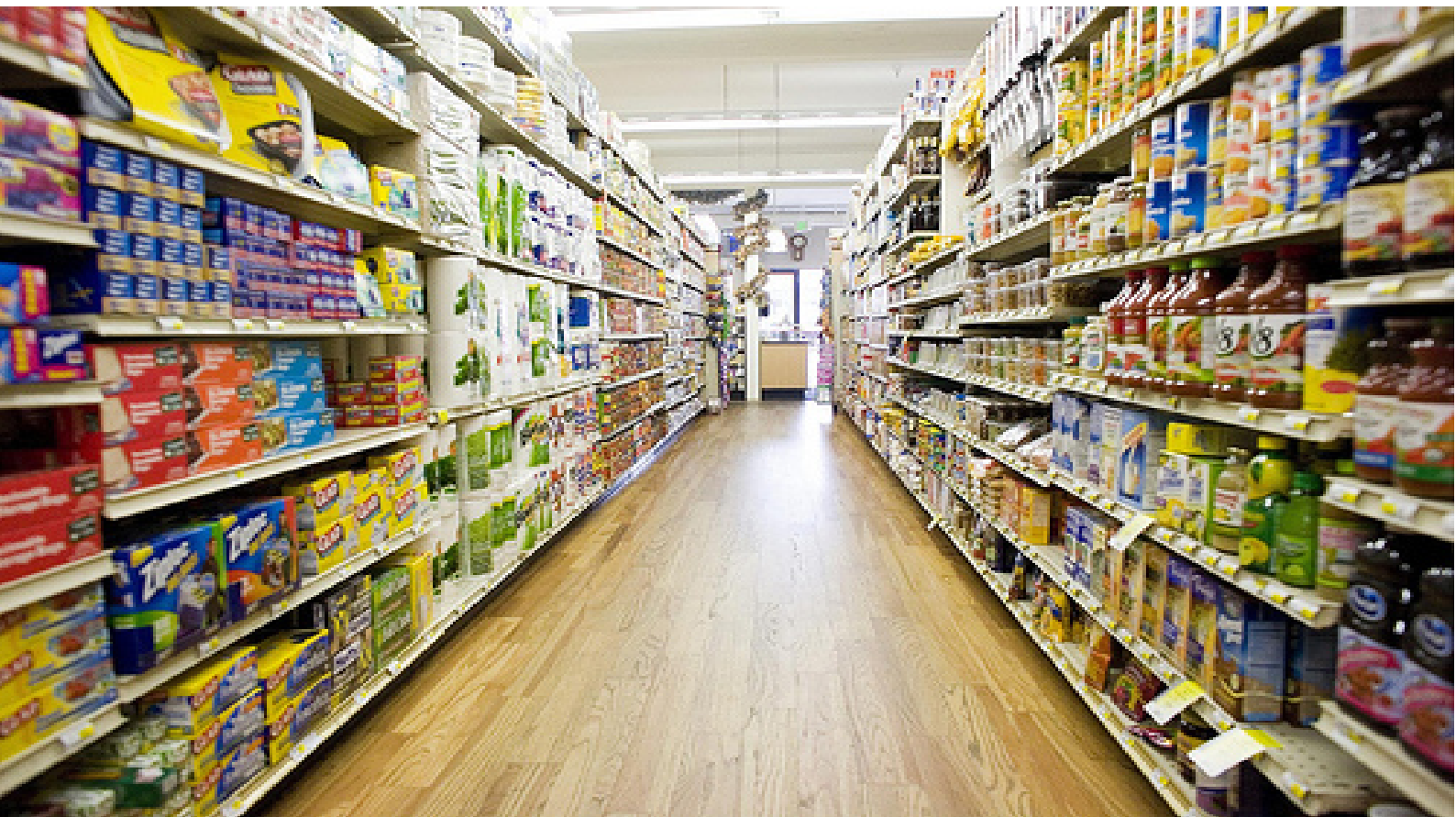


Taking forward the
establishment of a body to
monitor and enforce
compliance with the groceries
supply code of practice
(GSCOP)

A Consultation

FEBRUARY 2010



Explanation of the wider context for the consultation and what it seeks to achieve

In April 2008 the Competition Commission (CC) published its final report of its two year investigation into the Groceries Market. In this investigation the CC found that the transfer from some retailers of excessive risks and unexpected costs to their suppliers constitutes an Adverse Effect on Competition (AEC) under the terms of the Enterprise Act 2002. If continued, the practices could result in a reduction in innovation and investment in the supply chain and lead to consumer detriment. The document can be found at:

http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf

The CC proposed a package of remedies to address this AEC.

- 1) A new strengthened code of practice – the Grocery Supply Code of Practice (GSCOP) established by the Groceries Market (Supply Chain Practices) Market Investigation Order 2009 (the Order);
- 2) A Supermarkets Ombudsman to oversee and enforce the GSCOP, and to arbitrate disputes arising under it.

In August 2009, the CC concluded its consultation on these remedies and established the GSCOP using its powers under the Enterprise Act. It also recommended that the Government establish a GSCOP Ombudsman with the powers to impose penalties for breaches of the Code. The document can be found at:

http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

The Government's response published on 13 January 2010 accepted the need for a body to monitor and enforce compliance with the Code. This consultation paper seeks your views on how the body should be set up, the powers that it has and who it might be.

Issued on	05 February 2010
Respond by	30 April 2010
Enquiries to	Steve Smith, Consumer and Competition Policy Directorate, Department for Business Innovation and Skills, Bay 414,1 Victoria Street, London SW1H 0ET Telephone number: 020 7 215 2776 Email address: steve.x.smith@bis.gsi.gov.uk

This consultation is relevant to large grocery retailers with an annual turnover of £1 billion in the UK and those businesses that supply large retailers with grocery produce either directly or through intermediaries. Trade associations and other non Government organisations may also have an interest.

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Foreword from Kevin Brennan MP

Supermarkets represent one of the most dynamic areas of growth in UK retail and account for 86% of our spending on food & groceries. The importance of the groceries sector is key to the UK economy in terms of investment, innovation and jobs. Retail accounts for about 10% of GDP with groceries making up to 50% of that, including and providing some 1.5 million jobs.



Grocery retailers are doing a good job overall. An ever increasing number of consumers use them because of the convenience, choice and range that they offer. Consumers benefit through having a competitive market that offers good value.

Despite the market generally working well, the Competition Commission (CC) has some concerns over the long term future of the supply chain. The CC's main concern was the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, through the adoption of supply chain practices that transferred excessive risks and unexpected costs to those suppliers. The CC found that when, in the hope of gaining competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes. The CC concluded that if left unchecked, this will ultimately have a detrimental effect on consumers, by leading to lower quality goods, less choice of goods, or less product innovation.

We firmly believe that suppliers deserve a fair deal. These kind of practices need to be stopped if consumers are not to lose out in the longer term. The new Groceries Supply Code of Practice (GSCOP) is a welcome step forward with new and strengthened provisions together with extended grocery retailers' coverage.

But more is needed to make the Code truly effective. Grocery retailers had the opportunity to work with the CC to put in place an Ombudsman. These undertakings were not accepted by the grocery retailers and the CC has asked Government to intervene.

We have accepted the need for the GSCOP to be independently monitored and enforced. The principle of establishing a body to monitor and enforce the GSCOP is not a matter for this consultation.

But we need to ensure that there remains flexibility for commercial negotiations between suppliers and retailers to take place around prices and other commercial elements of the supply agreement. We are keen to ensure that the right balance is made so that suppliers are dealt with fairly in order that they can plan ahead with confidence but also that retailers are not prevented from securing the best deals and passing on benefits to consumers.

We are also considering the name given to the body. Many representations received by my department have indicated that the term Ombudsman may confuse and mislead as to its role. For the purposes of this consultation we have adopted the name GSCOP compliance monitoring and enforcement body.

Interested parties are invited to give their views on the way in which the CC's proposal for the body to monitor and enforce compliance with the groceries supply code of practice (GSCOP) is taken forward.

A handwritten signature in black ink that reads "Kevin Brennan". The signature is written in a cursive style with a long horizontal flourish at the end.

Kevin Brennan MP

Executive Summary

The Purpose of this consultation

1. The Competition Commission (CC) identified in its report into the supply of groceries in the UK that some large retailers are transferring excessive risk and unexpected costs to suppliers which reduces innovation and investment in the grocery supply chain. On 13th January the Government announced its response to the recommendation, stating that it:
 - a. Accepts the CC view that the GSCOP needs independent monitoring and enforcement to address fully the Adverse Effect on Competition (AEC);
 - b. Agrees that the body monitoring and enforcing compliance with the GSCOP should have the power to hear anonymous complaints;
 - c. Would consult after the GSCOP comes into force on 4 February 2010 on the specific powers that a body to monitor and enforce compliance with the GSCOP should have, and whether a new body should be set up or an existing body be given these powers.
2. These practices were identified despite the existence of the Supermarket Code of Practice (SCOP), a Code drawn up following the 2000 broad based investigation on grocery retailing conducted under the Fair Trading Act. The investigation highlighted the existence and operation of a group of practices that operated against the public interest in relation to the behaviour of five grocery retailers towards their suppliers. This led to the drawing up of the SCOP which has regulated the conduct of the four largest retailers (Asda, Morrisons, Sainsbury's and Tesco) with respect to their suppliers.
3. The Office of Fair Trading (OFT) has overseen the operation of the SCOP since it's creation. The OFT reviewed the SCOP in 2004 and published an independent audit of retailers' compliance with the SCOP in March 2005. In addition to the audit the OFT called for evidence of other aspects of the supply of groceries by grocery retailers that negatively impacted on competition. The OFT decided in August 2005 not to refer the market to the CC, but reconsidered this decision following an appeal to the Competition Appeal Tribunal (CAT) by the Association of Convenience Stores, and made a reference in May 2006. One of the OFT's concerns was that there was evidence to suggest that buyer power had increased since 2000 and that this buyer power could harm consumer choice.
4. A broad range of issues relating to the groceries supply chain were raised with the CC in its final report in April 2008. The CC was clear to point out that the exercise of buyer power by grocery retailers is likely to have positive implications for consumers, especially where the competition between grocery retailers is effective, consumers benefit through lower prices. It can also spur innovation in the supply chain. The exercise of buyer power can, however, raise concerns in certain limited circumstances. The CC found that when, in the hope of gaining competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes.

The CC concluded that if left unchecked, this will ultimately have a detrimental effect on consumers, by leading to lower-quality goods, less choice of goods, or less product innovation, which is not in consumers' long term interest.

5. To address the concerns that it identified, the CC decided to establish a new Groceries Supply Code of Practice (GSCOP). This Code, which enters into force on 4 February 2010, applies to all firms which are active in the sector and have annual retail groceries turnover of £1 billion or more. The new GSCOP is based on the SCOP but represents a significant strengthening and expansion of the SCOP requiring retailers, for example, to put all contracts in writing and prohibiting retrospective adjustments to payments. The GSCOP also allows for independent binding arbitration of disputes and requires grocery retailers to provide reasonable notice and commercial justification before a supplier is delisted (the GSCOP provides that a retailer may only de-list a supplier for genuine commercial reasons). These are set out in more detail later in the consultation document.
6. Many suppliers had told the CC that they were reluctant to use the complaints process in the SCOP due to concerns over being identified and the likelihood of being delisted by the retailers.
7. The CC considers that the GSCOP will be much more effective with an Ombudsman in place to address the "climate of fear" that many suppliers mentioned existed under the previous code of practice. The CC believes that a regulator is necessary both to enforce compliance with the GSCOP and to carry out investigations. These functions should include, for example, investigations of anonymous complaints, complaints arising from third parties and recurring complaints against a particular retailer. The body will also require the power to raise funds from designated retailers to cover the costs of the body monitoring and enforcing compliance with the GSCOP.
8. The CC does not have the powers to set up new public bodies. The CC sought, but failed, to obtain voluntary undertakings from retailers for an Ombudsman. Consequently the CC recommended that Government take the necessary steps to establish an Ombudsman, as soon as practicable, with powers to enforce the GSCOP and levy monetary penalties on retailers for non compliance.
9. Government has considered very carefully the CC's recommendation and has received a large number of representations from all sides of the debate. More recently Ministers have met with a number of businesses and representative organisations to hear their views face to face.
10. Government accepts that GSCOP compliance needs independent monitoring and enforcement and a mechanism to hear anonymous complaints. This last point is very important. However, there are differing views on whether Government creates a new body or whether this can sit within an existing structure. At the same time we need to consider the regulatory burden that this might impose in developing any policy proposals. This consultation is therefore seeking views on:

- What powers the body monitoring and enforcing compliance with the GSCOP should have, in addition to the body being able to hear anonymous complaints;
 - Access to the body;
 - Who the monitoring and enforcement body could be, including some possible options;
 - Should a sanctions regime be introduced and how might it operate alongside any appeals mechanism, and;
 - The funding of the body monitoring and enforcing compliance with the GSCOP.
11. Therefore, we are consulting with all those who have an interest in the grocery supply chain. This includes the largest grocery retailers who are directly covered by the GSCOP, alongside medium sized and smaller grocery retailers for which independent monitoring and enforcement might have an impact. We also want to hear the views of those who supply large grocery retailers either directly or through other routes. The GSCOP itself applies only to direct suppliers to retailers but the CC has proposed that the body should be able to investigate complaints from any other person.
12. Competition is a reserved matter in the UK and therefore any GSCOP enforcement system that is set up will cover Scotland, Wales and Northern Ireland.
13. The responses received will help frame a more focused and detailed consultation that will be required before a final decision is made on the make up of the body.
14. If all or part of the response is confidential please see paragraph 11 (Confidentiality and Data protection).

Definition of groceries

15. For the purposes of the response 'groceries' includes food (other than that sold for consumption in the store), pet food, drinks, cleaning products, toiletries and household goods.
16. The term excludes petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers and magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products.

How to Respond

17. When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation

represents and, where applicable, how the views of members were assembled.

18. Consultation responses can be sent electronically to GSCOPmonitoringbody@bis.gsi.gov.uk

19. A response can (also) be submitted by letter, fax or email to:

Steve Smith
Consumer and Competition Policy Directorate 2 (CCP2)
Department for Business, Innovation and Skills.
Bay 414
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 2776
Fax: 020 7215 2837
Email steve.x.smith@bis.gsi.gov.uk

20. A list of those organisations and individuals consulted is in Annex B. We would welcome suggestions of other organisations or individuals who may wish to be involved in this consultation process.

Additional copies

21. You may make copies of this document without seeking permission. Further printed copies of the consultation document can be obtained from:

BIS Publications Orderline
ADMAIL 528
London SW1W 8YT
Tel: 0845-015 0010
Fax: 0845-015 0020
Minicom: 0845-015 0030
www.bis.gov.uk/publications

22. An electronic version can be found at www.berr.gov.uk/files/file54425.pdf.
A Welsh language version can be found at www.berr.gov.uk/files/file54426.pdf.

