

Every little bit helps

With luck, the new groceries code adjudicator will effect real change

by *Pat Treacy and David George**

Grocery retailing has undergone revolutionary change over the last few decades. As the traditional quartet of the local butcher, baker, greengrocer and fishmonger has given way to the omnipresent national supermarket chain, retailer buyer power vis-à-vis suppliers has increased tremendously. Belatedly, the regulation of the groceries sector is catching up. The recent establishment of the groceries code adjudicator, implemented following recommendations made in 2008, marks a significant milestone in this saga.

Background

The UK's Competition Commission (CC) first investigated the groceries sector in 2000. Among several issues of concern, the CC considered 52 alleged abuses of retailer buyer power. By and large, the CC found that competition in the groceries sector was healthy. However, the big four supermarkets agreed to abide by the supermarkets code of practice (SCOP) to address certain supply chain concerns. Reviews of the SCOP carried out in 2004, 2005 and 2006 revealed dissatisfaction with the SCOP among suppliers (OFT papers 697, 783 and 845): in particular, a lack of prescriptiveness of the SCOP and reluctance to complain for fear of commercial reprisals were seen as potential issues.

In 2006, the groceries sector was again referred to the CC. The CC 2008 report found that certain supply chain practices essentially “transfer excessive risks or unexpected costs” to suppliers through retrospective adjustments to supply agreements or risk-taking at suppliers’ expense. These practices were found to have “the potential to diminish significantly suppliers’ incentives to invest in new products, capacity or production processes” which could harm consumers (CC 538, para 9.41).

To address these concerns, the CC adopted the Groceries (Supply Chain Practices) Market Investigation Order (the order). Schedule 1 contains the groceries supply code of practice (the code). The order came into force in February 2010. It requires the code’s incorporation in all grocery supply agreements. It also imposes training and reporting obligations on designated retailers (the top 10 supermarkets, each with groceries sales in excess of £1bn), and requires them each to establish a code compliance officer. The order provides a dispute resolution mechanism (arbitration) where disagreement arises about the interpretation of the code.

The CC recommended that the code be monitored by an ombudsman and consulted with the main supermarkets about its establishment. These talks ultimately ended without success. At the last election, there was cross-party support for establishing some form of ombudsman. Following consultation, the Groceries Code Adjudicator Act 2013 was enacted in June. This instrument describes itself as “an Act to set up a groceries code adjudicator with the role of enforcing the groceries code and encouraging compliance with it”.

The code

The code contains 17 paragraphs. The first deals with matters of interpretation. The second sets out the key principle of fair dealing, which requires that “a retailer must at all times deal with its suppliers fairly and lawfully ... in good faith ... without duress and in recognition of the supplier’s need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues”. The principle of fair dealing is new to the code; the old SCOP had no equivalent.

The remainder of the code lists practices that are either banned outright, substantially restricted or imposed upon the retailer. These practices fall into four broad groups, described in more detail below.

First, practices that involve changing a concluded deal are restricted. For instance, there is a complete ban on retrospective changes to agreements (although contracts providing for retroactive amendment in specified circumstances are permitted). Restrictions are also imposed on the retailer’s ability to “require” the supplier to change supply chain practices without notice or compensation (a supplier is “required” to do something if it does not agree to undertake an action “in response to ordinary commercial pressures”). In addition, payments should be made without delay. (See paras 3-5).

Second, practices that involve a payment from the supplier to the retailer are restricted. For example, suppliers are restricted from requiring contributions to marketing costs; retailers cannot demand compensation for shrinkage (in-store theft); the circumstances in which retailers can seek compensation for consumer complaints or wastage (food going off) are restricted; payments demanded as a condition for being a supplier are substantially restricted; and retailers cannot require suppliers to use a third party’s services (such as delivery services) where there is a financial kickback from the third party to the supplier, except in limited circumstances. (See paras 6, 7, 8, 9, 11 and 15).

Third, certain practices are permitted only in the context of a promotion. So, for instance, a retailer can require payments to secure better positioning or an increased allocation of shelving space only in the context of a promotion but it cannot require suppliers to predominantly fund promotions. (See paras 12 and 13).

Fourth, certain practices to improve general fairness are imposed on the retailer. A retailer must, for example, generally compensate a supplier if loss arises from the retailer’s forecasting errors (say, overordering for promotions). It must also follow certain procedures, such as providing a right to appeal, before delisting a supplier, and the decision to delist can only be based on “genuine commercial reasons”. (See paras 10, 14 and 16).

Following the introduction of the code, all retailers appointed code compliance officers and provided compliance training. Certain retailers extend training to non-buying staff to improve general awareness of the code and generate

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flexibility for internal staff movements. However, suppliers remain reluctant to raise complaints under the code: they generally have continuing commercial relations with retailers which they do not wish to jeopardise.

