penalties be levied?**

We suggest the body issues a formal decision requiring the payment of a fine. In the event of non-compliance, the body should refer the matter to the OFT for further enforcement.

30 **16. What levels should they be set at?**

The CC called on BIS to give the body powers to issue “significant monetary penalties” (paragraph 11.272). We assume that penalties must be significant to the retailer but the exact level will vary depending on the turnover and profitability of the retailer involved (what is significant to Aldi may not be significant to Tesco). We therefore consider it appropriate for the body to define this in light of each individual case.

31 Certainly penalties should be linked to the level of harm caused by any non-compliance, with appropriate increases to ensure the delivery of a deterrent effect. Aggravating factors such as repeated or flagrant breaches should result in further additional increases.

32 **17. Are there other deterrents that could be effective?**

Levying significant fines, though strong, is not in itself a complete deterrent. Certainly the threat of such fines was not sufficient to encourage retailers to give voluntary undertakings to establish the body as the CC originally hoped.

33 Risk of reputational damage, or “naming and shaming”, is a further potential deterrent and the CC provided the mechanism for this in requiring a summary of a retailer’s compliance report to be featured in its annual report or displayed prominently on its website (see GSCOP Order Notice paragraph 10(5)) and for the body to publish its own annual report to the OFT (Final Report, paragraph 11.271(e)). These are important provisions. We also suggest the body is not unduly constrained in spreading awareness of individual retailer’s compliance with the GSCOP, being able for example to send its annual report to bodies such as consumer organisations, ethical investors and the media.

34 Just as levying significant penalties is not a sufficient deterrent on its own, so the risk of reputational damage on its own is not sufficient. Retailers may be expected to counter any adverse publicity surrounding breaches of the GSCOP by shifting the focus to other more positive aspects of their behaviour and contribution to consumers.

35 A further deterrent present in the GSCOP itself is the requirement on retailers to compensate suppliers in certain circumstances eg. changing supply chain procedures (4(b)), forecasting errors (10(1)) and over-ordering promotional stock (14(1)).

36 An additional deterrent would exist were those retailers who provoke the greatest number of disputes and complaints and have the greatest number of these upheld be required to pay a greater proportion of the costs of the body. We believe this to be the correct way of allocating costs (see questions 24 and 25 below) although we suspect the deterrent effect of this cost allocation to be relatively small.

37 Finally, the body's powers to launch proactive investigations where breaches of the GSCOP are suspected, whether or not there has been a complaint, is expected to be a significant deterrent, underlining the importance of this aspect of the remedy.

38 **18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?**

We do not believe that legislation should go beyond the measures outlined by the CC to remedy the AEC it has found.

39 **19. Who should hear appeals?**

We suggest appeals are heard by the High Court.

40 **20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?**

No. While specific disputes may only be brought by direct suppliers (without the protection of anonymity), both direct and indirect suppliers, especially primary producers and other suppliers who supply indirectly through wholesalers, consolidators or importers, should be able to raise complaints, anonymously or otherwise. This is recommended by the CC (paragraph 11.446(b)) and will increase the evidence base on which the body may assess compliance with the GSCOP.

41 **21. Should large suppliers be excluded so that the body monitoring and enforcing compliance with the GSCOP can focus on complaints from smaller ones who are more vulnerable because of their size?**

The CC looked at this and concluded that the practical difficulties were too significant to make this workable (paragraph 11.290). We concur, as any countervailing buyer power is not a matter of overall scale. It will vary by supplier, that supplier's business with a particular retailer and on a product by product basis (ie. a small supplier may have a 'must-stock' product; equally, a large supplier may supply many low volume secondary products).

42 More importantly, from what aspect of the body's activities should large suppliers be excluded?

- Were they to be excluded from being able to bring **specific, named complaints** for arbitration, this would leave large suppliers with only one option, to bring a case before a court under contract law. This runs contrary to the principles of equality under the law, natural justice and that courts should be used as a last resort, with parties using other means first to resolve disputes;

- Were large suppliers to be excluded from **providing information** to the body on the performance of the GSCOP, via anonymous complaints, the body would be deprived of an important source of information, making it more difficult for it to assess how well the remedy is working and to judge the scale of any breach (and its overall impact on consumers). This would weaken the performance of the body;
- The body is expected to **consult** from time to time, on proposed guidance and the overall working of the GSCOP. Were large suppliers to be excluded from such consultations, the body would be deprived of an important source of information on the market and the effectiveness of the remedy. This cannot be in the interests of the remedy or of consumers.

43 Finally, to exclude large suppliers would run counter to the objective of the remedy to work in the long term interests of consumers. A large supplier by definition will serve many millions of consumers so a retail practice that adversely affects its ability to invest and innovate will harm many more consumers than that same practice applied to a small supplier with only one product of small scale.

