



The Groceries (Supply Chain Practices) Market Investigation Order 2009

- 1 The British Brands Group is grateful for the opportunity to comment on the Competition Commission (CC)'s draft Order relating to supply chain practices in the UK groceries market and the accompanying explanatory note. Because it is only the Order that will be legally binding, most of our comments focus on this.
- 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 the vast majority of their products to consumers. The GSCOP and the way it is monitored and enforced is therefore directly relevant to our members, and directly relevant to our members' real customers, ie. UK shoppers and consumers.
- 3 We are encouraged that the draft Order represents a significantly stronger approach in addressing the Adverse Effect on Competition (AEC) identified by the CC than the existing Supermarket Code of Practice (SCOP). While we have relatively few comments, believing the Order to be valuable in making this market work well for consumers, those that we have are essential to the practical working of the GSCOP, the achievement of the CC's objectives and the discharge of its duties under the Enterprise Act 2002. We express our concerns forcefully in this submission in the hope that the CC will take heed of them.
- 4 The four significant areas that threaten the effectiveness of this remedy are:
 - effective enforcement of the remedy**
 - the Supply Agreement**
 - written confirmation of agreements**
 - requirements by retailers**

We address each of these in turn as they are crucial to an effective GSCOP, before turning to other considerations.

5 EFFECTIVE ENFORCEMENT

The enforcement provisions in the Order are far too reliant on suppliers bringing complaints to be effective and the duty on retailers to comply is hopelessly weak. These two points render the whole proposed remedy ineffective and as a result it may well not meet “the purpose of remedying, mitigating or preventing the adverse effect on competition” in section 134(4) of the Enterprise Act 2002, opening it to challenge.

- 6 The remedy is heavily reliant on suppliers bringing a claim of breach of contract under the Supply Agreement as the mechanism to enforce the Order, yet experience over the last seven years since the SCOP came into force shows this simply will not happen. Suppliers will not bring such claims, whether because of the “climate of fear” or because the commercial risks of jeopardising crucial customer relationships, over both the short and long term, are so huge. It is wholly unrealistic to expect them to do so. As the CC itself said at paragraph 11.350 of its Report: “...relying on ...disputes as the basis for monitoring and enforcement of the GSCOP would undermine its effectiveness as a remedy”.
- 7 This unrealistic reliance on suppliers is compounded by an extremely weak duty on the authorities to enforce compliance. It seems that the OFT only has a duty to ensure that retailers include the GSCOP in their Supply Agreements in accordance with article 5(1) of the draft Order, nothing more (see penultimate paragraph of letter from John Fingleton to Andrew George MP, 19 February 2009). This is hopeless and makes the Order as currently drafted unworkable as a remedy. We also believe it to be inconsistent with paragraph 11.273 of the CC’s Final Report which states:

If neither we nor BERR are successful in establishing the Ombudsman within a reasonable period of time, the functions of the Ombudsman will be carried out by the OFT, with the exception of dispute resolution, which will be carried out by a recognized independent dispute resolution body (such as CEDR).

The “functions of the Ombudsman” include all the matters set out in paragraph 11.271 of the CC’s report and include the “overriding objective of monitoring and enforcing the GSCOP”. It is clearly vital that, until an Ombudsman does take office, the OFT is fully apprised of the need to enforce the obligations in the GSCOP, not just the obligations in the CC’s Order.

- 8 There seems to be some confusion here between private contractual remedies and public policy remedies. Under the terms of a Supply Agreement a supplier will have contractual rights *vis-à-vis* a retailer, with concomitant remedies (for injunctive relief or damages) in respect of any breach of contract. If, as is suggested, retailers are required to incorporate the GSCOP into every Supply Agreement then the supplier would have private remedies in respect of any breach of the GSCOP. Such remedies are designed to remedy any damage **suffered by that supplier individually**.
- 9 However, the proposed GSCOP is a public policy remedy designed to repair the adverse effects on competition identified by the CC. The remedy is a public policy measure, independent of any individual bilateral contract, and is designed to remedy the AEC for the benefit of the wider public. A public policy remedy should not be left to the private sector to enforce. If, as has been found by the CC, the retailers’ practices that give rise to an AEC have a detrimental effect on consumers, then it should be for the

public authorities to ensure that the remedy is enforced. It would be a dereliction of the public bodies' duties to seek to rely on arbitrary enforcement by private parties (who can only ever enforce contractual duties owed to them individually) when what is required is enforcement of the public policy objective for the benefit of the public generally.