Many suppliers believe that retailers have failed to comply fully with the code since its establishment in 2010. When commenting unattributably, suppliers indicate that even basic issues such as timely payment remain a problem. Publicly, suppliers are unwilling to express concerns with compliance, except via trade associations.

Further information on compliance is limited. Although the order requires retailers to prepare “detailed and accurate” annual compliance reports for their internal audit committees, only a “summary” need be published. The public summaries indicate that few complaints are made each year – precise numbers are not usually provided. For example, Asda’s compliance summary refers to “a small number” of complaints and the Co-op refers to “a small handful of alleged breaches”. To date, all complaints have been dealt with internally. Of the 10 retailers, only Morrisons and Sainsbury’s have experienced a complaint being elevated to the code compliance officer. No dispute has ever reached arbitration.

The adjudicator

The establishment of the adjudicator is expected to change the level of code compliance. The office of the adjudicator was established on 24 June this year. In January, the government appointed Christine Tacon to act as the adjudicator for an initial period of four years. Ms Tacon has a range of experience in the food, retail and farming industries, having previously worked for (among others) Mars Confectionery, Anchor Foods and Co-operative Farms.

The role of the adjudicator will be threefold: first, to act as arbitrator in disputes between retailer and supplier; second, to investigate complaints of breaches of the code and enforce the code; and third, to provide advice on matters relating to the code to suppliers and retailers and to recommend changes to the code to the OFT, if appropriate. Experience suggests that the arbitration function will rarely, if ever, be used. The investigatory and advisory functions are likely to be of far greater importance in practice.

The adjudicator may begin an investigation if she has “reasonable grounds” to suspect a breach of the code. It is likely that investigations will begin after complaints by suppliers or third parties representing suppliers (such as trade associations).

The government has recognised the key importance of preventing disclosure of the identity of the complainant – a supplier will be unwilling to complain if it is concerned that it will be exposed as a troublemaker. The Act stipulates that the adjudicator cannot make any “unauthorised” disclosure of information that might cause someone to think that a particular entity complained about a retailer. For the complainant’s identity to be revealed, the complainant must either consent or there must be some legal obligation on the adjudicator requiring disclosure such as a court order (in which case, some form of confidentiality arrangement would probably be imposed to protect the identity of the complainant).

Once an investigation is commenced, the adjudicator has powers to require a person (suppliers, retailers or third parties) to

provide information. It is anticipated that the adjudicator may use these powers to widen the scope of any initial complaint from an individual sector to multiple sectors, so that the adjudicator can eventually publish details of the outcome of the investigation without revealing the identity of the original complainant.

On 31 July, the adjudicator launched a consultation on proposed investigatory procedures and use of enforcement powers. Responses were requested by 22 October and the guidelines are expected to be finalised by Christmas. The draft guidelines indicate that the adjudicator will use certain prioritisation criteria to focus resources on cases with maximum impact and which have the greatest strategic importance to consumers. In deciding whether to act, the adjudicator will weigh up the costs of action versus the costs of inaction, and will only commence investigations where it is proportionate to do so. Investigations will be possible once the guidelines are finalised. It is anticipated that the adjudicator will carry out two to four investigations per year. Given limited resources, improving compliance via informal means will be another important function – for instance, the adjudicator has indicated that she intends to maintain an active dialogue with code compliance officers.

Where the adjudicator identifies breaches of the code, there are three enforcement options: a power to make recommendations explaining what a retailer must do to comply; a power to publish information (for example, by press release, open letter, annual report or even a newspaper advertisement); and a power to impose a financial penalty. The adjudicator has proposed that there should be the power to impose a fine of up to 1% of the retailer’s UK turnover. This would be around £400m in the case of Tesco, but closer to £10m for smaller retailers. The maximum penalty will be fixed by the BIS secretary of state, taking into account the adjudicator’s final recommendations.

Outlook

Some 13 years after the completion of the initial CC investigation, it seems likely that the adjudicator’s appointment and significant powers may effect change in the groceries sector, which has been the focus of so much attention by the competition authorities. At least initially, the adjudicator is likely to focus enforcement efforts on the most clear-cut breaches of the code. In due course, it is hoped that the adjudicator will provide advice on the interpretation of key terms such as “require” and, critically, that she will clarify the interaction of the principle of fair dealing with the specific provisions of the code. This may include giving guidance on whether the fair dealing principle can be used to extend the code to cover practices which do not quite fit under the existing specified practices.

Although the power to impose financial penalties will get publicity, recommendations (which the adjudicator must monitor for compliance) and the resultant headlines and reputational damage have possibly greater potential to engender significant changes in retailer behaviour. By way of illustration, this summer saw a £300,000 fine imposed on one of the major retailers for failing to comply with trading legislation relating to the display of half-price strawberries. The reputational harm caused by press coverage of the incident may well have had greater deterrent effect than the fine.