44 The CC provided a solution to the question of where the body should focus its activities, envisaging “that the GSCOP Ombudsman would prioritize the resources of its office to focus on those disputes and complaints concerning suppliers without market power over and above those concerning suppliers of major branded products that have market power” (paragraph 48 and 11.339). This is not contentious and we agree. The legislation should not exclude any direct suppliers, it being left to the body to decide on where best to focus its activities in the interests of consumers.

45 For the record, the CC noted that large suppliers may have countervailing buyer in their relationships with large retailers but it did not find there to be a **balance** of power. Large retailers hold the negotiating power even with the largest suppliers. The 2000 Supermarkets Report found that the very largest supplier to Tesco accounted for no more than 2% of Tesco’s sales, while Tesco would represent some 30% of that supplier’s sales.

46 Furthermore, the retailer holds the whip hand in key commercial areas including:

- access to the consumer (by deciding whether or not to list a product);
- deciding the consumer price of all products in store (included branded and competing own label products);
- allocating the shelf position and number of facings of all products in store (which affects rates of sale);
- deciding on all promotions in store; and
- controlling in-store communication.

These factors allow the retailer to influence consumer purchasing behaviour in store.

47 In addition to this control, the retailer is able to use its own label products as a potent threat not to list a branded product if the supplier fails to comply with its terms. The result is negotiating power tipped firmly in favour of the retailer.

48 The international scale or overall turnover of a supplier is sometimes quoted to illustrate the strength of suppliers. This however is a wholly inappropriate and misleading measure of negotiating power. A supplier's sales in Latin America, the USA, China or Africa cut no ice with a UK retailer when negotiating for space on a supermarket's sales, the wholesale price to be paid or the terms of supply.

49 **22. If there is to be a threshold how would it be calculated?**

It is not possible to calculate an evidence-based threshold relating to supplier power. Rather than set a rigid threshold, the body should be guided to prioritise disputes and complaints arising from suppliers without market power as the CC proposed. This would focus resources where they are most needed while retaining flexibility for the body.

50 **23. Is there anything else which should be specified i.e. is there an (e) to paragraph 5.3?**

We believe that one potential impact of an effective GSCOP is that retailers will find new ways to transfer excessive risks and unfair costs to suppliers to the detriment of consumers that are not covered by the Code. We therefore see an important function of the body to monitor behaviour which may breach the fair dealing provision but not be caught by any of the existing specific provisions. This information will be extremely valuable when the effectiveness of the GSCOP and the body come up for periodic review, to assess what changes may be needed to ensure this market works in the best interests of consumers.

51 **24. Is the CC's proposed formula the most appropriate way of calculating each party's share of the body's costs?**

We do not have detailed comments on how each party's share of the body's costs be calculated but support the principles that costs should be relative to the size of the retailer and, above all, to the total number of disputes and complaints (as an incentive to resolve potential problems quickly) and to the number of disputes and complaints that are upheld.

52 **25. Should the body's funding be based on other criteria, such as a flat rate charge for each of the designated retailers, if so what?**

The retailers covered by the GSCOP vary significantly in size and in their behaviour towards suppliers. We therefore consider that a flat rate would not be a proportionate way of allocating costs and would mean that retailers who do not transfer unexpected costs and excessive risks to suppliers would be subsidising those who do. This cannot be right.

53 In any event, it should be emphasised to designated retailers that they must fund the body and these costs must not be transferred either to consumers or suppliers, directly or indirectly.

26. Do you have any comments on the draft impact assessment at Annex D, including the costs and benefits of the options and any other specific issues?

We do not have any significant comments on the draft impact assessment. In terms of the options:

- we do not see a significant difference in cost between a new body being established or it being under the guise of an existing organisation, bearing in mind that in practical terms it must operate (and be seen to operate) independently in both scenarios;
- whether the body is able to levy penalties will affect the deterrence value of its work and therefore its effectiveness. The lower the deterrence, the higher the cost and the lower the benefit. Whether retailers dispute penalties will be dictated more by the veracity of the evidence than the penalties themselves;
- the risk of raising costs to indirect suppliers as a result of them being unable to seek redress is offset by their ability to raise complaints anonymously.

We consider it correct that the annual benefit of each option cannot be quantified as it is wholly dependent on the response and behaviour of the designated retailers.

55 **27. Do you have further quantitative and qualitative evidence on the impact of supply chain practices on investment and innovation?**

In this analysis it is relevant to include the significant impact of retrospective changes on suppliers' incentives to invest (paragraph 9.46) and the fact that in a such a large market as UK grocery, a small loss of investment is likely to have a significant detrimental impact on consumers (paragraph 10.16).

56 **28. Do you have other evidence regarding the potential costs associated with the GSCOP?**

No. As the consultation states though, this option of doing nothing is not relevant as it falls so far short of the remedy recommended by the Competition Commission to the AEC that it has found.

57 **29. Are there other indicators that could inform current and future levels of compliance with supplier practices covered in the GSCOP?**

It is hard at this stage to gauge future levels of compliance as there are so many variables, including economic and commercial factors as well as the effectiveness of the GSCOP and ombudsman as a deterrent (which will depend how the latter is set up). We agree though with the CC that the remedy's success will to a large extent be influenced by the body's ability to launch relevant proactive investigations (paragraph 11.350) which will in turn encourage compliance.