23. Other versions of the document in Braille, other languages or audio-cassette are available on request.

Confidentiality & Data Protection

24. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If

you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

25. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

Help with queries

26. Questions about the policy issues raised in the document can be addressed to:

Steve Smith
Consumer and Competition Policy Directorate
Department for Business, Innovation and Skills
Bay 414
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 2776
Email: steve.x.smith@bis.gsi.gov.uk

Complaints

27. If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Tunde Idowu, Consultation Co-ordinator
Department for Business, Innovation and Skills
Better Regulation Team
1 Victoria Street
London
SW1H 0ET

E-mail: Babatunde.idowu@BIS.gsi.gov.uk
Tel: 020 7215 0412
Fax: 020 7215 0235

Comments

28. We would be grateful for comments on our proposals together with any supporting evidence that you have. We would also welcome any other ideas or recommendations for change that would assist in meeting the policy objective of this consultation. We would appreciate it if you could

bring to our notice any unintended consequences or other implications that you have been able to identify in relations to our proposals.

29. You are invited to comment on the analysis of costs and benefits and equalities impacts. A draft impact assessment is attached at Annex D. You are asked to look at this and provide any data that you think useful. If you have suggestions of alternative mechanisms to achieving our objectives we would be interested to learn about them.
31. A list of helpful links to documents prepared by the OFT, CC and BIS in relation to this consultation can be found at Annex C.
32. A copy of the Code of Practice on Consultation is in Annex A.

List of consultation questions

Activities

1. **Should the body monitoring and enforcing compliance with the GSCOP be given all of these duties and powers?**
2. **Are some of the activities more important than others, if so what are they?**
3. **Are there additional activities that should be considered, if so what are they?**
4. **Are there some proposed activities that should be rejected, if so what are they?**
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?**
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?**
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?**
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?**
9. **Are the general principles too broad? Should they be made more specific? If so how?**
10. **Should the principles be set out in legislation?**

Who the body should be

- 11. Is there an existing body that could take on this role? If so who might this be?**
- 12. What are the benefits or downsides of an existing body taking this role?**
- 13. Is it important that a brand new body be created and are there strong arguments for or against this?**

Penalties regime

- 14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?**
- 15. If important, how should the penalties be levied?**
- 16. What levels should they be set at?**
- 17. Are there other deterrents that could be effective?**
- 18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?**
- 19. Who should hear appeals?**

Coverage

- 20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?**
- 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?**
- 22. If there is to be a threshold how would it be calculated?**
- 23. Is there anything else which should be specified i.e. is there an (e) to paragraph 5.3?**

Funding the body monitoring and enforcing compliance with the GSCOP

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

Impact Assessment

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? Please provide supporting evidence.

Specific Impact Assessment questions

27 Do you have further quantitative and qualitative evidence on the impact of supply chain practices on investment and innovation? (paragraph 47)

28 Do you have other evidence regarding the potential costs associated with the GSCOP? (paragraph 61)

29 Are there other indicators that could inform current and future levels of compliance with supplier practices covered in the GSCOP? (paragraph 64)

30 Do you have evidence that could help to quantify the impact of reduced supplier investment and innovation on consumers? (paragraph 65)

31 Do you have any evidence that could help project the number of complaints and disputes under a GSCOP enforcement body? (paragraph 70)

32 Are there other existing bodies, of which the GSCOP enforcement body could be part? (paragraph 78)

33 Do you have any other evidence on the costs and benefits of establishing a new body to monitor and enforce the GSCOP? (paragraph 85)

34 Do you have any further evidence on the likely costs associated with appeal of GSCOP arbitrations? (paragraph 94)

35 Do you have further evidence on the effectiveness of fines as a deterrent? (paragraph 95)

36 Do you have data on the number of direct and indirect suppliers in the UK groceries market? (paragraph 106)

Equality Impact Assessment Questions

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?

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

Chapter 1 - Introduction

1.1 There has been a significant level of activity by the competition authorities in the groceries market over the past decade or so. The CC itself has conducted four inquiries in the grocery retailing sector since 1999/2000. The first, commonly known as the 2000 investigation, was broadly based and similar to the most recent investigation but conducted under the monopoly provisions of the Fair Trading Act 1973. The second and third inquiries were more limited and held in response to specific merger transactions.

1.2 The 2000 investigation 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.

1.3 One of these groups of practices related to the behaviour of five grocery retailers towards their suppliers. The CC decided that any main party with more than an 8% share of grocery purchases for resale from its stores was, for the most part, able to control their relationships with suppliers to their own advantage, whilst the smaller multiples are not able to do so to anywhere near the same extent. It therefore specified that a grocery retailer with a national share of grocery sales of over 8% should be required comply with a code of practice. This led to the establishment of the Supermarkets Code of Practice (SCOP). The original five grocery retailers identified by the CC were Asda, Safeway, Sainsbury's, Somerfield and Tesco. Somerfield was later found to have less than an 8% share and did not become a signatory to the SCOP. Safeway was subsequently acquired by Morrisons, and Morrisons agreed to be bound by the SCOP as if it was a signatory.

1.4 Provisions of the SCOP covered issues such as standard terms of business, prices and payments, promotions, compensation, consumer complaints, third party dealings and staff training. The Code in full can be found at:

http://www.offt.gov.uk/shared_offt/monopolies/supermarkets2.pdf

1.5 The OFT continued to look at a range of issues following the 2000 investigation. This included oversight of the SCOP. In response to concerns by parts of the supply sector over the effectiveness of the SCOP the OFT undertook a review of the SCOP in 2004 and an audit of retailers' compliance in 2005.¹

1.6 The compliance audit of supermarkets looked at a sample of 500 grocery supplier relationships with the big four supermarkets. 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

¹ http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft783.pdf

the payments and the payments in question, which mostly concerned Safeway before its acquisition by Morrisons, appeared to have ceased.

1.7 Without the use of mediation to resolve disputes as envisaged by the Code, it was difficult to assess the Code's effectiveness.

1.8 The OFT invited parties to present evidence related to the SCOP audit and other evidence on whether there were aspects of the supply of groceries by grocery retailers that adversely affected competition. The OFT initially concluded that there were no grounds for a market investigation reference to the CC. However, this decision was challenged by the Association of Convenience Stores (ACS) to the Competition Appeal Tribunal (CAT). The OFT investigated the matter further and made a reference to the CC on 9 May 2006 which led to the CC investigation.

1.9 The OFT reference² was made on the grounds that several features of the market could reasonably be suspected to be preventing, restricting or distorting competition. In summary the OFT was concerned that aspects of the planning system, land holdings, buyer power and some pricing policies in respect of large grocery retailers could all, to some extent have anti competitive affects. During the course of the CC investigation it considered each of these matters.

1.10 In considering the specific issue of the exercise of buyer power, the CC did not find that this was necessarily harmful to consumers. However, in the course of its investigation the CC identified, in limited circumstances, practices carried out by large retailers that could lead to a significant reduction in the incentive and ability of suppliers to invest and innovate for new product lines or production processes. The CC was particularly concerned over the retailers making retrospective adjustments to terms of supply that impose excessive risks and unexpected costs on suppliers. Particular retailers were also passing on risks to suppliers for the loss (shrinkage) of small high value products. Manufacturers could influence the level of risk by including security features in packaging and the retailers by storing the products adequately and prescribing particular forms of packaging.

1.11 In all, the CC received 380 concerns from suppliers and supplier associations. Nearly half of the concerns related to the transfer of excessive risks or unexpected costs from grocery retailers to suppliers, and one third to requirements for retrospective payments or other adjustments to previously agreed supply arrangements.

1.12 The CC concluded that if left unchecked, this will ultimately have a detrimental effect on consumers, by leading to lower-quality goods, less choice of goods, or less product innovation, which is not in consumers' long term interest.

1.13 The CC's final report published on 30 April 2008 set out its findings and remedies. The CC decided to establish the Groceries Supply Code of

² http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft845.pdf

Practice (GSCOP)³ based on the existing SCOP but amended to cover large grocery retailers with UK groceries turnover of £1 billion or more. In addition the GSCOP included an overarching fair dealing provision to prohibit a number of practices that had been taking place. Other important features were the automatic provision of standard terms and conditions being provided to suppliers before the contract is entered into, the introduction of binding arbitration and protection against the delisting of suppliers.

1.14 In addition to this remedy, the CC decided to seek undertakings from grocery retailers to establish a GSCOP Ombudsman to effectively monitor and enforce compliance with the GSCOP. The CC said that if it was unsuccessful in obtaining satisfactory undertakings within a reasonable period of time it would ask Government to intervene and take the necessary steps to create a GSCOP Ombudsman. In its response of 29 July 2009, the Government said that if the CC was unable to secure undertakings and the recommendation was made to Government that it would primarily base any assessment on what was in consumers' best interests⁴.

1.15 Despite a round of consultations the CC was unable to obtain undertakings from the grocery retailers to establish a GSCOP Ombudsman⁵. On 4 August 2009 formally requested that the Government take the necessary steps to establish an effective Ombudsman.

1.16 The Government accepted the need an independent body to monitor and enforce compliance with the GSCOP and published its response to the formal recommendation on 13 January⁶.

1.17 The consultation is specifically seeking views on aspects of the proposed enforcement regime which are contained within the following chapters, namely

- What powers the body monitoring and enforcing compliance with the GSCOP should have, in addition to the body being able to hear anonymous complaints;
- Access to the monitoring and enforcement body;
- Who the monitoring and enforcement body could be, including some possible options;
- Should a sanctions regime be introduced and how might it operate alongside any appeals mechanism, and;
- The funding of the body monitoring and enforcing compliance with the GSCOP.

³ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

⁴ <http://www.berr.gov.uk/files/file47089.pdf>

⁵ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

⁶ <http://www.berr.gov.uk/files/file54194.pdf>

Chapter 2 - The Proposals: Activities of the body

2.1 Government accepts the need for an independent body to monitor and enforce compliance with the groceries supply code of practice (GSCOP) and is seeking views on the activities that the body should be given.

2.2 The GSCOP Order was made in August 2009 and came into force on 4 February 2010. This sets out in detail the incorporation of a fair dealing provision as an important safeguard against the transfer of excessive risk and unexpected cost from large grocery retailers to their suppliers. This provision constrains bad practice whilst allowing commercial flexibility. The CC's principal concerns are around retrospective adjustments to terms of supply. However, there are other circumstances where, although allocations of risk may be agreed up front, these could be excessive for the supplier since the retailer is best placed to control those risks. The Order will be enforced, and suppliers will be able to take disputes to arbitration, from that date.

The full Order can be viewed at:

http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

2.3 The CC, in completing its final report, took evidence from a large number of parties and made a convincing case for the need for an independent body to monitor and enforce the GSCOP. The CC estimates that at least 20 of the 52 practices identified in the 2000 investigation continued to be practised despite the introduction of the SCOP. Government has also received many representations in writing and held many face to face meetings which support this view. Government agrees that monitoring and enforcement of compliance with the GSCOP is necessary to ensure its effectiveness. Government is, therefore, seeking views on how this proposal should be taken forward. The proposals should be read in conjunction with the CC's Notice of Proposal to accept undertakings pursuant to section 165 of, and Schedule 10 to, the Enterprise Act 2002 and public consultation on the proposed Undertakings, which can be found in full at:

http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/ombudsman_undertakings.pdf

The activities of the body monitoring and enforcing compliance with the GSCOP as proposed by the Competition Commission

2.4 The overriding objective of the body monitoring and enforcing compliance with the GSCOP will be to undertake Investigations and arbitrate Disputes arising from the Code to promote the interests of consumers. The CC has made it clear that the enforcement body role should be restricted to matters relating to the Code.

The proposed principal duties of the body monitoring and enforcing compliance with the GSCOP as set out by the CC are:

(a) to act as an arbitrator between Designated Retailers and Suppliers in relation to Disputes arising under the Code;

2.5 The body monitoring and enforcing compliance with the GSCOP will act as an arbitrator of Disputes and shall conduct any arbitration in accordance with the Rules of the Chartered Institute of Arbitrators, the costs will be borne by the Designated Retailer, unless the arbitrator decides that the Supplier's claim was vexatious or wholly without merit, and the decision will be binding and final on both the Designated Retailer and the Supplier, subject to appeal. This function forms part of the GSCOP Order that came into force on 4 February and will, therefore, be part of the enforcement regime.

(b) to receive complaints in relation to a breach of the Code, and where appropriate to conduct Investigations;

2.6 As well as undertaking dispute resolution, the CC proposed that the monitoring and enforcement body should also have the power to receive and, where appropriate, investigate complaints regarding breaches of the GSCOP. There is an important distinction between this function and the dispute resolution function. Where a dispute is notified to the body monitoring and enforcing compliance with the GSCOP, due process will require that a retailer has the opportunity to answer and address any particular allegations. A dispute will therefore necessarily concern specific allegations made by a specific supplier against a specific retailer.

2.7 By contrast, the CC envisages that complaints could be received by the body monitoring and enforcing compliance with the GSCOP on a confidential basis, as a form of information-gathering. A single complaint would usually not result in any action other than its being collected and verified. There would not be a duty to act on every complaint. Verification might involve meeting with the complainant to understand the scope of the complaint. Once the monitoring and enforcement body has sufficient information - for example, to spot a pattern of behaviour among retailers or areas of concern within a particular retailer's buying practices - it could open an investigation. The nature and scope of the investigation would reflect the area or areas of concern. It might concern a particular retailer or retailers' behaviour; a particular sector or sectors; or over a particular period of time. It is important to note that where an investigation had been opened on the basis of complaints, the purpose of the investigation would be to understand the pattern of behaviour, not the individual complaints. On this basis, the CC does not consider that there would be any need to disclose the complainants that originated the investigation and they would be kept confidential from the retailer. By investigating areas of recurring concern, the body monitoring and enforcing compliance with the GSCOP would help build confidence in the operation of the groceries supply chain.

2.8 The CC proposes that the body monitoring and enforcing compliance with the GSCOP, in response to a complaint from a third party, could contact the supplier against which the alleged breach of the Code had been committed, to

corroborate the details of the complaint. Moreover, it should be noted that complaints, in and of themselves, will not lead to sanctions being imposed on a retailer.

2.9 In order to carry out an effective investigation, the body monitoring and enforcing compliance with the GSCOP would require information gathering powers. Retailers would be under a requirement to provide such information as the enforcement body needed to perform its functions. In the course of undertaking investigations, the monitoring and enforcement body might identify possible amendments to the GSCOP. The OFT would assess if the CC needed to be advised that the GSCOP Order should be amended accordingly.

2.10 Government has already stated in its response that the body monitoring and enforcing compliance with the GSCOP should have the power to hear anonymous complaints.

(c) to publish guidance on specific provisions of the Code and the Scheme when necessary;

2.11 The body monitoring and enforcing compliance with the GSCOP should periodically publish guidance on the interpretation of specific provisions of the Code, and/or how the monitoring and enforcement body expects such provisions to operate; and the practices and procedures necessary to complete his functions pursuant to this Scheme, whether to replace or compliment existing guidance on such functions.

2.12 Before publishing any guidance, the body monitoring and enforcing compliance with the GSCOP will publish its proposed guidance for consultation, and will consider any representations made on the proposed guidance. The guidance would address the specific provisions of the Code or the practices and procedures relating to the Scheme.

(d) to make recommendations to Designated Retailers on how to improve compliance with the Code and to monitor progress on the implementation of such recommendations;

2.13 Following an Investigation, the body monitoring and enforcing compliance with the GSCOP may make recommendations to a Party (or Parties) on how to improve their compliance with the Code. A recommendation should specify the relevant provisions of the Code; the practice of the Party (or Parties) when interacting with its Suppliers which gives rise to the need for the recommendation; and those actions which should be undertaken or discontinued by the Party (or Parties) to prevent the practice from continuing.

