Submission to the Department of Enterprise, Trade and Employment

Code of Practice for Grocery Goods Undertakings, Consultation Paper
Submission S/09/003

SEPTEMBER 2009

The Competition Authority
An tÚdarás Iomaíochta

1. INTRODUCTION

1.1 This submission is a response to the Tánaiste and Minister for Enterprise, Trade and Employment's recent call for submissions on her intention to introduce a Code of Practice for Grocery Goods Undertakings.

1.2 It is intended that the Code of Practice will have as its key objective "*the need to achieve a balance in the relationship between grocery goods undertakings, taking into account the need for a fair return to both suppliers and retailers, the need to enhance consumer welfare and the need to ensure that there is no impediment to the passing-on of lower prices to consumers*".

1.3 This submission examines this objective and questions whether it can best be achieved through the proposed Code of Practice. The Competition Authority has indentified a number of issues relating to the proposed Code of Practice and suggests an alternative remedy that could more effectively combat harmful practices that may exist within the sector, by strengthening the provisions of the Part 2A of the Competition Act 2002 in order to encourage private action.

1.4 This submission is structured as follows:

- Section 2 considers the rationale for modelling the Irish Code of Practice on the approach taken in the UK, given that there are: (1) significant differences between how the grocery sectors in Ireland and the UK operate; (2) significant differences between the findings of reports that examined the grocery sectors in Ireland and the UK; and (3) in Ireland, unlike in the UK, there is specific legislation concerning the grocery sector, i.e., Part 2A of the Competition Act 2002.

- Section 3 questions what value a Code of Practice and an Ombudsmen would bring to perceived current problems in the sector. The Authority proposes an alternative and more effective remedy that can be used directly by the industry.

- Finally 'Appendix A' presents a number of reviews and assessments that have been undertaken in the UK since the introduction of a code of practice there. A common conclusion running through these independent reviews is that the UK code of practice is not being utilised by the sector and is therefore largely ineffective.

1.5 The Competition Authority would be happy to discuss its concerns and proposals with the Tánaiste and the Department of Enterprise Trade and Employment.

2. THE PROPOSED CODE OF PRACTICE

Suitability of UK Model for Irish Retail Sector

2.1 The proposed Code of Practice for Grocery Good Undertakings appears to be modelled on a similar code of conduct which was first introduced in the UK in 2002. The code of conduct in the UK was introduced, and subsequently revised, following in depth inquiries conducted by the Competition Commission in the UK. In this regard, it is worth noting that the findings of reports concerning the grocery sector in Ireland carried out by the Competition Authority (the three *Grocery Monitor* reports and the *Retail-related Import and Distribution Study*) show that the features and competitive dynamics of the grocery sector are different in Ireland from in the UK.

2.2 The Competition Authority's 2009 *Retail-related Import and Distribution Study* ("the 2009 Report") discusses the range of features of a number of retail sectors, including groceries, in Ireland that have contributed to the situation where consumer prices in Ireland are high, especially in comparison with prices in Northern Ireland. In relation to the grocery sector in particular, the Competition Authority did not find any behaviour or practice, relating for example to the buyer power of retailers, adversely affecting the normal competitive dynamics of supply chains. Indeed, it was noted that there are situations in the grocery sector in Ireland where the strength of some buyers may ultimately have pro-consumer benefits. Therefore, in contrast with the reasons for the UK Code, the purpose of introducing a Code of Practice in Ireland would not appear to be to address an adverse effect on competition (or ultimately, on the consumer) and it would not be based on the findings of detailed studies of the grocery sector.

2.3 One of the findings of the 2009 Report is that the speed of adjustment in prices is related to the degree of flexibility of supply chains. One danger inherent in the proposed Code of Practice is that undue restriction of supply chain relationships may limit the degree of flexibility within those chains. Over the past year, a number of developments, principally the fall in the value of Sterling against the Euro and the contemporaneous onset of the recession and associated fall off in consumer demand have meant that grocery retailers in the Republic of Ireland have sought to dramatically reduce prices. To achieve price reductions, grocery retailers have sought reductions in their costs. A major component of every retailer's costs is the cost of product and consequently all have aggressively pursued reductions in the prices paid to suppliers. Where such price reductions were not forthcoming, alternative sources of supply were sought. Much of the debate about the grocery sector reflects the natural tensions that have emerged between retailers and suppliers. If the proposed Code of Practice limits this natural tension between retailers and suppliers, the implication is that price adjustment may slow or indeed stall. In this regard, consumers, as result of a Code of Practice designed to protect suppliers, may face higher prices than might otherwise be the case.

