

Supermarkets:

The code of practice and other competition issues

Conclusions

August 2005

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1 INTRODUCTION

- 1.1 Our paper of 22 March 2005, *Supermarkets: The code of practice and other competition issues*¹ covered a report on the findings of the audit of supermarkets' compliance with the supermarkets code of practice ('the Code') carried out on our behalf by PKF. That audit found that, by and large, supermarkets were complying with the Code, and found no evidence that disputes between supermarkets and suppliers were leading to any significant impact on competition in this market.
- 1.2 We invited further comments on those findings and on a number of wider issues relating to the supply of groceries in the UK that were raised in the course of our review by 31 May. We also renewed our call for firm evidence of breaches of the Code. This paper sets out our conclusions on the Code review and on the wider issues, and describes how we will continue to monitor and enforce compliance with the Code.
- 1.3 We received 29 responses to our consultation and met several stakeholders during the course of our further investigation.
- 1.4 The background to our involvement in the supply of groceries by supermarkets was set out in paragraphs 2.1 – 2.5 and 3.1 – 3.6 of the 22 March paper. A copy of the Code is at Annexe B to that paper.

¹ OFT783 is available on the OFT's website at <http://www.offt.gov.uk/NR/rdonlyres/3A2B629B-59D2-4547-B879-83A9483D3BE6/0/oft783.pdf>.

2 SUMMARY

The Code

2.1 Our assessment of representations received in response to the review of the Code has provided no evidence to change the interim conclusions that we reached in March. In the light of this:

- we see no case for revocation of, or change to, the Code at this time. In particular, we do not believe that making it more prescriptive would be beneficial to the parties involved and might well damage the efficient operation of the market
- we will continue to monitor the operation of the Code pro-actively, concentrating on improving its usefulness rather than on frequent retrospective review
- we will secure better recording in writing of supermarket – supplier dealings
- we confirm that trade associations can take group actions on behalf of their members under the Code, and
- we see no case for the creation of a supermarket ombudsman or regulator to deal with Code issues.

2.2 These matters are discussed in more detail in Section 3 below.

Wider competition issues

2.3 Consumers are benefiting from competition in grocery retailing. Accordingly, we conclude that there is no case for a market investigation reference. Acquisitions by supermarkets which are likely to give rise to a substantial lessening of competition will continue to be referred to the Competition Commission or undertakings in lieu obtained. These matters are discussed in Section 4 below.

Other issues

- 2.4 Some stakeholders have raised concerns which are outside the OFT's remit. For example, it is for DEFRA to consider issues relating to the viability of the rural economy and for the Office of the Deputy Prime Minister to consider planning matters which have an impact on the diversity of local high streets. These matters are discussed in Section 5 below.

3 THE CODE

3.1 In deciding how to take matters forward on the Code, we have taken account of three factors:

- the Competition Commission's (CC) 2000 and 2003 reports² found, by and large, that suppliers were satisfied with their overall relationships with the multiples they supplied, or had developed a working relationship in the interests of continuing business
- the Code is not meant to shield suppliers from hard bargains driven by supermarkets, and
- most importantly, consumers are benefiting from competition in grocery retailing (see below).

Improving the Code's usefulness

3.2 Suppliers and their representatives continue to complain that the Code's lack of prescriptiveness and suppliers' fear of complaining combine to make the Code ineffective. However, PKF's audit indicated that the supermarkets were, by and large, complying with the Code and no-one has provided evidence to counter this assertion. We discuss below what can be done to improve confidence in the effectiveness of the Code's ability to put supplier-supermarket relations on a clearer and more predictable footing – and in particular to try to reassure suppliers that the Code is an adequate means of dealing with complaints and encourage them to use it to address their concerns.