(e) to advise and report publicly on the operation of the Scheme and the Code

2.14 The body monitoring and enforcing compliance with the GSCOP shall keep the Code and the Undertakings under review and report publicly on them annually.

2.15 The reports should include a summary of each resolved dispute between retailers and suppliers and a summary of any investigations undertaken, where these have identified a breach of the GSCOP. Reports could be published subject to commercial confidentiality. The body monitoring and enforcing compliance with the GSCOP would have regard to the nature of the information and the impact on parties that could arise through disclosure.

2.16 In addition to outlining the activities that the monitoring and enforcement body should undertake, as shown above, there are general principles to which the body should have regard.

2.17 It has been proposed that in discharging his duties the body monitoring and enforcing compliance with the GSCOP shall:

(a) have regard to the overriding objective of the GSCOP Scheme to work in the long term interest of consumers , and the findings of the CC in the Report;

(b) not facilitate or encourage coordination among Retailers and/or Suppliers. Such coordination could arise from, for example, round-table meetings and the encouragement of any dialogue between Suppliers and Retailers outside normal bilateral commercial arrangements; and

(c) avoid any activity that is not focused on the overriding objective of the Scheme. In particular, in undertaking his functions the monitoring and enforcement body should confine his activities to evaluating the operation of the Code and should not consider other commercial elements of the Supply Agreement.

2.18 The ultimate objective of the body monitoring and enforcing compliance with the GSCOP is to promote the long term interests of consumers. We do not see any role for the enforcement body that goes beyond the monitoring and enforcement of the GSCOP.

Questions.

1 Should the body monitoring and enforcing compliance with the GSCOP be given all of these functions and powers?

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

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

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

- 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?
- 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?
- 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?
- 8** Are the suggested principles (a-c in 2.17 above) to be considered by the body monitoring and enforcing compliance with the GSCOP in carrying out its duties appropriate?
- 9** Are the general principles too broad? Should they be made more specific? If so how?
- 10** Should the principles be set out in legislation?

Chapter 3 - The Proposals: Who the body should be

3.1 Government is seeking views on whether the body monitoring and enforcing compliance with the GSCOP should be a new one or are there suitable existing bodies to take on these functions.

3.2 The CC assessed in detail two options. The first was a GSCOP Ombudsman, and the second a combination of dispute resolution by an independent arbitrator with monitoring conducted by the OFT. The government has recognised for the GSCOP to be effective it requires a body to monitor and enforce the GSCOP.

3.3 The CC's preferred option is for an independent body to monitor and enforce compliance with the GSCOP, which would be able to develop working relationships with the sector, build industry expertise and promote best practice. This option might bring slightly higher costs than inclusion of the enforcement function in an existing body, but could bring the advantage of specialisation in the GSCOP and grocery supply chain.

3.4 Another option would be to give all of the monitoring and enforcement functions associated with the GSCOP to the OFT, in which case the cost might be less than a dedicated body (through, for example the sharing of back office functions).

3.5 The OFT already has some familiarity with the subject matter. It has been responsible for monitoring the SCOP and has been willing to accept anonymous complaints. It also has an important role in ensuring that the GSCOP is embedded in the designated grocery retailers by 4 February 2010. The main elements of the OFT's role when the Order comes into effect will be:

- to designate retailers who meet the designation criteria in Article 4 after the Order is made;
- to monitor and enforce the obligations on designated retailers that are set out in the Order, ensuring that these retailers;
 - incorporate the GSCOP into supply agreements and make those agreements available in writing to their suppliers;
 - train staff on the GSCOP;
 - appoint compliance officers;
 - respond to requests from suppliers to initiate dispute resolution proceedings, and;
 - produce compliance reports and submit them to the OFT

3.6 If a separate body to monitor and enforce compliance with the GSCOP was set up, the OFT's role would be confined to the operation and

enforcement of the Order rather than the GSCOP. Under these circumstances the OFT would not: provide guidance on the interpretation of the GSCOP; determine whether matters fell within its scope; resolve disputes between suppliers and retailers as to the operation of the GSCOP; nor would it proactively investigate confidential complaints by suppliers about breaches of the GSCOP. The OFT role is explained in more detail at http://www.offt.gov.uk/shared_offt/monopolies/GSCOP-OFT-advice.pdf

3.7 The OFT therefore has been identified by a number of stakeholders as a body that could undertake the GSCOP monitoring and enforcement role. However, this consultation is not confined to considering the OFT as the existing body who could undertake a monitoring and enforcement role. We are keen to hear whether there are other suitable bodies that could undertake effective monitoring and enforcement of GSCOP compliance.

Questions

- 11. Is there an existing body that could take on this role? If so who might this be?**
- 12. What are the benefits or downsides of an existing body taking the monitoring and enforcing compliance with the GSCOP role?**
- 13. Is it important that a brand new body be created and are there strong arguments for or against this?**

Chapter 4 - The Proposals: Penalties regime

4.1 The CC has proposed that Government gives the body monitoring and enforcing compliance with the GSCOP the added power to levy penalties on retailers that breach the GSCOP.

4.2 The CC has incorporated the existing provisions in the SCOP for the payment of compensation by retailers into the GSCOP. However the CC is not convinced that the payment of compensation alone is sufficient incentive for retailers to comply with the SCOP or adequately reflect the effect the retailers' behaviour may have on suppliers and considers that the body monitoring and enforcing compliance with the GSCOP would be more effective if it had more comprehensive powers to investigate and penalize retailers for non-compliance with the GSCOP. The CC has therefore recommended that in addition to establishing the body to monitor and enforce compliance with the GSCOP, that Government considers giving the body additional powers to levy penalties for GSCOP breaches. Penalties should only be imposed when there is very strong and convincing evidence and decisions should be capable of appeal.

4.3 Although there is a sound argument for imposing penalties to deter bad practice it has been argued that the reputational damage to a retailer of being named as treating suppliers in an unfair manner would also act as a deterrent.

4.4 The loss of customers who felt strongly about the fair treatment of suppliers could be more damaging than simply imposing penalties.

4.5 Where the body monitoring and enforcing compliance with the GSCOP has taken a decision with regard to a breach of the GSCOP we envisage an appeals process being made available to parties. We would be interested to hear views on how this should be set up and work in practice.

Questions

- 14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?**
- 15. If important, how should the penalties be levied?**
- 16. What levels should they be set at?**
- 17. Are there other deterrents that could be effective?**
- 18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?**
- 19. Who should hear any appeals and how should the process work?**

Chapter 5 - The Proposals: The body's coverage

5.1 The body monitoring and enforcing compliance with the GSCOP should be able to take code related complaints from all suppliers not just those covered by the GSCOP.

5.2 The CC in its April 2008 report stated that the body monitoring and enforcing compliance with the GSCOP would need to prioritise 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.

5.3 The body monitoring and enforcing compliance with the GSCOP when using its discretion will consider the following information in relation to the obligations under the Code that it proposes to investigate:

(a) complaints from Suppliers, including but not limited to, those complaints that result in the arbitration of a Dispute;

(b) complaints from Retailers regarding the practices of a Party (other retailers) when interacting with its suppliers;

(c) complaints from any other person, but only to the extent that it relates to a breach of the Code and/or the Undertakings; and

(d) any other information obtained by the body monitoring and enforcing compliance with the GSCOP or the OFT, whether in the public domain or as a result of a Designated Retailer's reporting obligations under the Order or these Undertakings.

5.4 When exercising its discretion the enforcement body will have regard to issues which it considers to be relevant including those specified in 5.3 (a) to (d).

5.5 The body monitoring and enforcing compliance with the GSCOP must have a degree of discretion, for example the person mentioned in (c) might raise completely unmeritorious arguments. Such complaints need to be supported by sufficient evidence to be of use to the enforcement body in taking forward any investigation.

5.6 Retailers covered by the GSCOP have questioned whether large suppliers should be included within the proposals. They believe that large suppliers could use the new GSCOP and proposed body to lever enhanced terms leading to higher retail prices. This matter was looked at when the SCOP was first introduced in 2002. The general consensus then was that exclusion was not appropriate and would weaken the Code. It would also be difficult to determine with any precision what turnover and or other criteria was taken into account.

5.7 The CC observed in its 2008 report that the buyer power of even the largest grocery retailers may be offset by the market power of suppliers particularly those which supply the most prominent branded goods.

5.8 The CC noted that in order to be meaningful for any such criteria to determine the power of a supplier it would have to access the suppliers' dealings in individual products and with individual grocery retailers which would entail significant practical difficulties. The GSCOP does not exclude large suppliers with buyer power and so it may be difficult to justify excluding them from access to the body enforcing and monitoring the GSCOP. However, we would expect in practice the body to exercise some discretion in deciding which areas to investigate.

Questions

- 20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?**
- 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?**
- 22. If there is to be a threshold how would it be calculated?**
- 23. Is anything else which should be specified in 5.3 above, i.e. is there an (e)?**

Chapter 6 - The Proposals: Funding the body

6.1 The body monitoring and enforcing compliance with the GSCOP should be reimbursed by the designated grocery retailers

6.2 The CC has estimated that the upfront cost to retailers of establishing the GSCOP to be approximately £1 million in total. The annual cost associated with compliance with the GSCOP is approximately £1.7 million per year. The estimated cost of an enforcement body that can receive complaints from all suppliers is £120,000 per retailer. Across the ten grocery retailers covered by the GSCOP, this amounts to £1.2 million per year. Therefore, the total ongoing costs of the GSCOP and the enforcement body would be about £3 million per year. The CC noted that these costs on retailers should be considered in the context of retail grocery turnover of around £110 billion.

6.3 The CC recommended that the OFT pay all the monitoring and enforcement body's reasonable costs in the first place but recover them from designated parties.

6.4 It is recommended that the OFT invoice each of the Parties for their share of the costs and expenses incurred by the body up to the maximum of the Budget for that quarter, less any costs and expenses of the body monitoring and enforcing compliance with the GSCOP recovered from Designated Retailers under Article 11(7) of the Code. The share of costs and expenses attributable to each Party shall be determined by the monitoring and enforcement body and shall be borne by each Party according to a set predetermined formula.

6.5 The CC has proposed that the following formula shall be used to calculate each Party's share of the cost of the body monitoring and enforcing compliance with the GSCOP:

$$\frac{a(R_p/R_a)+b(T_p/T_a)+c(A_p/A_a)+d(D_p/D_a)}{e+f+g+h}$$

Where:

$$a = 4$$

$$b = 3$$

$$c = 2$$

$$d = 1$$

R_p = Number of Recommendations made to that Party by the Ombudsman

R_a = All Recommendations made by the Ombudsman

- T_p = That Party's turnover for retail supply of Groceries
- T_a = All Parties' turnover for retail supply of Groceries
- A_p = Number of Disputes between that Party and its Suppliers reported pursuant to paragraph 8.1 of the Scheme
- A_a = All Disputes between the Parties and Suppliers reported pursuant to paragraph 8.1 of the Scheme
- D_p = Number of Disputes between that Party and its Suppliers reported pursuant to Article 10(1) (c) of the Code
- D_a = All Disputes between Designated Retailers and Suppliers reported pursuant to Article 10(1) (c) of the Code
- e = 4 unless if $a(R_p/R_a)$ equals 0 then it also equals 0
- f = 3 unless if $b(T_p/T_a)$ equals 0 then it also equals 0
- g = 2 unless if $c(A_p/A_a)$ equals 0 then it also equals 0
- h = 1 unless if $d(D_p/D_a)$ equals 0 then it also equals 0

Questions

24. Is the CC's proposed formula the most appropriate way of calculating each party's share of the body monitoring and enforcing compliance with the GSCOP costs?

25. Should the funding of the body monitoring and enforcing compliance with the GSCOP be based on other criteria, such as a flat rate charge for each of the designated retailers, if so what?

Chapter 7 - What happens next?

7.1 Following receipt of responses to this consultation we will publish a Government response by 29 July (90 days after the consultation closes). This will include a summary of views expressed and reasons given for decisions finally taken. Any proposal for legislative change will undergo further more detailed consultation. If legislation is taken forward it will be subject to a Post – Implementation Review, which would be undertaken 3 to 5 years after implementation.

Annex A : Code of Practice on Consultations

1. Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. Consultation should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Consultation exercise should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

The complete code is available on the Better Regulation Executive's web site, address <http://bre.BIS.gov.uk/regulation/consultation/code/>

Annex B: List of Individuals/Organisations consulted

ActionAid
Aldi
Andrew George MP
Asda
Association of Convenience Stores
Association of Master Bakers
Bananalink
British and Irish Ombudsman Association
British Brands Group
British Chambers of Commerce
British Independent Fruit Growers Association
British Retail Consortium
Cabinet Office
Campaign to Protect Rural England
Church of England
Competition Commission
Confederation of British Industry
Consumer Focus
Co-operative Group Ltd
Country Land and Business Association
Department for Environment, Food and Rural Affairs
Department of Environment Northern Ireland
Department for International Development
Divine Chocolate
Fairtrade Foundation
Federation of Small Businesses
Food and Drink Federation
Friends of the Earth
Grassroots Action on Food and Farming
Iceland
Lidl
Marks and Spencer
Michael Hutchings
Morrisons
National Farmer's Union
Office of Fair Trading
Rural Shops Alliance
Sainsbury's
Scottish Government
Somersetfield
Tesco
Trade Unions Congress
Traidcraft
Treasury Department
Waitrose
War on Want
Welsh Assembly Government

Annex C: Related links

1) Code of practice on supermarkets' dealings with suppliers (SCOP)

http://www.offt.gov.uk/shared_offt/monopolies/supermarkets2.pdf

2) Office of Fair Trading Supermarkets: The code of practice and other competition Issues: March 2005

http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft783.pdf

3) Press Notice: OFT to refer grocery market to Competition Commission84/06: 9 May 2006

<http://www.offt.gov.uk/news/press/2006/84-06>

4) The grocery market: The OFT's reasons for making a reference to the Competition Commission OFT845: May 2006

http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft845.pdf

5) The CC's final report on the supply of groceries in the UK: 30 April 2008

http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf

6) The Government response to the final report ; 29 July 2008

<http://www.berr.gov.uk/files/file47089.pdf>

7) News Release 36/09: CC Publishes Code of Practice and Ombudsman Recommendation: 4 August 2009

http://www.competition-commission.gov.uk/press_rel/2009/aug/pdf/36-09.pdf

8) The revised groceries supply code of practice (GSCOP): August 2009

http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

9) The CC's proposed undertakings to establish a GSCOP Ombudsman Scheme

http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/ombudsman_undertakings.pdf

10) The OFT role in GSCOP Order enforcement

http://www.offt.gov.uk/shared_offt/monopolies/GSCOP-OFT-advice.pdf

11) BIS Press Release Government Announces Go-Ahead for Supermarket Enforcer: 13 January 2010

<http://nds.coi.gov.uk/content/detail.aspx?NewsAreaId=2&ReleaseID=410284&SubjectId=2>

12) The CC groceries market page

<http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm>

Annex D: Draft Impact Assessment

Summary: Intervention & Options

Department /Agency: Business Innovation and Skills (BIS)	Title: Impact Assessment of the introduction of an Ombudsman to monitor and enforce the groceries supply code of practice (GSCOP)	
Stage: Consultation	Version: Draft	Date: February 2010
Related Publications: Competition Commission, <i>The Supply of Groceries in the UK: Market Investigation (April 2008)</i> , http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm Competition Commission, <i>The Formal Recommendation (August 2009)</i> http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf		

Available to view or download at:

<http://www.bis.gov.uk>

Contact for enquiries: Steve Smith

Telephone: 0207 215 2776

What is the problem under consideration? Why is government intervention necessary?