2.4 As discussed in the 2009 Report, pricing of groceries in Ireland tends to take the form of "high-low pricing", at both retailer and supplier levels, in that everyday prices are high but there are regular promotions at low prices (e.g. 33% off, 3 for 2 offers and so forth). This is different to the UK where there tends to be "every day low

pricing", which is a form of longer term price promotions/price cuts. "High-low pricing" relies on heavy promotional activity. The Code of Practice would most likely make such activity more difficult to operate.

The Current Statutory Provision

2.5 Much of the conduct at issue in the proposed Code of Practice is already prohibited by legislation. The Competition (Amendment) Act 2006 which inserted a new Part 2A into the Competition Act 2002 ("the Act") was itself enacted to prevent certain unfair trading practices in the grocery trade. Its provisions prohibit/prevent the following practices in the grocery trade:

- Attempts to impose resale price maintenance;
- Discrimination by applying dissimilar conditions to equivalent transactions in the sector;
- Compelling or coercing payment or allowances for advertising or display of goods; and,
- "Hello money" in relation to new or extended retail outlets or outlets under new ownership.

2.6 The crucial point to note is that such conduct is only prohibited where its object or effect is the prevention, restriction or distortion of competition. If this "competition test" was not included, then conduct which could be pro-competitive and ultimately pro-consumer could be prohibited. Similarly, if a Code of Practice was introduced which did not have such a "competition test" then pro-consumer conduct could be prohibited. Furthermore, if a Code of Practice is enshrined in statute, then in so far as it replicates prohibitions contained in Part 2A of the Act, minus the requirement of an effect on competition, the Code of Practice would conflict with the provisions of Part 2A of the Act.

2.7 Part 2A of the Act may be enforced by either a private plaintiff (aggrieved party) or by the Competition Authority.

2.8 The remedies available to a private plaintiff are reliefs by way of injunction or declaration and damages including exemplary damages. The Competition Authority is entitled to relief by way of injunction or declaration only.

2.9 To date, no cases have been brought before the courts under Part 2A of the Act. Certain industry sources have indicated that suppliers are reluctant to bring actions or make complaints under Part 2A of the Act out of fear of being delisted by retailers. Of course, this echoes concerns raised by the experience to date of the Code of Practice in the UK. Further information on this point may be found in the Appendix to this Submission. It is not clear why it is thought that the attitude of suppliers towards making complaints would change if a Code of Practice were introduced, especially given that the strongest duty of the proposed ombudsman appears to be to merely act as an arbitrator in relation to disputes arising under the Code of Practice.

3. AN ALTERNATIVE APPROACH

The Critical Issue: What Value Will a Code of Practice and Ombudsman bring?

3.1 Given the reluctance of the sector to bring private actions or make complaints to the Authority under Part 2A of the Act and the minimal impact a Code of Practice has had in the UK, the Authority considers that the proposed Code of Practice and Ombudsmen will do little to address the main concerns raised by the operation of Part 2A of the Act to date. The Authority can see no additional incentive in the proposed Code of Practice for suppliers to come forward and make complaints to an Ombudsman. Without suppliers willing to come forward and give evidence or information, the proposal will be no more successful than the Code of Practice in the UK (see Appendix A) or Part 2A of the Act.

3.2 In addition, creating an Ombudsman involves costs. These costs would either have to be paid for by the exchequer, i.e. taxpayer, or the industry, which in turn will pass these costs on to consumers. As it is not clear what benefits an Ombudsman would bring, imposing these costs is not justified.

An Alternative Approach

3.3 The behaviour which the proposed Code of Practice seeks to address, such as coercion of slotting allowances and retaliatory delisting by supermarket retailers against suppliers, is more appropriate for private action than for public enforcement. There are a number of reasons why this is so.