58 **30. Do you have evidence that could help to quantify the impact of reduced supplier investment and innovation on consumers?**

We do not have such evidence and note the difficulty that the CC also experienced in this area (paragraph 10.16).

59 **31. Do you have any evidence that could help project the number of complaints and disputes under a GSCOP enforcement body?**

It is very difficult to anticipate the number of complaints under this “Base case” scenario bearing in mind the variables involved (see our answer to question 29). However, as there would be no power to levy penalties under this option, the deterrence of the remedy will undoubtedly be weaker and therefore complaints likely to be higher.

60 While we envisage potentially more disputes than under the SCOP, primarily due to more and smaller retailers being included, we anticipate the numbers will remain very low because of the importance to suppliers of strong ongoing trading relationships. It is interesting to note that in his latest report, the CRR Adjudicator mentioned in paragraph 23 above states that there were no formal complaints during the period covered by the report but that there were 13 inquiries for informal guidance. The power to levy penalties is expected to have more impact on levels of compliance by retailers than on suppliers’ willingness to bring disputes, which we believe will only be brought *in extremis*.

61 **32. Are there other existing bodies, of which the GSCOP enforcement body could be part?**

The CC’s remedy calls for an independent body and we believe this to be a crucial element of its success. Were this to be impossible politically, the only organisation that could “host” the body is the OFT. However, for the remedy to be effective under this option, the body must be – and seen to be – in all other ways wholly independent.

62 **33. Do you have any other evidence on the costs and benefits of establishing a new body to monitor and enforce the GSCOP?**

We perceive there to be limited differences in cost between a body set up under the auspices of the OFT and a wholly independent body, as the credibility of the remedy (certainly for suppliers) relies on the body being seen to be independent, however it is set up. The benefits of an independent body however can be expected to be seen in potentially greater levels of proactivity, stronger engagement with suppliers, more credible findings and stronger deterrence. We therefore agree with the CC’s view that there will be incremental net benefits to arise from an independent enforcement body.

63 We do not share the concern that an independent body would be more susceptible to influence from suppliers than the OFT. It depends on how the body is set up and its objectives, which must focus on the consumer interest and addressing the AEC. This includes the body being instructed to focus its activities on those suppliers without market power (without a specific exclusion of any direct suppliers).

64 As an aside, we note that the manifestos of the main political parties present the ombudsman as primarily safeguarding suppliers. We believe strongly that the emphasis should be on the consumer interest and addressing the AEC.

65 **34. Do you have any further evidence on the likely costs associated with appeal of GSCOP arbitrations?**

The CC anticipates that investigations sparked by complaints will be infrequent, perhaps one or two per year (Memorandum: the need for a grocery ombudsman, paragraph 2.6). At the same time we consider that disputes will be rare, being brought only *in extremis*. Meanwhile, the new requirement for agreements to be in writing will make it easier to identify, with

greater certainty, whether a breach of the GSCOP has occurred, strengthening the evidence base. These factors all combine to reduce the likely number of appeals by retailers, which we anticipate will be in the very low single figures, if any.

66 **35. Do you have further evidence on the effectiveness of fines as a deterrent?**

As we stated in our answer to question 17, we do not consider that fines will be a full deterrent, the prospect of fines not being sufficient to encourage retailers to establish an ombudsman voluntarily. We do however believe that fines have a deterrent value and send an important and clear message that breaches of the GSCOP are considered serious and do not go unpunished. The fines are therefore integral to the reputation risk discussed in paragraph 89 of the Impact Assessment. There is therefore no question in our minds that compliance in the absence of fines will be markedly lower than were penalty powers available.

67 **36. Do you have data on the number of direct and indirect suppliers in the UK groceries market?**

We do not have any information to qualify further the number of direct and indirect suppliers identified by the CC.

68 **37. Do you have any evidence on how the options around the activities, penalties, the body, access to the body and funding would have amongst different groups of business or consumers?**

The CC's recommendation, if implemented unamended, would not disadvantage significantly any particular type of direct supplier and would treat all consumers equally, although there would be a bias towards suppliers without market power.

69 Were large direct suppliers to be excluded from the body's activities, this would discriminate against them, depriving them of the dispute resolution procedure and leaving the courts as their only source of redress. It would also discriminate against consumers of those large suppliers' products who may be deprived of the benefits of higher levels of investment. Excluding large suppliers would certainly give rise to inequalities.

70 **38. Are there any other equality issues that we need to consider in this area?**

We are not aware of other equality issues.

71 **NAME OF THE BODY**

We support the body being called the GSCOP Ombudsman and do not believe this will cause undue confusion with more consumer-facing ombudsmen. The way its role is explained and the audiences with which it will communicate should minimise confusion.

72 We do not believe the body should be called a "regulator" as we see that as over-stating its role, while an "adjudicator" or "monitor" underplays its important enforcement role.