In its investigation of the UK groceries market, the CC found that large grocery retailers were transferring excessive risks and unexpected costs to suppliers, by exercising their buyer power. The CC considered that this might have an adverse effect on suppliers' ability to invest and innovate, which could ultimately reduce choice and value and/or increase prices for consumers, relative to a well-functioning market. Under certain circumstances, retailers may have less incentive to take action to mitigate such risks, giving rise to moral hazard. Having failed to agree voluntary undertakings to establish a body to enforce the GSCOP, the CC has recommended that BIS set up such a body. The Government has accepted in principle the need for such a body and is consulting on the nature of the body and its powers.

What are the policy objectives and the intended effects?

The principal objective is to promote innovation and investment in the groceries supply chain, which will ultimately be beneficial to consumers, as well as the wider economy. The objective of independent enforcement of the GSCOP is to prevent the practice of supply chain behaviour by grocery retailers that has an adverse impact on the ability and willingness of suppliers to invest and innovate.

What policy options have been considered? Please justify any preferred option.

The following elements have been analysed with reference to a 'base case', which amounts to the establishment of an enforcement body with the power to accept anonymous complaints from all suppliers (both direct and indirect):

- Whether establishing a body to monitor/enforce GSCOP requires the creation of a new body
- Whether a GSCOP monitoring/enforcement body should have the power to levy penalties
- Whether a GSCOP monitoring/enforcement body should only consider code-related complaints from direct suppliers (i.e. those covered by GSCOP)

In relation to the above 3 issues, there is currently no 'preferred' option.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? BIS will review the policy 3 to 5 years after the introduction of an enforcement body

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: February 2010

Summary: Analysis & Evidence

Policy Option: Creation of new body	Description: Whether establishment of a body to monitor/enforce the GSCOP requires the creation of a new body
--	--

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition)	Yrs	
	£ 0.2 million		One-off cost for establishing an independent body to monitor and enforce the GSCOP (£200,000), borne by grocery retailers.
	Average Annual Cost (excluding one-off)		
£0	10	Total Cost (PV)	£0.2 million
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
	One-off	Yrs	
	£ Unknown		
	Average Annual Benefit (excluding one-off)		
£ Unknown	10	Total Benefit (PV)	Unknown
Other key non-monetised benefits by 'main affected groups'			
A new dedicated body may improve compliance, thereby promoting more investment and innovation in the groceries supply chain.			

Key Assumptions/Sensitivities/Risks
The number of investigations undertaken by the enforcement body is assumed to be the same, regardless of whether it is a new body.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) Unknown	NET BENEFIT (NPV Best estimate) Unknown
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What is the geographic coverage of the policy/option?	UK								
On what date will the policy be implemented?	2010								
Which organisation(s) will enforce the policy?	TBD								
What is the total annual cost of enforcement for these organisations?	£ 0								
Does enforcement comply with Hampton principles?	TBC								
Will implementation go beyond minimum EU requirements?	N/A								
What is the value of the proposed offsetting measure per year?	£ N/A								
What is the value of changes in greenhouse gas emissions?	£ N/A								
Will the proposal have a significant impact on competition?	Yes								
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> <tr> <td style="text-align: center;">N/A</td> <td style="text-align: center;">N/A</td> <td style="text-align: center;">N/A</td> <td style="text-align: center;">TBC</td> </tr> </table>	Micro	Small	Medium	Large	N/A	N/A	N/A	TBC
Micro	Small	Medium	Large						
N/A	N/A	N/A	TBC						
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">TBC</td> </tr> </table>	N/A	N/A	N/A	TBC				
N/A	N/A	N/A	TBC						

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ TBC	Decrease of £ -	Net Impact £ TBC

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: Power to levy penalties

Description: Whether a body to monitor and enforce the GSCOP should have the power to levy penalties

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'	
	One-off (Transition)	Yrs		
	£ Unknown			
	Average Annual Cost (excluding one-off)			
	£ Unknown		Total Cost (PV)	£ Unknown
<p>Other key non-monetised costs by 'main affected groups'</p> <p>The possibility of penalties might give retailers incentive to dispute cases, increasing the cost of each individual investigation. There would also be costs associated with the right of appeal.</p>				

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'	
	One-off	Yrs		
	£ Unknown			
	Average Annual Benefit (excluding one-off)			
	£ Unknown		Total Benefit (PV)	£ Unknown
<p>Other key non-monetised benefits by 'main affected groups' The possibility of penalties incentivises compliance, by increasing costs of non-compliance, which allows suppliers to maintain investment and innovation through increased certainty. Possibility of savings to individual complainants, as able to receive punitive damages without pursuing individual follow-on cases.</p>				

Key Assumptions/Sensitivities/Risks

Retailers with penalties may pass on costs to consumers through higher prices. A positive ongoing cost associated with this option would imply less than full compliance, which would then give rise to investigations; if compliance were full across all GSCOP retailers, then ongoing costs would be zero.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ Unknown	NET BENEFIT (NPV Best estimate) £ Unknown
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What is the geographic coverage of the policy/option?			UK		
On what date will the policy be implemented?			2010		
Which organisation(s) will enforce the policy?			TBD		
What is the total annual cost of enforcement for these organisations?			£ TBC		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			N/A		
What is the value of the proposed offsetting measure per year?			£ N/A		
What is the value of changes in greenhouse gas emissions?			£ N/A		
Will the proposal have a significant impact on competition?			Yes		
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		N/A	N/A	N/A	TBC

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)		
Increase of	£ TBC	Decrease of	£ -	Net Impact	£ TBC

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: Limiting the scope of the GSCOP enforcement body

Description: Whether a body to monitor and enforce the GSCOP should only consider code-related complaints from direct suppliers

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'	
	One-off (Transition)	Yrs		
	£ Unknown			
	Average Annual Cost (excluding one-off)			
	£ Unknown		Total Cost (PV)	£ Unknown
<p>Other key non-monetised costs by 'main affected groups'</p> <p>Indirect suppliers could not claim for redress due to breaches of GSCOP, potentially raising costs. They may continue to suffer from low profit margins, impacting their ability to invest.</p>				

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'	
	One-off	Yrs		
	£ Unknown			
	Average Annual Benefit (excluding one-off)			
	£ Unknown		Total Benefit (PV)	£ Unknown
<p>Other key non-monetised benefits by 'main affected groups'</p> <p>Potential reduction in complaints (and costs) associated with GSCOP compliance.</p>				

Key Assumptions/Sensitivities/Risks

Assumes that there is a significant proportion of indirect suppliers in the UK groceries supply chain.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ Unknown	NET BENEFIT (NPV Best estimate) £ Unknown
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What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	2010			
Which organisation(s) will enforce the policy?	TBD			
What is the total annual cost of enforcement for these organisations?	£ TBC			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	Yes			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	TBC

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of	£ TBC	Decrease of	£ -
		Net Impact	£ TBC

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Strategic Overview

1. On 9 May 2006, the Office of Fair Trading (OFT) referred the supply of groceries by retailers in the UK to the Competition Commission (CC) for investigation. The CC had previously conducted an inquiry into the grocery retailing sector in 2000, stemming from criticisms of the prices and profits of UK grocery retailers during the late 1990s. During that investigation, the CC uncovered supermarket practices that were operating against the public interest in terms of the behaviour of five grocery retailers (Asda, Safeway, Somerfield, Sainsbury's and Tesco) towards their suppliers. This led to the establishment of the Supermarket Code of Practice (SCOP)¹ which regulated the conduct of the (now) four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco)² with respect to their suppliers.
2. Following the 2000 investigation, the OFT continued to provide oversight of the SCOP and also conducted competition assessments of various mergers (e.g. Safeway and Somerfield).³ In carrying out its responsibilities, the OFT continued to receive complaints and representations about grocery retailing with regards to the operation of SCOP, pressures facing convenience stores and the market position of Tesco. In response to continuing concerns about the effectiveness of the SCOP, the OFT commissioned and published the results of a compliance audit in 2005.⁴
3. In addition to inviting parties to present evidence related to the SCOP audit, the OFT also invited evidence on whether there were aspects of the supply of groceries by retailers that adversely affected competition. The OFT initially decided that there was no ground for a market investigation but following a challenge of this decision in the Competition Appeal Tribunal (CAT) by the Association of Convenience Stores (ACS) and Friends of the Earth, the OFT withdrew its decision. After further investigation the OFT referred a market investigation to the CC in May 2006.
4. On 30 April 2008, the CC published its final report (hereafter referred to as the 'CC report').⁵ It found that, in many respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers. However, there were concerns that grocery retailers transfer excessive risk and unexpected costs to their suppliers through various supply chain practices. This was deemed to have an Adverse Effect on Competition (AEC) and as such the CC proposed the following remedies:
 - (i) A new strengthened code of practice – the Grocery Supply Code of Practice (GSCOP) established by the Groceries Market (Supply Chain Practices) Investigation Order 2009;
 - (ii) A Supermarkets Ombudsman to oversee and enforce the GSCOP, and to arbitrate disputes arising under it.
5. In August 2009, the CC concluded consultation on these remedies and established the GSCOP (or Code) using its powers under the Enterprise Act (2002). It also recommended that the Government establish a GSCOP Ombudsman, with the powers to impose penalties for breaches of the Code, after retailers failed to voluntarily establish such a body.⁶ The Government's response, published on 13 January 2010,⁷ accepted the need for an

¹ http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_7.pdf

² Somerfield was one of the original five but did not become a signatory of SCOP because its market share was less than 8 per cent, the threshold at which the CC decided that the SCOP should apply.

³ Morrisons' proposed acquisition of Safeway in 2003 (http://www.of.gov.uk/shared_of/mergers/morrison.pdf) and Somerfield's acquisition of 114 stores from Morrisons in 2005

(http://www.of.gov.uk/shared_of/mergers_ea02/2005/somerfieldmorrisondecision.pdf)

⁴ OFT, *Supermarkets: The code of practice and other competition issues*, OFT783, March 2005.

⁵ http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm

⁶ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

⁷ <http://www.berr.gov.uk/files/file54194.pdf>

enforcement body to monitor and enforce the Code. The nature and scope of this body is the focus of the impact assessment.

Background

6. In 2007, an estimated £110.4 billion of grocery sales were made through nearly 100,000 grocery stores in the UK.⁸ Groceries include food, pet food, drinks, cleaning products, toiletries and household goods.⁹
7. The CC identified seven major categories of grocery retailer in the UK.
 - (i) Large grocery retailers carry a full range of grocery products and have an integrated wholesaling function that purchases directly from food and drink manufacturers.¹⁰ There are currently eight large grocery retailer brands: Asda; Morrisons; Co-operative Group Limited (CGL, which now also incorporates Somerfield); Marks and Spencer (M&S); Sainsbury's; Tesco and Waitrose.
 - (ii) *Regional grocery retailers* (e.g. Booths in north-west England, Dunnes in Northern Ireland and regional Co-ops) operate in a particular part of the UK with mid-sized and/or larger grocery stores and may also operate convenience stores. They carry a full range of grocery products and generally use wholesalers to source supplies or use buying groups to negotiate on their behalf with their suppliers.
 - (iii) *Symbol group retailers* (e.g. Spar, Lonsdale and Costcutter) operate stores under a common fascia (or symbol). They may be independently owned or directly owned by the symbol group or affiliated wholesalers. Symbol group retailers generally source supplies through affiliated wholesalers.
 - (iv) *Convenience store operators* are all operators of convenience stores (smaller than 280 square metres) and include large grocery retailers, regional grocery retailers, symbol group retailers and independent non-affiliated convenience store operators. According to IGD, there are approximately 50,000 convenience stores in the UK.¹¹
 - (v) *Limited Assortment Discounters* (LADs) carry a limited range of grocery products and base their retail offer on selling these products at competitive prices. The three major LADs in the UK are Aldi, Lidl and Netto.
 - (vi) *Frozen food retailers* (e.g. Iceland and Farmfoods) specialise in the sale of frozen foods and generally carry a limited range of other grocery products.
 - (vii) *Specialist grocery retailers* primarily sell an individual grocery product category and include bakeries, budgets, greengrocers and off-licences.
8. In 2007 large grocery retailers accounted for approximately 85 per cent of total grocery sales and the biggest four (Asda, Morrisons, Sainsbury's and Tesco) accounted for just over 65 per cent. Figure 1 shows how market shares have developed since 2002, with a notable increase for Tesco and Morrisons (with the latter primarily due to the acquisition of Safeway in 2004).
9. In terms of profitability for the large retailers, the average operating margin (proportion of revenue left over after paying variable costs) fluctuated between 3.6 to 4.5 percent between 2000 and 2007. However, as Figure 2 shows, there were significant variations as Tesco

⁸ IGD, *UK Grocery Outlook*, September 2007. Total sales exclude non-grocery and tobacco sales.

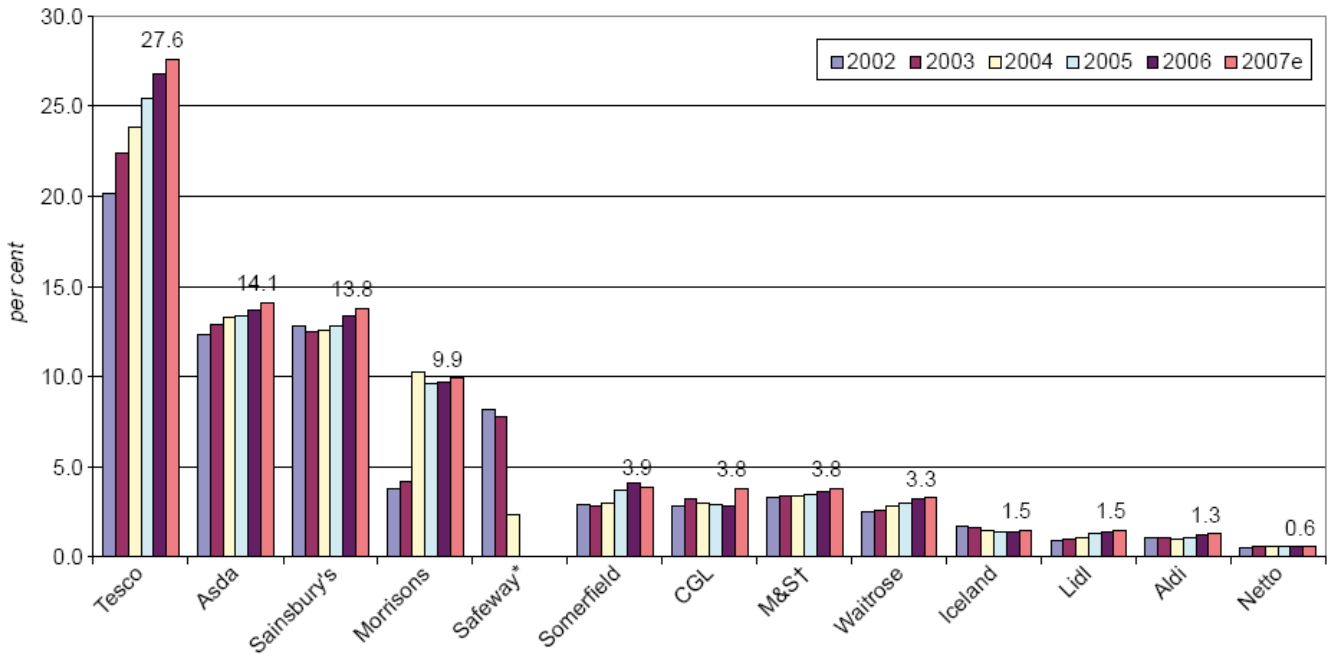
⁹ This is the definition of groceries that was given in the CC's terms of reference and does *not* include: petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers and magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products.