3.4 In the case of private action there will be an identifiable plaintiff who, as a supplier will be able to show he has suffered a significant and quantifiable harm. That plaintiff will have in their possession all relevant evidence necessary to prove the elements of the case and will be able to quantify their financial loss to the court. If successful, that plaintiff should be able to recover damages from the court. Therefore, the basis should exist for an effective private remedy.

3.5 If an injured party complains to the Authority, the injured party is a mere witness to an action brought by the Authority where at best, the outcome that can be achieved in court is a Declaration and or Injunction. Of course, the injured party might then be able to follow the Authority's case with his own action in damages, but will still have to prove fault as it is a separate stand alone proceeding. If the supplier complains to the Authority, this does not vitiate the requirement that the supplier in the end must come forward and give evidence as a witness in both the Authority's case and any subsequent follow on action that the supplier might bring.

3.6 The Competition Authority believes that serious consideration should be given to strengthening the provisions of Part 2A of the Act, in order to encourage and incentivise private actions by injured parties under the Act. In fact this might be better described as overcoming the strong disincentives for plaintiffs for commencing a private action. What is clearly required is a method of encouraging injured parties, and in this instance this means suppliers, to overcome their fear of

retaliation by retailers for taking action and their fear of the downside risks of litigation. Cases under the Competition Act are usually complex and expensive and as with all litigation carry a risk that the case, no matter how well founded, might fail. Encouraging private actions in this instance must include incentives for the plaintiff to bring an action in the first place. With a robust basis for private action, and with effective remedies for an injured plaintiff, there would be no need to set up another State body. Accordingly, we suggest the following amendments to Part 2A of the Act.

3.7 Retaliatory delisting should be prohibited. Retaliatory delisting occurs when a retailer removes a supplier's product from its shelves in retaliation for not paying slotting allowances or hello money. The practice has been cited as a prime concern of suppliers and a primary reason for the lack of complaints to date[1].

3.8 Fault requirement in a follow on action for damages under Pat 2A of the Act should no longer be required. This would make any follow on action that might be taken by an injured party, including a supplier, after a proceeding taken by the Authority, more straight forward. Any finding by the Court in a case brought by the Authority or settlement of such case should be prima facie evidence that there has been a breach of Part 2A of the Act by the defendant in the follow on action.

3.9 Consideration should be given to limiting the exposure to costs of a plaintiff under Part 2A of the Act if the plaintiff loses the private action under Part 2A of the Act.

3.10 As competition cases are potentially complex and very expensive and the risks to the plaintiff are high, consideration should be given to incentivising private actions under Part 2A of the Act by allowing for the award of higher damages to the plaintiff. Higher damages in this instance are damages that are over and above the quantifiable loss suffered by the plaintiff and should be a remedy available at the discretion of the court such as an award of double damages as suggested in the 2005 Commission Green Paper. This award of higher damages not only would encourage private actions by plaintiffs who are best placed to institute such proceedings, but would also have a strong deterrent effect on would be offenders. Higher damages should be an option to the court in addition to the existing remedies of declaration, injunction and 'ordinary' damages (including exemplary damages).

3.11 A new remedy of restitution should also be created. This remedy should be available in cases brought by the Authority under the Act.

3.12 The Competition Authority believes that the strengthening of the statutory provisions relating to private actions for breach of Part 2A of the Act in this way will:

- Address the apparent fear of coming forward that currently afflicts suppliers;
- Offer an additional encouragement in the form of effective remedies;

[1] Joint Oireachtas Committee , Pricing Competition and Promotion Issues, Public Hearing, 4th February 2009

- Create a more effective deterrent to retailers from engaging in the prohibited behaviour; and,

- Render unnecessary the creation of a new State body or extending the remit of an existing one.

A. APPENDIX A

A.1 The proposed Code of Practice for Grocery Goods Undertakings is modelled on the approach taken in the UK. The UK Supermarket Code of Practice ("SCOP") came into force on the 17 March 2002. The Office of Fair Trading ("OFT") were asked to monitor the effectiveness of the code and to prepare an annual report on how well it worked particularly in relation to dispute resolution.