- 10 This scheme is recognised in the Enterprise Act which provides clear enforcement procedures. In brief, there are two different types of enforcement envisaged. First, undertakings and orders can be enforced by "any person who may be affected by a contravention of the undertaking or (as the case may be) order" (section 167 (3) and (4)). Secondly, the OFT is required by section 162(1) to keep under review the carrying out of any undertaking or order and can take the necessary enforcement measures under section 167(6).
- 11 Assuming – as is required by the legislation and as has been found by the CC – that the AEC found by the CC has adverse consequences for consumers generally, then it is a necessary consequence that consumers are entitled to be protected in the future by relying on the public authorities to enforce the GSCOP.
- 12 We believe this fundamental problem with the draft Order may be resolved by making the GSCOP, currently in Schedule 1, an integral part of the Order itself. This would have the result of imposing a statutory duty on retailers not just to include the GSCOP within their Supply Agreements (with the consequence that any supplier individually harmed by a breach can sue for breach of contract) but also to comply with its provisions; breach of that duty can then be enforceable as a matter of public policy for the benefit of the public at large by the OFT or Ombudsman.
- 13 THE SUPPLY AGREEMENT

Article 6(1) of the draft Order requires all terms of each Supply Agreement to be recorded in writing, with article 6(2) requiring this to take place prior to entering into the Supply Agreement. Retailers are to include their proposed terms and conditions when providing the written copy of the Supply Agreement to the supplier. This raises the real – and new – risk that it will be retailers' terms and conditions that apply rather than those that are mutually agreed. This would represent a fundamental change in current commercial practice, be at odds with the purpose of the remedy and be disproportionate in relation to the AEC. It would also open the CC to challenge by effectively imposing an implied obligation on suppliers (to accept retailers' terms) which it does not have the power to do since suppliers were not the perpetrators of the AEC.
- 14 Many branded goods suppliers would prefer to have no agreement at all with a retailer rather than have to accept or be required to supply product under unfavourable terms from the retailer. Therefore, where retailers seek to impose their own terms on suppliers, suppliers must be able to reject these terms (in whole or in part) where these are not fair and reasonable. It is crucial that the freedom to negotiate and agree to mutually satisfactory terms is retained. To emphasise the point, suppliers must not be required or be pressured in any way to accept the retailer's terms and conditions.
- 15 The measures proposed in the draft Order are likely, in practical terms, to result in retail buyers simply insisting on buying according to their standard terms and conditions. This will be the most straightforward way for retailers to meet the Code's requirement for a

written Supply Agreement. It is highly likely therefore that retailers will present their standard terms and conditions to suppliers on a “take it or leave it” basis on every occasion. With the default position being the proposal of the retailer’s terms (as opposed to supplier’s terms), a new onus will be placed on each supplier to expressly reject the proposed terms each time and seek to agree mutually acceptable terms to govern that Supply Agreement. This will place suppliers at a significant disadvantage *vis-à-vis* the status quo and fail to satisfy the fair dealing principle in paragraph 2 of the GSCOP.

- 16 The net effect will be to increase significantly retailers’ commercial power, thereby contradicting the purpose of the draft Order. With the current draft, were suppliers to reject a retailer’s standard terms and conditions (in whole or part), insisting that some or all of their own terms are incorporated into the Supply Agreement, it is hard to see how a Supply Agreement will ever be concluded in accordance with article 6(2).
- 17 To resolve this, we propose that article 6(2) is redrafted as follows:

6(2) A Designated Retailer must not enter into a Supply Agreement ~~with a Supplier unless the Supplier has~~ unless **both parties have mutually agreed all the terms of the Supply Agreement and both have** a written copy of the Supply Agreement, including ~~all proposed~~ **all proposed** terms and conditions which are intended **by the parties to the Agreement** to form part of, but are not wholly documented in, the Supply Agreement.