¹⁰ Large grocery retailers, however, tend to purchase fresh produce from produce wholesalers rather than directly from primary producers

¹¹ <http://www.igd.com/index.asp?id=1&fid=1&sid=17&tid=0&folid=0&cid=91>

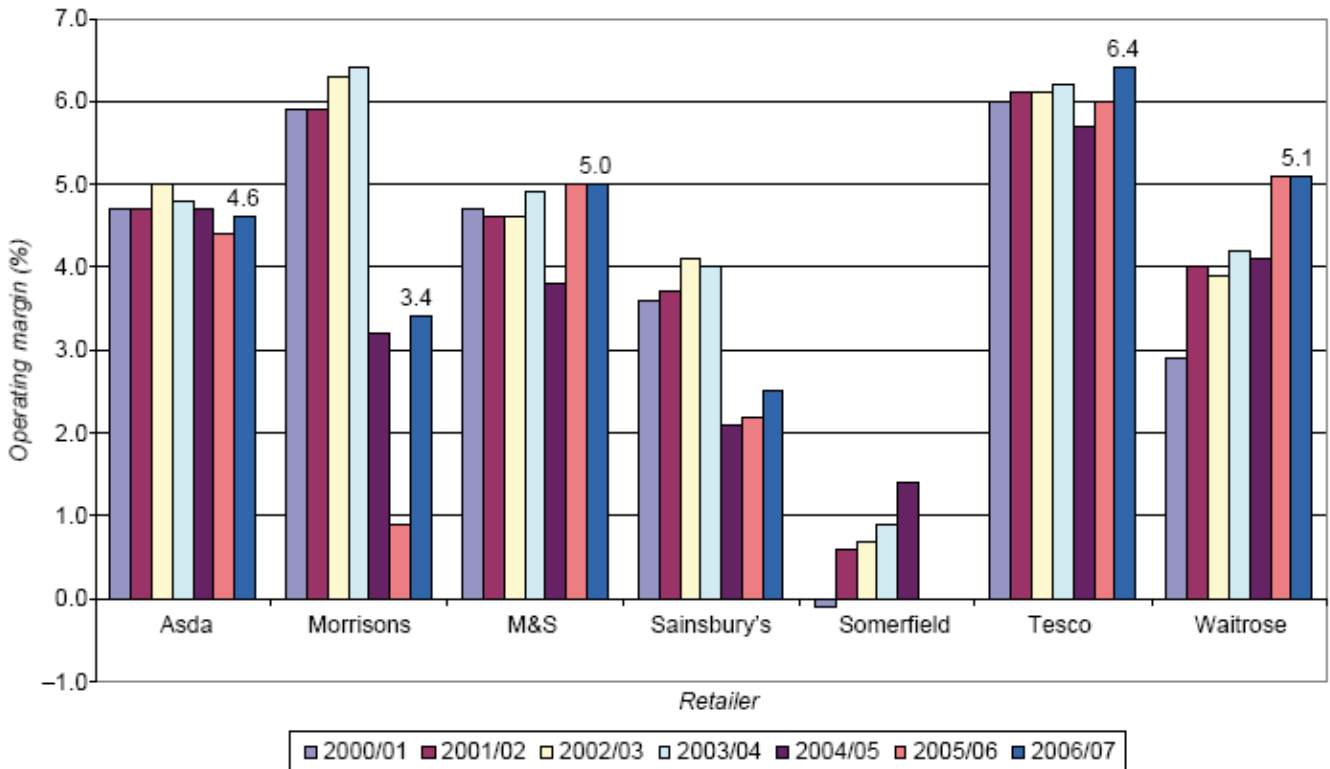
consistently maintained an operating margin of around 6 per cent, while Asda and M&S earned margins of 4.5 to 5 percent.

Figure 1: National sales by grocery retailer, 2002-2007



Source: Verdict, *UK Grocery Retailers 2008*, February 2008.
 *Safeway was purchased by Morrisons in 2004.
 †M&S sales relate to grocery only.

Figure 2: UK grocery retailers, operating margins, 2000-2007

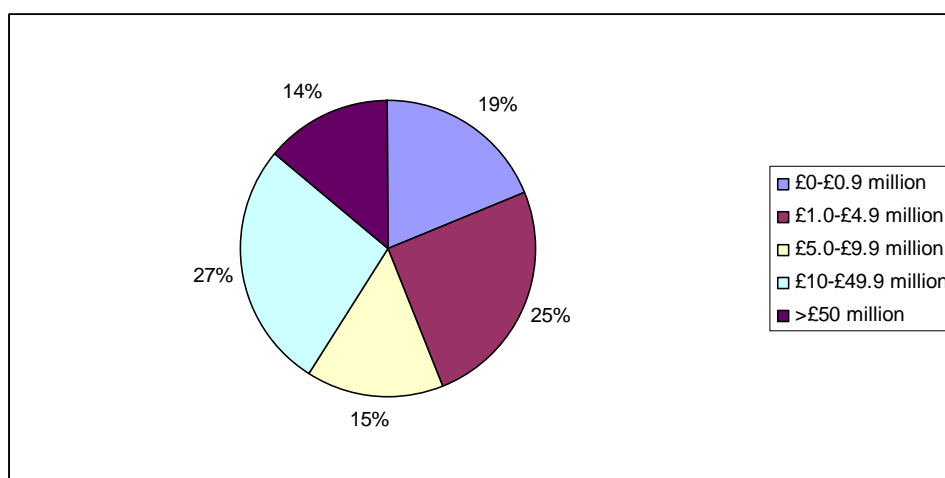


Source: IGD, *UK Grocery Outlook*, 2007.
 Note: Somerfield data for 2005/06 is not available.

The UK groceries supply chain

10. As stated earlier, large grocery retailers purchase most goods directly from food and drink manufacturers while regional retailers, symbol group retailers and convenience store operators tend to purchase goods through wholesalers and buying groups. The latter are affiliations of several wholesalers that have been established to obtain more favourable terms from suppliers. The value of the groceries supply chain is of the order of £70 billion in annual sales to grocery retailers.¹²
11. There are a large number of firms that supply groceries to UK retailers, including food and drink manufacturers, primary producers and fresh food wholesalers (e.g. packers and processors). There are approximately 311,000 farm holdings, 3,600 fresh food intermediaries and 6,600 food and drink manufacturers in the UK (although not all of these necessarily supply grocery retailers).¹³
12. According to the CC, grocery retailers purchase relatively little of their fresh produce directly from UK farmers, as most of it is supplied through intermediaries such as packers, processors and fresh food wholesalers. Retailers told the CC that this is a more efficient method than dealing individually with a large number of farmers and intermediaries have a greater ability to source alternative supplies where there is a shortfall in domestic production. In 2006, six large grocery retailers (Asda, M&S, Morrisons, Sainsbury's, Somerfield and Tesco) informed the CC that the combined value of their direct purchases from farmers amounted to approximately £295 million. This compares to £14.3 billion in total agricultural production annually and £16.7 billion in fresh food sales by those grocery retailers in total.¹⁴
13. Nevertheless, the limited value of direct purchases by grocery retailers from primary producers can understate the importance of their relationship. Farmers may be members of, or shareholders in, intermediary businesses that market their produce to grocery retailers. Furthermore, the figure of £295 million does not include transactions with processors that are vertically integrated with primary production.
14. There is large variation in the size of businesses supplying grocery retailers. Suppliers include branded goods' producers such as Coca-Cola, Unilever, Kimberly-Clark and Procter & Gamble as well as small businesses and primary producers. Figure 3 shows the proportion of suppliers to grocery retailers according to their revenue. Comparing the revenues of grocery retailers and suppliers, it is clear that the majority of the latter are of a smaller size, with almost 60% having annual revenue below £10 million.

Figure 3: Suppliers to UK grocery retailers, by grocery revenue



Source: GfK, *Research on suppliers to the UK grocery market: A Report for the Competition Commission, January 2007*

Note: The GfK sample size was 426 suppliers

¹² CC report, paragraph 10.16

¹³ CC Report, paragraph 3.31

¹⁴ CC Report, paragraph 3.32

Rationale

15. The relevant market failure in this case is that of **market power**, which occurs through the exercise of buyer power. Buyer power is a form of market power that a firm – in this case a grocery retailer (or wholesaler or buying group) – is able to exercise in relation to its suppliers. Exercising this power allows the grocery retailer to extract a better deal from its suppliers than would otherwise be the case, for example by obtaining lower prices or preferable purchasing terms from the supplier.
16. In general, the exercise of buyer power by grocery retailers is likely to have positive implications for consumers. For example, if retailers pass on the lower prices they obtain from suppliers (through the exercise of buyer power) this can result in lower retail prices for consumers. In addition, grocery retailers' buyer power may act as a countervailing force to any market power possessed by suppliers. Furthermore, the exercise of buyer power can spur innovation in the supply chain by creating incentives for suppliers to develop new products and ensure that their operations are cost-efficient.
17. However, the exercise of buyer power by grocery retailers (and wholesalers or buying groups) may have a detrimental effect on suppliers – for example, a supplier is likely to earn a smaller profit margin on goods sold to a grocery retailer with buyer power than those sold to grocery retailers that do not have buyer power.
18. In particular, the exercise of buyer power by grocery retailers may raise concerns in certain limited circumstances, if it allows retailers to impose excessive risks and unexpected costs on suppliers, which reduces suppliers' incentive or ability to invest and innovate. In the long run, this could lead to reduced capacity, reduced product quality and fewer new product offerings, and ultimately, a detriment to consumers.
19. In assessing the behaviour of grocery retailers in relation to suppliers, the CC particularly looked at the supply chain practices of grocery retailers that might transfer excessive risks or unexpected costs on suppliers and thereby reduce supplier investment and innovation, when compared with the levels of investment and innovation that would be observed in a well-functioning market.
20. In their analysis, the CC concluded that there are circumstances where allocations of risk may be agreed up-front between a retailer and supplier, but that the extent of risk transferred to the supplier is excessive. In particular, the CC raised concerns regarding the transfer of risk from grocery retailers to suppliers in situations where this transfer gives rise to 'moral hazard'.
21. In this case, such a situation arises where the retailer has the ability to affect the degree of risk incurred, but as a result of the transfer, the retailer has less incentive to minimize that risk. In these situations, the transfer of risk increases the total risk borne by the parties, and also increases the costs to the supplier.¹⁵

The issue

Existence of buyer power in the groceries supply chain

22. The CC study concluded that large grocery retailers (and some large wholesalers and buying groups) have buyer power in relation to at least some of their suppliers, although it could be offset by the market power possessed by suppliers of the most prominent branded goods. This conclusion was based on the fact that the majority of suppliers have significantly fewer sales than most of the retailers and because large retailers generally pay

¹⁵ As an example of this, the CC references practices whereby retailers may impose liability for losses suffered as a result of shrinkage (i.e. losses that arise where stock is lower than it should be, due to theft, the goods being lost or accounting error) on some of its suppliers. The CC felt that suppliers had almost no capacity to address losses due to shrinkage and that retailers were best placed to control risks associated with shrinkage (e.g. by improving security at depots or stores, or improving stock accounting procedures).

lower prices for grocery products. An econometric analysis¹⁶ showed that the four largest grocery retailers paid, on average, between 4 and 6 per cent less than the mean. By contrast, large wholesalers pay, on average 2 to 3 per cent above the mean while small wholesalers pay prices that are, on average, 8 to 9 per cent above the mean. Further support for the existence of buyer power in the grocery market was provided by a supplier survey, commissioned by the CC as part of its investigation (see Table 1).

Table 1: Supplier customers from whom the lowest gross margins are received

Customers from whom the lower gross margins are received	%
Any of the four largest grocery retailers	53
Any other grocery retailers	17
Wholesalers/buying groups	8
Independent retailer	6

Source: GfK, *Research on suppliers to the grocery market: A Report for the Competition Commission, January 2007*

Supply chain practices that may affect supplier investment and innovation

23. Grocery suppliers make investments in an uncertain commercial environment where demand may fall or costs may rise unexpectedly. Investment decisions are made by estimating the likely returns and balancing this against the risks involved. The supply chain practices of grocery retailers are likely to have an important bearing on this calculation. In particular, if they transfer more risk and greater cost to suppliers then it may diminish suppliers' incentives to invest in new products, capacity or production processes.
24. The transfer of risks or costs between grocery retailers and suppliers is not necessarily a problem, but if excessive risks or unexpected costs are transferred, these may affect suppliers' willingness to invest or innovate. In deciding which supply chain practices might give rise to the transfer of excessive risks or unexpected costs, the CC considered both complaints submitted to them by suppliers regarding grocery retailers' conduct and evidence from suppliers as to the supply chain practices that would be most prone to reduce their investment or innovation.
25. Of the 52 practices considered by the CC during its investigation,¹⁷ it found that half had the potential to result in the transfer of excessive risks or unexpected costs from grocery retailers to suppliers. In some cases, the impact of these practices depends on the specific way in which the practice is carried out by a grocery retailer. In other cases, certain practices will almost always have this effect.
26. The principal manner in which excessive risks or unexpected costs can be transferred from grocery retailers to suppliers is through retailers making retrospective adjustments to the terms of supply. Retrospective changes to previously agreed supply arrangements in favour of retailers will almost always create additional uncertainty, shifting risk and added costs to suppliers.¹⁸
27. Further, such retrospective adjustments are likely to diminish significantly suppliers' incentives to fund investments for the development of new products or improved production

¹⁶ CC Report, Appendix 5.3: http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_5_3.pdf

¹⁷ These 52 practices refer to specific supply chain practices of grocery retailers that were identified in the CC's 2000 investigation. A full list of these can be found in Annex 3 of Appendix 9.8 of the CC's final report (http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_8.pdf)

¹⁸ For example, a requirement for a price adjustment after goods have been ordered or after products have been delivered is a typical practice that is a source of unexpected costs to suppliers. Similarly, requirements for financing or promotions that were not agreed in advance with suppliers are also retrospective adjustments that are a source of uncertainty.

processes. Consequently, suppliers may come to expect that these retrospective changes might take place, hence they may become reluctant to undertake new investment projects. The level of uncertainty will increase as suppliers become unable to determine the nature of these unexpected adjustments, or their frequency, or to quantify their impact on future earnings.