A.2 The OFT published its first review and audit of the code in February 2004. The consultation exercise carried out as part of their review revealed a widespread belief among suppliers that the code was not working effectively. Of those suppliers (including trade associations) which responded to the consultation, most believed that the code had not brought about any change in the behaviour of the supermarkets. The principal reason given by respondents for the perceived lack of effectiveness of the code was the fear among suppliers of complaining. A second review by the OFT in March 2005 had similar results.

A.3 Following publication of the Groceries Market Investigation Report in April 2008 the Competition Commission ("CC") announced that it would be tightening the provisions of the Supermarket Code of Practice and broadening its application such that more grocery retailing will be required to abide by its terms. On the 4th August 2009 the CC also recommended to the Department for Business, Innovation and Skills (BIS) that it should establish an Ombudsman to arbitrate on disputes between grocery retailers and investigate complaints under the new Groceries Supply Code of Practice (GSCOP). How well this new system will work has yet to be seen.

A.4 The following sections examine in more detail the effectiveness of the UK Code of Practice to date.

UK SCOP – OFT review of operation of the Code February 2004

A.5 The CC conducted a broad-based investigation into grocery retailing in the UK in 2000. They concluded that certain practices carried out by supermarkets gave rise to a complex monopoly situation, and found that two groups of these practices operated against the public interest. The first group of practice related to pricing behaviour and the second group related to the behaviour of five grocery retailers towards their suppliers. This led to the establishment of the SCOP, which regulated the conduct of the four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco) with respect to their suppliers.

A.6 The code was not voluntary, any multiple meeting the 8 per cent criterion (having at least an 8% share of grocery purchases for resale) was required to give undertakings to comply with the Code of Practice, which would be designed to meet the concerns identified. It included provisions for independent dispute resolution and other main parties were encouraged to comply with the Code.

A.7 The OFT published a review and audit of the SCOP in February 2004. The consultation carried out as part of the review revealed a widespread belief among suppliers that the code was not working effectively. One trade association representing one significant grocery sector even said that the situation had worsened since the publication

of the 2000 CC monopoly report. The OFT said that the principal reason given by respondents for the perceived lack of effectiveness of the code was the fear among suppliers of complaining. Suppliers, both large and small, were concerned at being de-listed by the supermarkets or being required to trade with them on worse terms if they made complaints.

A.8 At the time of publishing the review the OFT said that no cases had gone to mediation formally under the code and that they had only ever received one written complaint concerning a particular instance of an alleged breach of the code. This was found to be outside the scope of the code as the contract was made before the introduction of the code. The OFT said that they had not received any requests for guidance on the code since it took effect from either the supermarkets or from suppliers or their trade associations.

A.9 The OFT made reference to an earlier CC survey which was undertaken as part of a merger report into the sector. This survey found that 79 to 94 per cent of suppliers reported that the code had not changed their dealings with the supermarkets and six to 15 per cent said matters had worsened.

A.10 The OFT did find that during their review a number of suppliers claimed that retailers were in fact breaching aspects of the code. However, the information received was anecdotal in nature with respondents asserting breaches of the code but giving no details. Accordingly, it was difficult to draw any firm conclusions as to how individual supermarkets were operating under the code and, in particular, whether (and, if so, the extent to which) any of the supermarkets were in breach of the code.

A.11 The Report concluded "*While we recognise the fear among suppliers, there is little that can be done under the current code, or indeed any code of this nature, however rigorously drafted, if suppliers are not prepared to assert their rights under it. No enforcement mechanism, whether in the form of an ombudsman or a regulator or changes to the current mechanism such as access to mediation without prior complaint to the supermarket, will have any effect if suppliers fail to use the code*".

OFT Review and Audit of SCOP March 2005

A.12 Given the reluctance of suppliers to provide specific evidence of alleged breaches of the Code, the OFT did a second review and obtained information from the supermarkets by conducting a focused compliance audit of each of the four supermarkets' dealings with suppliers.

A.13 The second audit found supermarkets were, by and large, complying with the Supermarkets Code of Practice but that the Code was not being used to resolve disputes. They found few cases (eight out of 500) where a dispute had triggered supermarkets' mechanisms for resolving disputes. There were indications that disputes were usually handled outside the formal Code procedure.