We also suggest that the explanatory note includes the following clarification:

For the avoidance of doubt, any Retailers’ terms and conditions of purchase, including any standard form of terms and conditions, will not apply by default. All terms must be mutually acceptable to both parties.

If, as suggested in 12 above, the GSCOP is in the body of the Order, then the public policy obligation to comply with the GSCOP (and therefore to resolve the AEC found by the CC) will be completely independent of any private bilateral contractual provisions agreed between any supplier and any retailer.

- 18 WRITTEN CONFIRMATION OF AGREEMENTS

Article 6(7) of the Order holds the retailer responsible for confirming all subsequent agreements and arrangements to the Supply Agreement in writing. This again increases the commercial power of the retailer in each transaction. Were a retailer to record any aspect of an arrangement or agreement inaccurately or incompletely, the supplier is disadvantaged, as any further discussion with the retailer may well be considered “unconstructive to the commercial relationship”.

- 19 To resolve this, we suggest that suppliers are encouraged to acknowledge in writing any retailer’s written confirmation of subsequent agreements or arrangements, thereby allowing the supplier either to confirm the accuracy of the written record or provide corrections. The monitor / enforcer, whether the OFT or Ombudsman, would then have a more complete picture of the transaction and the positions of the respective parties.

20 REQUIREMENTS BY RETAILERS

In the Schedule, there is scope for retailers to **Require** certain significant actions where the supplier does not genuinely volunteer or agree, as long as these are ordinary commercial pressures – presumably for the retailer, not the supplier. Of particular concern is the scope to require changes to supply chain procedures as long as reasonable notice is given (Schedule 1, Part 3, paragraph 4) and to require part-payment of a promotion on giving reasonable notice.

- 21 A significant change to the supply chain may, for example, be a requirement by one retailer for all its suppliers to pack products in certain outer (transit) packaging. Such a requirement would cost suppliers many millions of pounds, even with reasonable notice being given, and could result in the introduction of significant costs and inefficiencies into the entire grocery supply chain, were different retailers to require products to be packed in different forms of outer packaging. The result would be higher costs to consumers and the potential distortion of competition between retailers. This cannot be the intention of the draft Order.
- 22 Such significant changes must be by written agreement, especially in situations where a supplier may be supplying many different retailers. We therefore propose that paragraph 4(a) of the GSCOP is deleted entirely and 4(b) is reworded as:

(b) fully compensates that Supplier for any net resulting costs incurred ~~as a direct result of the failure to give Reasonable Notice.~~

- 23 Permitting retailers to **Require** suppliers to fund a promotion, even if not predominantly, without their agreement is also wholly unreasonable, disproportionate and contrary to the purpose of the draft Order. Significant sums would be involved. Such a provision would both legitimise and authorise all retailers covered by the draft Order to require such payments, potentially on a regular basis, providing a loophole for millions upon millions of pounds to be siphoned over time from suppliers to the covered retailers, imposing excessive costs on suppliers and distorting competition between retailers (notably those falling outside the Code and with less buyer power).

- 24 To resolve this significant anomaly, we propose that paragraph 13(1) is reworded as follows and paragraph 13(2) is deleted:

(1) A Retailer must not, directly or indirectly, Require a Supplier ~~predominantly~~ to fund the costs of a Promotion.

25 OTHER CONSIDERATIONS

Variation of Supply Agreements and terms of supply

The provisions of paragraphs 2(a) and (b) and paragraph 3 allow retrospective and unilateral changes to Supply Agreements yet this is the area that we understood caused the CC most concern (see Final Report, paragraph 11.316) and which the CC intended to ban completely. This is expressed clearly in the Final Report, paragraph 11.306:

Accordingly, we decided that retrospective changes to agreed terms of supply should be prohibited outright.

There is therefore a significant contradiction and anomaly between the Final Report and the proposed GSCOP in relation to the variation of supply agreements.