28. Other practices may initially appear acceptable, but are also open to exploitation by grocery retailers as a means of effectively lowering the price paid to suppliers or transferring excessive risks to suppliers.¹⁹
29. A number of grocery retailers have made submissions to the CC stating that it is in their interest to establish strong relationships with suppliers and ensure that they invest.²⁰ The CC determined that while this is in the long-term interest of the retailers, it can be overshadowed by the short-term necessity of extracting the best possible terms and conditions from suppliers in order to compete effectively with other grocery retailers.
30. Effectively, a potential side-effect of competition between retailers with buyer power in the grocery market is reduced incentives to invest and innovate on the part of suppliers, which is also detrimental to consumers in the long run. However, they may have benefited in the short term from buyer power because large grocery retailers have passed lower supplier prices to consumers in the form of lower retail prices.

Evidence of supply chain practices

31. On the basis of the evidence collected, the CC concluded that supply chain practices which transfer excessive risks and unexpected costs to suppliers, including through the use of retrospective payments and other adjustments to supply agreements, are sufficiently prevalent to cause concern.
32. In a survey of 50 UK grocery suppliers conducted by Grant Thornton, the effects of commercial uncertainty on suppliers were studied.²¹ It was found that: 31 per cent of suppliers felt that an order from a large grocery retailer was 'secure' only when the goods had been delivered to the retailer; 24 per cent of suppliers reported that they had experienced unexpected last-minute changes or cancellations and had received no form of compensation from the retailer concerned; only 50 per cent of suppliers felt highly confident at the time of delivery that the sale price would not be reduced by retrospective contributions sought.

Limitations of SCOP in preventing certain supply chain practices

33. Supply chain practices of the largest four grocery retailers are regulated under the SCOP, which was established after the CC's 2000 investigation. The OFT's compliance audit in 2005 did not identify widespread evidence of breaches. However, during the CC's recent investigation, 380 concerns were raised by suppliers and supplier associations and almost half were related to the transfer of excessive risks or unexpected costs from grocery retailers to suppliers. One-third were related to requirements for retrospective payments or other adjustments to previously agreed supply arrangements.²²
34. As part of the CC's supplier survey, information was collected from suppliers regarding a number of practices addressed under the SCOP. Table 2 shows that one-third to one-half of suppliers experienced practices such as payment delays, excessive payments for customer

¹⁹ For example, it may be quite legitimate for a grocery retailer to deduct sums from a supplier invoice where the supplier has not provided goods to the correct specification or as otherwise agreed between it and the grocery retailer. However, withholding payment either without cause or on a spurious basis may also be a means of imposing unexpected costs on suppliers.

²⁰ CC Report, paragraph 9.43

²¹ Grant Thornton UK LLP (2007), *Redressing the balance: Forging a more certain future for the UK grocery supply chain*, <http://www.grant-thornton.co.uk/pdf/11910GTFoodsuppliersreportFINAL.pdf>

²² CC Report, paragraph 9.59

complains and retrospective price adjustments from all grocery retailers (i.e. including retailers not regulated by the SCOP).

35. It also shows that SCOP has constrained the largest four retailers' buyer power to some extent but not completely. This is supported by evidence collected by the CC in a round-table discussion with grocery suppliers. The latter claimed that in many cases, retailers not covered by the SCOP sometimes imposed trading conditions that were worse than those imposed by the four largest retailers.²³

Table 2: Suppliers reporting various practices (addressed under the SCOP) carried out by grocery retailers in the past five years

Practice reported	All grocery retailers	Four grocery retailers covered by the SCOP	Increased frequency in the past 12 months
	%	%	%
Obligatory contributions to the marketing costs of grocery retailers	61	38	53
Delays in receiving payments from a grocery retailer substantially beyond the agreed time	48	28	37
Required to make excessive payments to grocery retailers for customer complaints	48	36	40
Additional services required in relation to packaging and distribution	37	29	49
Requested price reductions for products soon before or after delivery	37	26	58
Obligatory payments in return for stocking or listing products	35	22	33
Not being given standard terms of business by a customer when asked for them	19	12	32

Source: GfK, research on suppliers to the grocery market: A Report for the Competition Commission, January 2007

36. During their investigation, the CC also reviewed correspondence, predominantly email, between two grocery retailers (Asda and Tesco) and their suppliers during the period 18 June and 22 July 2007.²⁴ This highlighted a number of instances where the retailer did not breach the SCOP but still had the effect of transferring excessive risks or unexpected costs to suppliers. This was either due to the fact that, in most cases, the SCOP regulates a practice (e.g. requires that the retailer undertake the practice reasonably) rather than prohibiting it outright or because the SCOP does not sufficiently address a poor practice.²⁵

²³ CC Report, paragraph 11.280

²⁴ CC Report, Appendix 9.1: Case study of retailer and supplier correspondence, http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_1.pdf

²⁵ For example, the SCOP indicates that a supplier should only be required to make a payment for wastage where it arises because of the supplier's negligence or default or there is an agreement in writing setting out the terms of

37. Furthermore, the correspondence reviewed by the CC provided examples of retailers levying an agreed flat-rate charge in instances of wastage (permitted under the SCOP) even though it may have been grossly disproportionate to the loss suffered by the retailer or the supplier may not have been grossly disproportionate to the loss suffered by the retailer or the supplier may not have been grossly provided with an opportunity to review the evidence and confirm that the fee was legitimately charged. The latter was raised as a concern by a number of suppliers to the CC and such a practice could give retailers an incentive to over-compensate customers at the expense of suppliers.
38. Another example where the SCOP has failed to effectively prevent the transfer of excessive risk is the issue of shrinkage.²⁶ Amongst the concerns raised by suppliers and supplier associations to the CC, the latter found instances of retailers imposing liability on some of its suppliers for losses suffered as a result of shrinkage. These are losses that arise where stock is recorded on a company's books but is not on hand, due to theft, the goods being lost or accounting error. In the vast majority of cases, the supplier has no capacity to address shrinkage losses suffered by the retailer, who by contrast can improve security at depots or stores and improve stock accounting procedures. This highlights the potential for moral hazard in the grocery supply chain, as set out in the rationale section above.
39. For further evidence regarding retailer behaviour towards to suppliers and the effectiveness of the SCOP, the reader should refer to Section 9 of the Competition Commission's final report²⁷ and Appendix 9.8²⁸.

Evidence of impact on supplier investment and innovation

40. The evidence on supplier investment and innovation is not entirely clear. A number of studies reviewed by the CC²⁹ have shown fairly stable, sometimes increasing, levels of investment and R&D expenditure by food and drink manufacturers during the period 1995-2006. In addition, there was a steady growth in new grocery product launches in the UK during the period 2001 to 2005.
41. The GfK survey of suppliers³⁰ provides further evidence that innovation has remained robust in recent years:
- 90 per cent of respondents claimed to have developed new product lines in the past two years;
 - 87 per cent had developed existing product lines;
 - 82 per cent had improved their production processes, and
 - more than one-third stated that they had carried out some other type of innovation.
42. There were few differences between types of supplier but, as one might expect, larger companies conducted more product and process innovations – more than 90 per cent had developed new and existing product lines and improved their production processes, whilst almost half conducted another type of innovation. Furthermore, most suppliers (almost 70 per cent) stated that they had a budget for developing new product lines and existing lines, while 59 per cent stated that they had a budget for improving production processes.
43. However, almost 20 per cent of suppliers had no budget for innovation. Although a significant proportion of suppliers (43 per cent) claimed to be spending more on R&D for

such a payment. However, wastage is not technically defined and is capable of an interpretation that includes products that have deteriorated as well as those that have been ordered in excess of demand.

²⁶ CC Report, paragraph 9.48

²⁷ http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf

²⁸ Categorization of, and evidence on, supply chain practices of grocery retailers (http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_8.pdf)

²⁹ CC Report, Appendix 9.2: Supplier profitability and investment in innovation, http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_2.pdf

³⁰ GfK, *Research on suppliers to the grocery market: A Report for the Competition Commission*, January 2007

grocery products than five years ago (as a proportion of groceries revenue), a substantial minority (14 per cent) said they were spending less.

44. Of this latter group, the majority (77 per cent) claimed that they did not have enough money to invest and/or that margins were being squeezed, whilst the next most common reason (25 per cent) was that there was insufficient return on the investment due to customers demanding low prices. Other notable responses were that margins could not be improved through R&D (13 per cent), and that there was insufficient return on investment due to copycat products (11 per cent).
45. The CC also received submissions from suppliers³¹, a number of which claimed to be spending less on capital maintenance than is required. This would affect product quality and new product development in the future. The Country Land and Business Association claimed that large grocery retailers' practices resulted in margins that are too tight for suppliers and, therefore, leave insufficient funds for investment in new equipment and product innovation. Other submissions indicated that higher input costs for suppliers could not be passed on to retailers, also leading to lower margins and a reduced ability to invest. The views put forward by these organisations may reflect a concern about likely future trends in product innovation, given the current actions of UK grocery retailers.
46. It should be noted that product innovation is difficult to measure and a number of factors other than grocery retailers' buyer power might affect suppliers' propensity to invest and innovate. The CC concedes that current trends in, and levels of, product innovation may not indicate a cause for concern. However, a simple appraisal of the level of investment and innovation does not take account of the fact that their levels might have been higher in a well-functioning market or whether this level of product innovation could be expected to continue in the future.
47. Evidence from the supplier survey (Table 2) indicates that the prevalence of practices that may adversely impact on investment and innovation is increasing. This raises concerns that current levels of innovation or investment would not be maintained in the future were these practices to continue.

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

Remedies

48. To address the Adverse Effect on Competition that buyer power creates, the CC established the Grocery Supply Code of Practice (GSCOP)³² using its powers under the Enterprise Act (2002). This comes into force on 4 February 2010 and is based on the existing SCOP but includes a number of amendments such as:
- (i) applying the code to retailers that are controlled by corporate groups with, or which themselves have, an annual retail groceries turnover of £1 billion³³ or more;
 - (ii) an outright prohibition on suppliers being held liable for losses due to shrinkage;
 - (iii) a provision that ensures that suppliers are less subject to customer complaint charges;
 - (iv) a prohibition on retailers from making retrospective adjustments to the terms of supply;

³¹ CC Report, Appendix 9.2, paragraphs 40-45

³² http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

³³ Although there is an element of judgement in setting the threshold, the CC took into account the identity of the retailers where particular issues had been brought to its attention during the course of the investigation. There were very few cases which involved a grocery retailer with an annual turnover of less than £1 billion. Using this threshold, 10 grocery retailers will be subject to the GSCOP: Aldi; Asda; CGL (incorporating Somerfield); Lidl; Iceland; M&S; Morrisons; Sainsbury's; Tesco; and Waitrose.

- (v) a clear definition of wastage and a prohibition on retailers directly or indirectly requiring a supplier to pay for wastage unless it is due to the negligence or default of the supplier.
49. Therefore, the GSCOP clearly clarifies and addresses retailer practices that transfer excessive risk and unexpected costs to suppliers and prohibits practices where necessary, rather than regulating that they are undertaken reasonably.
50. Furthermore, the CC sought undertakings from retailers to establish a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP, in order to ensure its effectiveness. The large grocery retailers refused to offer suitable undertakings and so, as a result, the CC recommended that the Department for Business, Innovation and Skills set up the Ombudsman.³⁴ The Government received many representations in writing and held a number of face to face meetings on the issue. On 13 January 2010, it published a response and agreed that monitoring and enforcement of the GSCOP is necessary to ensure its effectiveness.³⁵ Therefore, the Government is seeking views on how this proposal should be taken forward.

Objectives

51. The principal objective is to promote innovation and investment in the groceries supply chain, which will ultimately be beneficial to consumers, as well as the wider economy. The objective of independent enforcement of the GSCOP is to prevent the practice of supply chain behaviour by grocery retailers that has an adverse impact on the willingness of suppliers to invest and innovate.
52. The Government has accepted the need for a body to enforce the GSCOP and is consulting on the nature and scope of its powers. The Government has also said that the GSCOP enforcement body should have a mechanism to hear anonymous complaints. This is considered to be particularly important as a number of suppliers expressed concerns to the CC over being identified in an investigation of a retailer's supply chain practices. They believed this could have detrimental consequences, such as being delisted by the retailer. The CC acknowledged the existence of this 'climate of fear' among suppliers in relation to disputes under the existing SCOP.
53. The GSCOP enforcement body will have regard to the overriding objective of the GSCOP Scheme to work in the long term interest of consumers and the findings of the CC. It will **not** facilitate or encourage coordination among retailers or suppliers³⁶, nor will it engage in any activity that is not focused on the overriding objective of GSCOP. In particular, the enforcement body will confine its activities to evaluating the operation of the Code and should not consider other commercial elements of the supply agreement.

Analysis of options

54. The following options for the GSCOP enforcement body are analysed:
- (i) Do nothing (i.e. GSCOP is introduced without a separate enforcement body);
 - (ii) Self-regulation;
 - (iii) Base case (an enforcement body with the power to accept anonymous complaints);
 - (iv) Whether establishment of a body to monitor and enforce the GSCOP requires the creation of a new body;

³⁴ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

³⁵ <http://www.berr.gov.uk/files/file54194.pdf>

³⁶ Such coordination could arise from, for example, round-table meetings and the encouragement of any dialogue between suppliers and retailers outside normal bilateral commercial arrangements.

- (v) Whether a body to monitor and enforce the GSCOP should have the power to levy penalties on retailers that breach the GSCOP;
- (vi) Whether a body to monitor and enforce the GSCOP should limit consideration of code-related complaints to only those direct supplier relationships covered by the GSCOP.
55. Given that the Government has already accepted the need for a GSCOP enforcement body, based on the evidence presented above, implementing the Code without such a body is not open for consultation. Furthermore, an option allowing retailers to voluntarily ensure that the GSCOP is monitored and enforced has already been proposed by the CC but failed to materialise. Therefore, the 'do nothing' and 'self-regulation' options are purely hypothetical and are only included in this impact assessment for completeness.
56. The Government consultation is seeking views on the scope and nature of a GSCOP enforcement body. This includes proposals regarding:
- activities of the body;
 - who the body should be;
 - penalties regime;
 - supplier coverage;
 - and funding.
57. A detailed analysis is not required for each of these proposals; indeed it would be unsuitable in some cases. Certain activities of the body included as part of the consultation – for example, whether it publishes guidance on specific provisions of the Code or reports publicly on the operation of the Code and enforcement scheme – are relatively marginal measures between which we are not able to easily distinguish analytically. Similarly, the allocation of funding for the enforcement body has little effect on overall costs and benefits.
58. Therefore, the options that are open for consultation and analysed in this impact assessment are options (iii)-(vi). In this context, the 'base case' represents the introduction of a GSCOP enforcement body that has the following characteristics: it has power to accept anonymous complaints; it is an existing body; it does not have the power to levy penalties; and it considers code-related complaints from both direct and indirect suppliers. The Government currently has no preferred options.

Do nothing

59. The GSCOP order has been established by the CC and will take effect from 4 February 2010. Therefore, under this option the ten largest grocery retailers would still be regulated by the Code but it would not be monitored or enforced by a specific body.

- costs

60. The CC has estimated the upfront cost to retailers of establishing the GSCOP to be approximately **£1 million** in total, which comprises training and legal costs, as well as redrafting terms and conditions.³⁷ The ongoing annual cost associated with compliance with the GSCOP was estimated by the CC to be approximately £168,000 per retailer.³⁸ Aggregated across 10 retailers, this gives a total ongoing cost of **£1.7 million per year**.