A.14 The audit found relatively little evidence of breaches of the Code. However there was evidence of some breaches consisting of supermarket requests that suppliers make lump sum payments in

relation to loyalty and continued supply. Suppliers appeared not to have complained to the supermarkets about having to make the payments and the payments in question, appeared to have ceased during the review. Without the use of mediation to resolve disputes as envisaged by the Code, the OFT said it was difficult to assess the Code's effectiveness. The Code's success depended on it being used. The OFT asked that suppliers overcome the fear of complaining and use the Code's dispute resolution procedure when they have concerns about their dealings with supermarkets.

The GSCOP

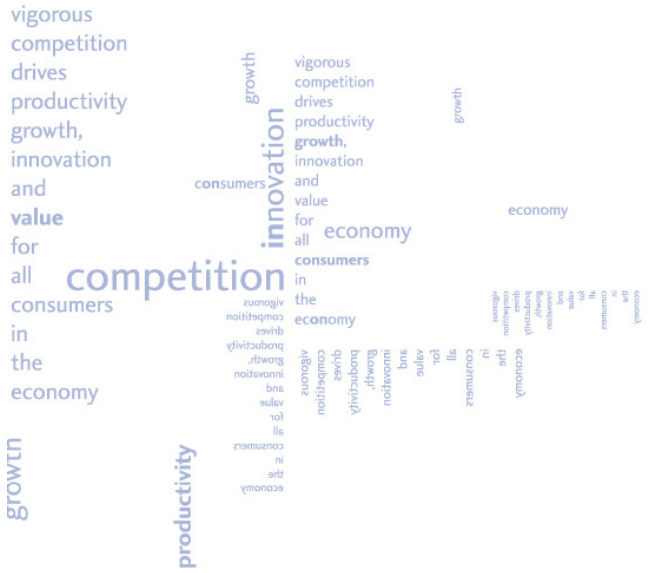
A.15 The Competition Commission published its final report in its inquiry into UK groceries retailing on the 30th April 2008. After examining ways to address concerns about relationships between retailers and their suppliers, the CC announced that they would be tightening the provisions of the Supermarkets Code of Practice and broadening its application such that more grocery retailers will be required to abide by its terms. They said they would also be seeking legally binding commitments from grocery retailers to establish an Ombudsman to oversee the revised Code. At the time they announced that if they could not secure suitable undertakings from grocery retailers, they would recommend that Government takes the necessary steps to facilitate the establishment of the Ombudsman. On the 4th of August 2009, having failed to get cooperation from retailers, the CC formally recommended to the Department for Business, Innovation and Skills (BIS) that it should establish an Ombudsman to arbitrate on disputes between grocery retailers and suppliers and investigate complaints under the new Groceries Supply Code of Practice (GSCOP).

A.16 The CC did not carry out a review of retailers' compliance with the SCOP as part of their investigation. They did however survey suppliers and supplier associations about their concerns and found that nearly half related to the transfer of excessive risks or unexpected costs from grocery retailers to suppliers, and one-third related to requirements for retrospective payments or other adjustments to previously agreed supply arrangements.

A.17 In general, the CC were told that practices which transferred risk to suppliers and retrospective payments were either not covered by the SCOP or were carried out in a manner consistent with the SCOP. The changes to the existing Code of Practice, aim to tackle these concerns and improve the existing system by making it more robust and proactive in tackling those practices which can damage investment by suppliers.

Comment

A.18 Since the introduction of a code of practice for supermarkets in the UK, a number of reviews and assessments of the code have taken place. The common conclusion running through these reviews is that the code of practice is not being utilised as intended because of the fear among suppliers of complaining. A new scheme is being set up early next year by the CC- the Groceries (Supply Chain Practices) Market Investigation Order. This scheme will provide for an Ombudsman and incorporates a Groceries Supply Code of Practice. It remains to be seen whether this new scheme will be successful in redressing the problems where the existing code has failed to address.



The Competition Authority, Parnell House, 14, Parnell Square, Dublin 1, Ireland
Tel: +353 (0)1 8045400 LoCall 1890 220224 e-mail: info@tca.ie

www.tca.ie