26 **No obligation to contribute to marketing costs**

We do not believe the Order should legitimise an obligation on suppliers to pay any of a retailer's marketing costs where there is no prior agreement to do so. We therefore suggest that the list in paragraph 6 is made non-exhaustive:

6. No obligation to contribute to marketing costs

Unless provided for in the relevant Supply Agreement between the Retailer and the Supplier, a Retailer must not, directly or indirectly, Require a Supplier to make any Payment towards that Retailer's **marketing** costs including of:

27 **Payments for wastage**

We question whether it is the CC's intention to allow retailers to require suppliers to pay for wastage when such wastage has nothing to do with the supplier. This is currently permitted under paragraph 8 of the GSCOP as long as the basis for such payment is set out in the Supply Agreement. We suggest the following amendment is considered:

8. Payments for wastage

A Retailer must not directly or indirectly Require a Supplier to make any Payment to cover any wastage of that Supplier's products incurred at that Retailer's stores unless:

- (a) such wastage is due to the negligence or default of that Supplier, and the relevant Supply Agreement sets out expressly and unambiguously what will constitute negligence or default on the part of the Supplier; ~~or~~ **and**
- (b) the basis of such Payment is set out in the Supply Agreement.

28 **No tying of third party goods or services for payment**

We suggest that the wording of this paragraph is tightened to ensure it is fair:

11. No tying of third party goods and services for Payment

(1) A Retailer must not directly or indirectly Require a Supplier to obtain any goods, services or property from any third party where that Retailer obtains any Payment for this arrangement from any third party, unless the Supplier's alternative source for those goods, services or property:

- (a) fails to meet the **reasonable** objective quality standards laid down for that Supplier by that Retailer for the supply of such goods, services or property; or
- (b) charges more than any other third party recommended by that Retailer for the supply of such goods, services or property **of an equivalent quality and quantity**.

29 **Due care to be taken when ordering promotions**

In paragraph 14, it is assumed that 'compensate' means payment by the retailer of a sum in respect of each unit equal to the difference between the promotional wholesale price and the non-promotional wholesale price. This requires clarification to ensure retailers do not seek to pay a lesser sum.

30 **No unjustified payment for consumer complaints**

In circumstances where a relevant product is justifiably replaced following a consumer complaint, paragraph 15(1)(a) should be clear that the Payment should not exceed the wholesale price. Recovery of the retail price in those circumstances is inequitable as the retailer would benefit from twice the cash margin it would have otherwise made where the product is replaced in store (ie. the retailer would receive its margin from the original sale to the shopper and again when seeking compensation from the supplier).

31 **Duties in relation to De-listing**

We do not believe that a retailer should be able, under the Order, to de-list a supplier's products because a supplier has exercised its rights under the Code. We therefore suggest this Section is clarified:

16. Duties in relation to De-listing

(1) A Retailer may only De-list a Supplier for genuine commercial reasons. For the avoidance of doubt, the exercise by the Supplier of its rights under any Supply Agreement, the Code or the failure by a Retailer to fulfil its obligations under the Code or this Order will not be a genuine commercial reason to De-list a Supplier. ...

32 **Reasonableness**

We are struck by the heavy reliance on reasonableness within the GSCOP, with this approach occurring in many of its provisions. While we appreciate that this is intended to provide flexibility, it also introduces uncertainty, making it unclear to both retailers and suppliers whether or not the GSCOP has been breached in any particular instance. This emphasises the importance of an active monitor / enforcer to oversee the Code and the important role for published guidance in bringing some clarity where there is currently uncertainty.

33 **Explanatory Note – paragraph 37**

We believe there is a misprint in the middle of this paragraph:

The Order seeks to ensure that suppliers are not under duress to acquiesce to requests made by ~~retailers~~ suppliers in respect of certain practices.

34 **CONCLUSION**

In summary, we believe the draft Order has significant potential to address the AEC that has been identified. However, to do so, it is **essential** that the enforcement provisions are addressed to make them effective. Furthermore, those aspects of the draft that will fundamentally and radically change the way business is currently transacted in this market but which are unrelated to the AEC (such as whose terms apply) must be addressed in the final Order to ensure that this remedy is proportionate and does not have undue or unforeseen consequences for consumers or competition.