61. There would also be operating costs associated with GSCOP arbitrations, which would depend on the number of such arbitrations. In the absence of an enforcement body, the

³⁷ CC Report, paragraph 11.413. The figure is based on the result of the OFT commissioned audits of the SCOP and costs reported by Tesco and Asda of introducing the existing SCOP.

³⁸ This cost includes the following elements: regular training; code compliance management time; internal audit compliance; external legal advice; answering queries; and responding to disputes from named complainants (the latter of which is estimated to account for approximately £0.7 million of the ongoing cost).

resolution of disputes under the GSCOP would be performed by a single independent arbitrator, nominated by an external body with expertise in alternative dispute resolution. However, as arbitrations are required anyway under the GSCOP, costs of arbitration do not represent an additional cost associated with the enforcement body.³⁹

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

- *benefits*

62. The CC did not find it possible to directly quantify the consumer benefits associated with continued investment and innovation by suppliers in the future, which the GSCOP should ensure by preventing the exercise of excessive buyer power (provided compliance is high enough, in the absence of a designated enforcement body).

63. It is not possible to accurately forecast the level of compliance for GSCOP with and without an enforcement body. However, an alternative proxy indicator for the likelihood of compliance is the supplier survey conducted by GfK for the Competition Commission. Using the data in Table 2 and by taking the mean average of the seven practices reported, it is estimated that the current level of compliance with the practices set out in the Code is 73% for the four largest retailers regulated by SCOP and would be 59%, if it were extended across all grocery retailers. The four largest retailers account for approximately 65% of the market, therefore by taking a weighted average there is currently a compliance rate of 68% across the grocery retailers subject to GSCOP.

64. Under the GSCOP it is expected that compliance will rise to 73% at the very least, as it represents an improvement to the existing SCOP and includes other large retailers with annual grocery turnover greater than £1 billion.⁴⁰ For those retailers that are not regulated by the GSCOP, the CC received very few cases during its investigation.⁴¹

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

65. Nevertheless, the CC determined that a small loss in investment and innovation would have a significant adverse effect on consumers. They noted that, in the context of annual retail grocery turnover of £110 billion and the value of the groceries supply chain (approximately £70 billion), even a small loss in investment and innovation by suppliers could have a significant detrimental impact on consumers

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

³⁹ Unless it is expected that the costs associated with arbitration for a body to monitor and enforce the GSCOP would differ significantly from those of an ordinary arbitrator, which we would not.

⁴⁰ However, the CC expressed a view that effective monitoring and enforcement of the GSCOP requires both the resolution of disputes *and* proactive investigation of retailers' behaviour in respect of particular practices (based on anonymous complaints). If the Code solely relies on formal dispute resolution, which is the case under this option, it is possible that the effectiveness of GSCOP would be undermined. This is because a retailer must be told the identity of a supplier if the latter brings a dispute which, as discussed above, creates a disincentive for the supplier to complain if there is a risk that they will be de-listed. In this case, compliance with the GSCOP may not rise significantly above 73%.

⁴¹ Given that the CC introduced the GSCOP as a remedy for selected grocery retailers, we would not expect retailers outside of GSCOP to be exercising buyer power that results in the transfer or excessive risk and/or unexpected costs.

66. Given that the Government has already accepted the need for a GSCOP enforcement body, based on the costs and evidence presented above, implementing GSCOP without such a body is not open for consultation. Therefore, it is not a feasible option for this impact assessment and has not been considered further.

Self-regulation

67. A self-regulatory option will also not be assessed. Even under the existing SCOP, practices that transfer excessive risk and unexpected costs to suppliers appear to have persisted, as discussed above. Furthermore, large grocery retailers have twice been given the opportunity to voluntarily establish a GSCOP enforcement body to monitor and enforce compliance with the new code.

68. After the CC report was published in April 2008, it prepared an initial draft of undertakings. Failing to receive agreement from any of the grocery retailers, the CC published a formal consultation to accept undertakings from grocery retailers for an ombudsman scheme in April 2009.⁴² Some retailers were opposed to any attempt to establish an enforcement body whilst some were prepared to sign up to undertakings, subject to changes that the CC felt would not be consistent with the final report. Other retailers were prepared to sign up provided that other retailers also signed up to them.⁴³ Without full agreement, however, the body could not be established. Therefore, an option allowing retailers to voluntarily ensure that the GSCOP is monitored and enforced has already been proposed by the CC and failed to be agreed.

Option 1: Base case (enforcement body with power to accept anonymous complaints)

69. As set out above, the base case constitutes the introduction of a body to monitor and enforce the GSCOP with the power to conduct proactive investigations on the basis of anonymous complaints. Such a body would be created within an existing body and consider code-related complaints from both direct and indirect suppliers, but would not have the power to levy penalties on retailers in the event of a breach.

Costs

70. Under this option, the role of the enforcement body would go beyond arbitration to include receiving complaints and carrying out investigations on the basis of this information. These costs are very difficult to forecast as they will depend on the number of complaints the enforcement body receives and the number of investigations it chooses to carry out. For example, if compliance were 100%, then it could be expected that the additional costs associated with this option would be zero, as there would be no (meritorious) complaints that would require investigation.

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

71. In estimating the costs associated with investigations undertaken on the basis of anonymous complaints, the incremental additional costs under this option are those pertaining to complaints that would not have been made under the base case (i.e. under a scenario where complainants would have to identify themselves). On the basis that complaints could be received from all parties (not just direct suppliers), but that the enforcement body did not have the power to impose penalties, the CC estimated the cost of enforcement (including

⁴² http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/ombudsman_undertakings.pdf

⁴³ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_ombudsman_response.pdf

OFT oversight) to be approximately £120,000 per retailer.⁴⁴ Across the ten grocery retailers subject to GSCOP, this would suggest an incremental additional cost of **£1.2 million per year** associated with this option, though it is difficult to estimate whether this is an upper bound.⁴⁵

72. Costs associated with arbitration are not additional to this option as they would be incurred in the absence of an enforcement body in any case (i.e. under the hypothetical 'do nothing' option).

Benefits

73. As set out above, under the GSCOP it is assumed that compliance across the groceries market would rise from 68% to 73% (at least). The existence of an enforcement body should increase the level of compliance to a level above 73%.⁴⁶

74. In the absence of an enforcement body with the power to accept anonymous complaints, the resolution of disputes requires the identification of the supplier bringing the dispute. Under the existing SCOP, a number of suppliers claim that they run the risk of being de-listed by retailers if they are identified during a dispute.⁴⁷ However, in the case of complaints made on a confidential basis, the enforcement body would investigate areas of recurring concern and help build confidence in the operation of the groceries supply chain.

75. Experience from Germany suggests that the power to initiate proceedings on the basis of anonymous complaints can be helpful in encouraging complainants to come forward (and also remedy cases informally without having to issue a decision).⁴⁸ This should help ensure that suppliers can make investments with a reasonable degree of certainty regarding their expected returns and the allocation of risk.

Risks

76. The estimated cost of this option, £1.2 million per year, will vary depending on the number of disputes and anonymous complaints that the enforcement body receives. If all of the grocery retailers regulated by the Code are fully compliant, then the number of complaints (and therefore the costs under this option) would most likely tend to zero.

77. A risk identified by one of the six CC Members who conducted the groceries inquiry (Professor Bruce Lyons) was that anonymity will not be protected in all cases. In Germany, the BKA stated that if an informal solution to anonymous complaints cannot be found, it has to issue a formal decision. In this case, the identity of the complainant needs to be revealed. However, given that the enforcement body will only investigate recurring practices or specific patterns (e.g. complaints related to a certain retailer or a specific sector), which will involve a number of suppliers, this risk should be mitigated to some extent.

⁴⁴ Covering the cost of inquiries based on anonymous supplier complaints (CC Report, paragraph 11.408). This cost is determined by a number of factors, including the likely number of investigations, such as: the nature of the investigations, how retailers decide to respond to investigations, amount and nature of regular monitoring, and retailers' responses to regular monitoring.

⁴⁵ This cost will be maximised where there is no overlap between those complainants who are willing to be identified and those who are not. If there is some overlap, the costs associated with enforcement will be lower, as some of these complainants have already been accounted for by dispute costs assessed under 'do nothing'.

⁴⁶ Unlike the SCOP, where disputes were mediated by an independent mediator appointed and paid for by the retailer, the proposed enforcement body would act as an arbitrator and also conduct proactive investigation of retailers' behaviour in respect of particular practices. The latter is important because it can be done on the basis of anonymous complaints.

⁴⁷ CC report, paragraph 11.348

⁴⁸ In Germany, the Bundeskartellamt (BKA) has conducted a number of investigations into the exploitation of buyer power by grocery retailers under German Competition Law and in 1999 was given the power to initiate proceedings based on anonymous complaints.

Option 2: Creation of a new body

78. A monitoring and enforcement body could, as recommended by the CC, be a stand-alone body (but with the enforcement body appointed, and its budget set, by the OFT) or it could be part of an existing body, such as the OFT.

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

79. In considering these proposals, we acknowledge the action that is taking place across Government to reduce the number of regulators, as set out in the recent 'Smarter Government' document.⁴⁹ In light of this, we would need to receive clear evidence that the role being considered here could not be conducted by an existing body to consider creating a new body specifically for this purpose.

Costs

80. The costs associated with an independent enforcement body would include both the one-off costs of setting up and operating the enforcement body's office, and the ongoing costs incurred by retailers (and suppliers) in interacting with the enforcement body.

81. Based on the cost incurred by the CC in setting up a home credit comparisons website,⁵⁰ the one-off costs associated with establishing an independent body as the body to monitor and enforce the GSCOP could be up to **£0.2m**. It is likely that this cost would be met (along with other set-up costs for the enforcement body) by grocery retailers.

82. The level of ongoing costs would primarily be determined by the number of investigations undertaken and disputes arbitrated by the enforcement body. Whether the enforcement body is a newly-created body or part of an existing body would not be expected to influence its level of activity. Therefore, in either case the annual cost should be the same as under option 1 (i.e. the base case). However, the CC received views from different parties who felt that this was not the case (see below).

Benefits

83. It might be argued that – given its prior experience in building up skills and background knowledge through enforcing the SCOP – there might be some advantage in the OFT being the designated monitoring and enforcement body. These advantages would then be lost if a new body were to be created expressly for this purpose. On the other hand, a dedicated body with industry expertise, which would build working relationships with supplier trade associations and retailers and monitor compliance and promote best practice, would also have advantages.

84. Overall, five of the six CC Members who conducted the inquiry expressed a strong preference for appointing an enforcement body independent of the OFT. The remaining CC Member (Professor Bruce Lyons) disagreed, as he was concerned that an ombudsman may find a role 'proactively' representing the interests of suppliers, including global manufacturers and large intermediaries, which he considered would reduce the benefits of competition. However, he believed the OFT was well placed to refrain from undesirable intervention because it had an embedded mission to make markets work well for consumers. He also expressed concerns that set-up and operating costs would be substantially higher for a new enforcement body than for the OFT.⁵¹

85. The CC majority view implies there would be incremental net benefits from having the functions carried out by an independent enforcement body rather than an existing one.

⁴⁹ <http://www.hmg.gov.uk/media/52788/smarter-government-final.pdf>

⁵⁰ Which was similar in that it was operated by an independent body and funded by the home credit companies

⁵¹ CC report, paragraphs 11.347 and 11.418

However, the lack of unanimity suggests there is uncertainty over the extent of these benefits.

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

Risks

86. It is likely that both a new enforcement body and the OFT (as a general competition enforcement body) would be seen as independent. However, existing bodies including the OFT may be less likely to be regarded as independent by suppliers or retailers, and this could affect both costs and benefits.
87. For example, suppliers told the CC that the OFT was not proactive in investigating disputes under the SCOP and expressed support for an independent mediator, conciliator or arbitrator. Many other parties⁵² questioned whether the OFT was the best authority to supervise and enforce retailers' compliance. By contrast, many submissions from retailers supported the continued involvement of the OFT in this role.

Option 3: Power to levy penalties

88. The CC has recommended to BIS that the enforcement body should have the power to impose monetary penalties on retailers in respect of breaches of the GSCOP. However, the CC did not carry out any specific analysis of the proportionality (i.e. benefits versus costs) of giving the enforcement body powers to impose penalties.
89. Under the base case, if the GSCOP enforcement body found in favour of a complainant, she would only have the power to award financial costs equal to the amount originally imposed on the complainant – i.e. the original costs imposed on the supplier would be given back to them to compensate for their loss. However, there would be a deterrence effect under the base case, due to the reputational risk associated with breaches of GSCOP, where such breaches could be identified and publicised by the enforcement body. This would be likely to result in negative publicity for the retailer, which would deter further breaches, both by the individual retailer and potentially across all retailers subject to GSCOP.
90. Under this option, the enforcement body would have the ability to impose a punitive element in addition to the original costs incurred by the supplier. That is, the monitoring and enforcement body would be able to impose a fine or penalty on the retailer that has breached GSCOP in excess of the costs incurred by the supplier as a result of the breach. In relation to the original scenario (i.e. where the enforcement body does not have this power), the only route available to claiming any money would be to take a follow-on case, based on the judgement of the enforcement body.

Costs

91. Adding the power to impose penalties could affect both the costs and benefits of the monitoring and enforcement body. For example, the possibility of penalties might give retailers more incentive to prolong investigations by disputing every point, however small, which would increase the cost of each individual investigation.
92. As there would also need to be a right of appeal, costs could also increase to the extent that decisions are appealed and it may be noted that the enforcement body is unlikely to have a strong incentive to avoid appeals since its budget needs to be flexible.⁵³ If there was an

⁵² For example, the ACS, suppliers, supplier organizations, non-governmental organizations, primary producer organizations and consumers

⁵³ The CC recommended that the enforcement body should have a flexible budget with a large contingency as it was concerned about the possibility that retailers would attempt to exhaust the enforcement budget in the

independent enforcement body, appeals could be made to the OFT (as suggested by the CC), but if the enforcement body was the OFT itself, appeal may have to be straight to the courts; this could further increase costs.

93. The cost of an appeal case varies widely according to the specifics of each case. Assuming that an existing appeals body were to be utilised for this purpose, it is likely to be more efficient in terms of overheads, staff costs etc. Data from the Competition Appeals Tribunal for 2009 suggests that average case costs are around £102,000 per year.⁵⁴
94. In the absence of information about the likely number of decisions by the GSCOP enforcement body, it is not possible to predict how many appeals there might be in any given year and therefore quantify any associated costs.

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

Benefits

95. In addition to the deterrence effect associated with negative publicity identified above, penalty powers will increase the potential cost to retailers of not complying with GSCOP, and hence will increase the incentive for retailers to comply with the GSCOP. A key factor affecting the size of benefits from penalty powers is the extent of GSCOP compliance in the absence of penalties. If compliance (in the absence of penalties) is high, then the incremental benefit of better compliance will be small. On the other hand, if compliance in the absence of penalties is low, improving compliance may realise the additional benefits of implementing the original recommendation.⁵⁵

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

96. Currently, the enforcement body has not yet come into operation and the GSCOP has only just been introduced. Consequently, there is no direct basis for assessing compliance in the absence of penalties. It may be possible to get a better view after the new regime has been in operation for a period of time.
97. For the purposes of this impact assessment, we considered whether data on compliance with the SCOP would enable us to make an estimate of GSCOP compliance by an enforcement body without penalty powers. However since the inadequacy of the SCOP and the absence of an enforcement body was the reason for establishing the GSCOP and recommending the establishment of an independent enforcement body, we concluded that SCOP compliance data was not useful in estimating GSCOP compliance by an enforcement body without penalty powers.
98. An alternative proxy indicator for the likelihood of compliance is the supplier survey conducted by GfK for the Competition Commission. This suggests that 68% of suppliers had undertaken action that would be in breach of the GSCOP, once it comes into force. As in the base case, we assume a range of likely compliance of between 73% and 100%, with benefits of 100% compliance being zero.

knowledge that effectiveness of monitoring and enforcement would be compromised (see footnote to paragraph 11.338 of the CC report).