² *Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom* (Cm 4842, October 2000) and *Safeway plc and Asda Group Limited; Wm Morrison Supermarkets plc, J Sainsbury plc and Tesco plc – a report on the mergers in contemplation* (Cm5950, September 2003)

Written terms

- 3.3 In our 22 March report, we expressed surprise at PKF's findings that none of the sample of suppliers asked supermarkets for written details of particular terms of trading³ – such as prices to be paid and volumes to be delivered. In our view, the effective resolution of disputes relies on both sides being in possession of written terms.
- 3.4 Transparency about terms of dealing is essential to suppliers' ability to negotiate assertively with supermarkets on matters including prices, volumes, discounts, overrides, and promotions. Supermarkets have assured us that these core terms are available in writing. However, there is a perception gap between the availability of information and how some suppliers feel about accessing that information. We know that clarity of core terms provides reassurance to suppliers. The Code requires such information to be available on request (Part 1, Clause 1). Thus, supermarkets should have the necessary mechanisms in place to provide it.
- 3.5 Good practice by supermarkets around use of written terms will help suppliers to complain and help supermarkets to demonstrate compliance more easily. We are not proposing a prescriptive, bureaucratic system since we recognise the dynamic nature of supermarket – supplier relations. But we do expect to see increased transparency about terms of dealing in this market. Encouraging this approach should remove any uncertainty that may exist in some quarters.

³ as opposed to general terms and conditions of trading which appear to be relatively easily available.

Refocused pro-active monitoring and enforcement by the OFT

- 3.6 We will continue to monitor the Code pro-actively and will refocus our activities on facilitating the workings of, and checking compliance with, the Code rather than concentrating on historic reviews of its effectiveness. This task will be made easier as suppliers and supermarkets put in writing the core terms of supply agreements between them as set out above.
- 3.7 This practical approach means we will check with the supermarkets, on a regular basis, their procedures for complying with the Code and will discuss with them any scope for improvement and changes as they arise. We welcome moves made by supermarkets to improve relations with suppliers and we are keen to see how they work in practice. Of particular interest to us will be the position of suppliers who raise Code-related issues with supermarkets. We will wish to see how such suppliers are treated by the supermarkets after they have raised issues / complained and to be assured that they will not be subject to any discrimination or sanctions as a result of complaining.
- 3.8 This refocused monitoring by the OFT should help suppliers overcome their stated objections to raising issues under the Code. We remain willing to discuss alleged specific breaches of the Code with suppliers and their trade associations on a confidential basis, and encourage trade associations, on behalf of their members, to tell us about alleged breaches of the Code.
- 3.9 Supermarkets have a clear responsibility to deal fairly with their suppliers and to honour the terms of the contracts they have with them. They have a continuing obligation to ensure they comply fully with the Code and ensure its successful operation.

Group action by trade associations using the code

- 3.10 We confirm that trade associations can pursue a case on behalf of their members with a supermarket and, if necessary, take a case to mediation under the Code. However, for such cases to be pursued effectively, the relevant evidence must be made available to both sides in the dispute. In other words, it is likely that group actions would still require individual suppliers to be identified as the source of the relevant evidence.

Prescriptiveness of the Code

- 3.11 Some respondents have said that the Code is robbed of its effectiveness by the fact that the concept of "reasonableness", referred to in several of its clauses, is not defined. However, against the background described in paragraph 3.1 above, more prescriptive regulation would not be desirable. We believe that an overly prescriptive Code could deter collaborative arrangements made between suppliers and supermarkets for perceived mutual benefit. In turn this could lead to adverse effects on competition in terms of less innovation and consumer choice, and possibly also higher prices if, for example, promotional activity were significantly curtailed. It is for a mediator to decide what is reasonable in the circumstances of each case.

Supermarket regulator / ombudsman

- 3.12 Some of the submissions received and coverage in the press have called for an ombudsman to regulate dealings between suppliers and supermarkets. Some in the industry want an 'independent regulator' to champion suppliers and consider complaints about supermarkets in confidence, such that the identity of the complainant is known only to the regulator / ombudsman. It is argued that this, combined with proactive monitoring of the operation of the Code by the regulator, would lessen or even remove the reported fear of complaining.
- 3.13 Anonymity is not normally possible where complaints are brought to an ombudsman. Natural justice does not allow findings to be made without

both sides being able to put their case. It is standard practice for an ombudsman, when he receives a complaint, to send a copy of the complaint to the body complained about (or at least to send details of the complaint to it). It is normal for an ombudsman to require the individual to take their complaint to the company in the first instance and exhaust its own complaints procedure, before he will consider the case. This recognised model is incorporated in the existing Code.