⁵⁴ Composed of £80,000 staff costs and £22,000 operating costs

⁵⁵ An OFT study on enforcement of competition law found that most companies and lawyers considered that fines were important or very important in deterring infringements, supporting the idea that compliance would be lower in the absence of financial penalties (http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/of962.pdf; Table 5.11, Table 18 in Annex A and Table 15 in Annex B).

99. A potential additional benefit under this option is the avoided costs for individual complainants of undertaking a follow-on action, following a favourable judgement by the enforcement body. Estimates from work on implementing the Consumer Advocate suggest that the average cost per action could be around £250,000 and £300,000.
100. Unfortunately, in the absence of information about the likely number of complaints once GSCOP comes into force, it is not possible to predict how many follow-on actions there might be in any given year and therefore quantify any associated costs.

Risks

101. An important factor that may affect the net benefits of adding penalty powers is the risk of the enforcement body's investigations finding 'false positives'. These involve erroneously finding breaches of the GSCOP (though these will ultimately be corrected by the appeals process), or finding breaches of the GSCOP that do not contribute to the adverse effects on supplier investment and innovation identified by the CC. To the extent that there are 'false positives', penalty powers could induce behaviour by retailers that is costly rather than beneficial.
102. An additional risk is that the punitive element imposed by the enforcement body in upholding a complaint could then be passed on to consumers in the form of higher prices. This could be particularly problematic for low-income consumers, for whom expenditure on food makes up a higher proportion of their income.
103. The enforcement body would only impose penalties where there is strong and convincing evidence that a retailer has committed a breach of the GSCOP. The CC accepted that it would not be appropriate to impose penalties based on anonymous complaints from suppliers.⁵⁶ Therefore, any dispute that could result in the imposition of a penalty would involve the supplier(s) being identified to the retailer. This may deter suppliers from seeking such resolutions if they consider the risk of de-listing to be sufficiently high.

Option 4: Limiting the scope of the GSCOP enforcement body

104. As set out earlier, there are a large number of firms that supply groceries to UK grocery retailers, either directly or indirectly. This includes food and drink manufacturers, primary producers and fresh food wholesalers, including packers, processors and wholesalers. It is unclear precisely what proportion of total supply to grocery retailers is delivered directly (e.g. from wholesalers, manufacturers or primary producers) or indirectly through intermediaries.
105. The CC report that the majority of grocery retailers' fresh produce is supplied via intermediaries such as packers, processors and fresh food wholesalers, as retailers feel there are certain advantages to this supply channel.⁵⁷ Data provided to the CC during their inquiry suggests that the average value of direct purchases from farmers by large grocery retailers in 2006 was approximately £49 million per year.⁵⁸ As an example, the CC report mentions about 20,000 milk producers compared to 200 milk processors, of which three (Arla, Dairy Crest and Wiseman) account for over 90 per cent of total processed liquid milk sold to grocery retailers in the UK.

⁵⁶ CC report, 11.372

⁵⁷ Such as: efficiencies arising from a single intermediary undertaking processing/packing on behalf of a number of farmers; the costs to a grocery retailer of trying to deal individually with the large number of farmers; the effectiveness of intermediaries at carrying out quality assurance activities compared with grocery retailers, and intermediaries' greater ability to source alternative supplies where there is a shortfall in production.

⁵⁸ £295 million across 6 retailers (Para 3.32, CC report), compared to £16.7 billion in fresh food sales for these retailers; it should be noted that the comparatively large proportion purchased by Morrison's through this channel is likely to distort an average figure across all retailers.

106. In their letter recommending the creation of a GSCOP enforcement body, the CC makes reference to there being 7,000 (direct) suppliers in the grocery supply chain.⁵⁹ This seems to be a very small number, especially taken in context of the earlier figures regarding the number of farm holdings, fresh food intermediaries and food & drink manufacturers. However, given that the CC reports that the market for grocery wholesale is relatively concentrated, with the 15 largest grocery wholesalers accounting for more than three-quarters of grocery wholesaling revenue,⁶⁰ these 7,000 suppliers could account for a significant proportion of the overall supply of groceries to retailers.

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

107. The original SCOP was designed to govern the relationship between retailers and their direct suppliers, not between intermediaries and primary producers. However, during their investigation, the CC reviewed some complaints from primary producers and found that it was not uncommon for processors and other intermediaries, in discussions with their suppliers (including primary producers), to attribute particular supply chain practices to direct intervention or pressure placed on the processor or intermediary by grocery retailers. The CC was told by grocery retailers that, in many cases, this attribution was incorrect and that the supply chain practices were in fact instigated unilaterally by the processor or intermediary, with no input from the retailer.

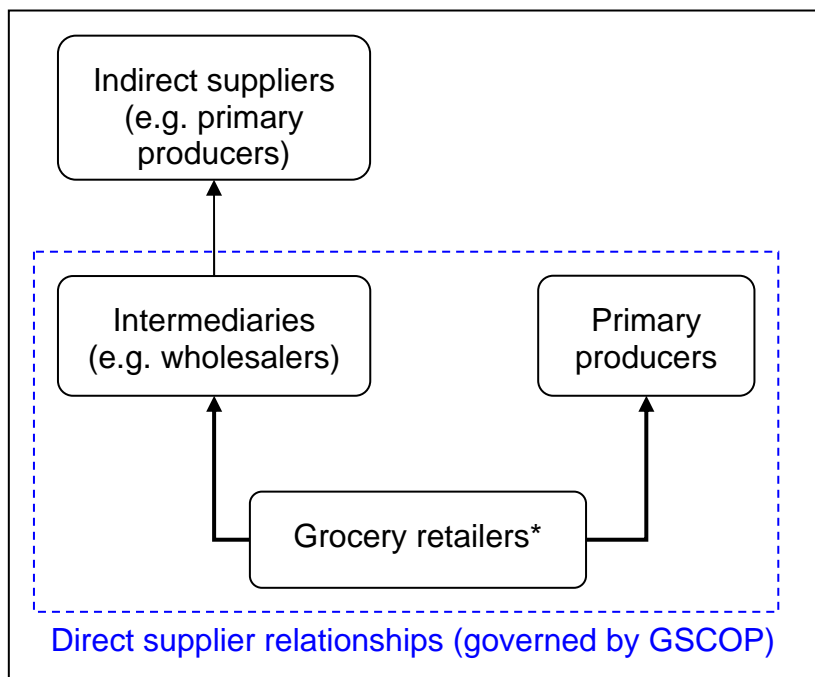
108. In order to increase transparency with respect to supply chain practices, the CC considered that primary producers and other suppliers to intermediaries and processors should also be permitted to make complaints to the enforcement body about alleged breaches of the GSCOP (i.e. retailers' conduct with respect to processors and intermediaries) where the primary producer or other supplier reasonably considers that the breach has had a direct or indirect effect on its interests.⁶¹ Increased transparency would help to reveal supply chain practices and the exercise of buyer power, which might in turn benefit those parts of the groceries supply chain with little or no market power.

⁵⁹ Para 2.7 of http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

⁶⁰ CC report, paragraph 3.27

⁶¹ It should be noted that retailers' contracts with suppliers based outside of the UK are also regulated by the GSCOP (as they were under the SCOP) and those suppliers have the right to arbitrate and make complaints to the enforcement body. There is no distinction based on country of origin and, in the case where the enforcement body receives complaints from indirect suppliers, this also applies to foreign intermediaries and primary producers.

Chart: Groceries supply chain



* - Only those grocery retailers covered by GSCOP (i.e. with turnover in excess of £1bn)

Costs

109. A subsequent impact of this option would be that indirect suppliers further up the supply chain would be severely impaired in terms of redress for any breaches of GSCOP, which could lead to costs being transferred onto them from intermediaries. As envisaged by the CC, this would then limit the scope for realising the full benefits of enforcement of the GSCOP. As the grocery supply chain at primary producer level is likely to be significantly less concentrated (with more small-scale enterprises), the benefits to these smaller suppliers from the increased marginal revenue could exceed the cost saving set out below.
110. Although there could be potential benefits under this option in the form of lower enforcement costs, the precise level of this reduction is difficult to estimate. However, it is possible that limiting the parties able to make complaints would lead to a loss of benefits greater than the cost saving.

Benefits

111. There are a large number of primary and other producers who are not direct suppliers to grocery retailers. Taking action to limit the scope of potential complainants to direct suppliers only – i.e. excluding the possibility for indirect suppliers to initiate a complaint against a grocery retailer who has breached the GSCOP that has ultimately resulted in this action transferring the costs up the supply chain via intermediaries – could significantly reduce the costs associated with enforcement.
112. Based on earlier figures⁶², it could be assumed that there are around 350,000-400,000 suppliers in the grocery supply chain. Under this option, complaints would be limited to direct suppliers only, of which there are estimated to be 7,000. Assuming that all suppliers are equally likely to make a valid complaint (and that each upheld complaint is equally costly), this might imply a reduction of around 98% in complaints (and enforcement costs) relative to a situation where all suppliers are permitted to complain. However, given the issues regarding concentration within grocery wholesaling, this might mean that the reduction in costs (if assessed on a value basis) would be much smaller.

⁶² 311,000 farm holdings; 3,600 fresh food intermediaries and 6,600 food and drink manufacturers in the UK

113. A number of retailers suggested that providing non-contracting parties with a right to complain would lead to complaints being vexatious or not based on a full and proper knowledge of the facts. However, the CC did not believe these concerns to be well-founded as the enforcement body would be required to contact the supplier and corroborate the details of the complaints.

Risks

114. Under this option, an important potential risk is the impact of costs borne by primary producers and indirect suppliers, for which they would then be unable to seek redress. In the most extreme case, these costs could lead to production of certain grocery items becoming unprofitable and such suppliers being forced to exit the market. This could then have an adverse effect on competition for the provision of grocery items to grocery retailers, by reducing the number of potential suppliers, as well as negative distributional effects through the geographic distribution of loss of employment (e.g. in key farming areas) and potentially an increase in carbon emissions associated with UK food supply.

115. The CC noted that increasing concentration in the groceries supply chain has led to many intermediaries themselves having buyer power over primary producers.⁶³ Even if the GSCOP and enforcement body is successful in preventing retailers from exercising their buyer power, the Code does not cover contracts between primary producers and intermediaries. Therefore, an adverse effect on competition may still exist in the supply chain if the enforcement body limits its scope to direct suppliers. It should be noted however that even if it receives complaints from indirect suppliers, the body will have limited authority to address a problem if it does not directly involve the large grocery retailer.

Enforcement

116. The focus of the consultation and impact assessment is in itself on enforcement. If the enforcement role is undertaken by an existing body, for example the OFT, its activities will need to be fully integrated.

Implementation

117. In the absence of any new intervention, from 4th February the OFT will take on the role of operating and enforcing the CC's Order, rather than the GSCOP. Therefore, the OFT will not provide guidance on the interpretation of the GSCOP; nor will it determine whether matters fall within its scope; nor will it have a role in resolving disputes between suppliers and retailers as to the operation of the GSCOP; nor will it proactively investigate confidential complaints by suppliers about breaches of the GSCOP.⁶⁴

Monitoring and evaluation

118. Ongoing monitoring is part of the enforcement body's role and it is expected that it will publish annual reports on compliance, which may impose burdens on the retailers subject to GSCOP. If a new organisation is created, it is expected to report to the OFT on a regular basis regarding the nature of complaints and disputes that it has investigated. In addition, BIS will review the proposed policy 3 to 5 years after the introduction of an enforcement body.

⁶³ CC Report, paragraph 11.292

⁶⁴ http://www.offt.gov.uk/shared_offt/monopolies/GSCOP-OFT-advice.pdf

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	Yes
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	Yes

Annexes

Competition Assessment

Would the proposals directly limit the number or range of suppliers?

None of the proposed options would directly limit the number of grocery retailers of suppliers.

Would the proposals indirectly limit the number or range of suppliers?

None of the proposed options would indirectly limit the number or range of grocery retailers as the GSCOP only applies to the ten largest retailers with annual grocery sales of more than £1 billion. They may, however, affect grocery suppliers. By ensuring that the GSCOP is monitored and enforced, thereby preventing the transfer of excessive risk and unexpected costs to suppliers, it is less likely that they will be forced out of business due to reduced profit margins or lack of investment and innovation. It is even possible that new entrants will enter the market if the returns remain sufficiently high.

If the power to levy penalties increases retailer compliance, then this will encourage market entry and supplier investment and profitability even further. The same argument applies if the enforcement body receives complaints from both direct and indirect suppliers.

Would the proposal limit the ability of suppliers to compete?

None of the proposals should limit the ability of grocery retailers to compete with each other as they are all subject to the same Code and regulations. They should, however, give grocery suppliers more ability to compete by ensuring that profit margins are sufficient and risks mitigated such that they have more resources to invest and innovate. Suppliers that are based outside of the UK are also covered by the Code, hence there is no additional benefit for supermarkets in contracting foreign grocery suppliers.

The level of competition in the upstream groceries supply chain may possibly, if anything, increase if the enforcement body receives complaints from indirect suppliers as well as direct suppliers.

Would the proposal reduce suppliers' incentives to compete vigorously?

On the contrary, grocery suppliers would have greater incentive to compete assuming that the enforcement body ensures that they know, with certainty, the costs and risks of their operations.

What alternative proposals have been considered?

A self-regulatory approach to establishing the GSCOP enforcement body has been proposed on two previous occasions and in both instances it failed to materialise. Therefore, it was not considered in this consultation. Implementing the GSCOP without an enforcement and monitoring body was also not considered because such a solution was applied under the existing SCOP and it failed to fully address the adverse effect on competition.

Other proposals have been included in the consultation, namely the activities of the enforcement body and how it is to be funded, but neither is substantively analysed in the impact assessment, as their overall impact on costs and benefits is likely to be marginal.

Small Firm Impact Test

The GSCOP regulates the practices of larger grocery retailers with annual sales of more than £1 billion. Therefore, none of the proposed measures will have an impact in small grocery retailers. However, they may have a positive impact on small grocery suppliers (e.g. primary producers) by preventing their customers from transferring excessive risk and unexpected costs to them. A larger number of small firms would benefit from the enforcement body if it investigated complaints from indirect suppliers as well.

Sustainable Development

By ensuring that primary producers and other grocery suppliers do not have their profit margins reduced by the exercise of buyer power, those enterprises will have greater financial resources to invest in innovative products and technology that reduces the environmental impact of production.

Race, Disability and Gender Equality Test

After initial screening as to the potential impact of this policy on race, disability and gender equality it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact.

Rural Proofing

To the extent that the enforcement body improves the operation and competitiveness of primary producers and rural enterprises that supply groceries, each option would have a beneficial effect in rural areas.