- 3.14 We have considered the role of the Office of the Produce and Grocery Industry Ombudsman in Australia which can mediate in disputes between supermarkets and their suppliers. It is clear in this ombudsman's procedures that both parties would normally reveal to the other their identities and at least the basic details of complaint.
- 3.15 Similarly, independent regulators, such as those originally set up to license the activities of the privatised utilities, would normally need to share complaints with operators so the circumstances and legitimacy of the allegations can be verified and the issues made in the complaint addressed. That would usually mean revealing the identity of the complainant.
- 3.16 Supermarket suppliers could not reasonably expect an ombudsman scheme to provide guarantees of anonymity for complainants. Such a scheme would increase regulation and bureaucracy without providing any obvious benefits over the current Code.

4 WIDER COMPETITION ISSUES

- 4.1 The central consideration is whether there is evidence that consumers are being denied the appropriate levels of price, quality and choice in grocery retailing as a result of developments in competition and structural changes to the market such that intervention by the OFT is called for.
- 4.2 Since the publication of the CC's 2000 report, consumers have benefited from competition in grocery retailing which has secured lower food prices overall and a greater choice of product lines in supermarkets with no evidence of reduction in the quality of the produce available.
- 4.3 Inevitably, competition brings about change. That has manifested itself in the increased competitive pressure faced by smaller retailers as the large supermarkets have diversified into convenience retailing; and in changes in the respective market shares of the major supermarkets. It is not for the competition authorities to deny any players in a market opportunities for organic growth where they arise out of a perceived need and ability to meet consumer demand. We do, however, consider merger proposals very carefully and have acted and will act where these might give rise to a substantial lessening of competition.
- 4.4 We have received no firm evidence to show that below-cost selling and price flexing⁴ are affecting competition adversely. The opinion has been expressed to us that price-flexing has decreased since 2000, driven no doubt by the increasing importance of the internet (which, by its nature, reflects national rather than regional prices) as a source of price data.

⁴ i.e. charging different prices in different areas for the same groceries

- 4.5 There is no evidence that, as a result of supermarkets' entry into the convenience store sector, there has been any consumer detriment.
- 4.6 We are not aware that any of the other practices which the CC's 2000 report identified as adversely affecting competition are continuing or of the emergence of any new practices with such an effect.

5 OTHER ISSUES

- 5.1 In paragraph 4.12 of our 22 March report, we referred to certain non-competition issues about the growth of supermarkets on which people had expressed concerns. Where those effects relate to competition between suppliers we are able to consider them as part of our economic analysis under our competition powers. However, we do not have a remit to consider any wider effects on the rural economy and diversity of local high streets of the growth of supermarkets. It is for DEFRA to promote the former and the latter comes within the scope of planning regulations, overseen by the Office of the Deputy Prime Minister.
- 5.2 Some responses to our consultation have said that supermarkets' pressure to cut costs and meet particular standards (for example to do with quality and packaging) affects the viability of overseas suppliers, especially the smaller ones in poor countries. UK competition law cannot be applied to this issue and so the OFT has no jurisdiction over it. However, the Department for International Development is conducting a joint project with the International Institute for Environment and Development to explore the application by retailers of supply chain standards. This is with a view to creating opportunities and identifying favourable outcomes for small scale producers in developing countries to participate in international supply chains, given the rise of private standards.

6 CONTACT POINTS ON CODE ISSUES

Suppliers who wish to raise issues relating to the Code should contact:

Remedies Monitoring and Enforcement Team
Markets and Policy Initiatives Division 4
Office of Fair Trading
Fleetbank House
2 – 6 Salisbury Square
London
EC4Y 8JX

Telephone 020 7211 8574 or 020 7211 8524

E mail: bob.macdowall@oft.gsi.gov.uk or siobhan.furlong@oft.gsi.gov.uk