

The Groceries Supply Code of Practice – an overview

CMS Cameron McKenna







Introduction

The Groceries Supply Code of Practice (the 'Code') is a result of the Competition Commission's investigation of the groceries market which it undertook between May 2006 and April 2008.

The Competition Commission found an adverse effect on competition due to a number of market features including supply chain practices that were detrimental to suppliers. The Competition Commission recommended various remedies to address these adverse effects. One of the remedies was an improved code of practice in the form of the Code, together with an ombudsman to ensure effective enforcement of the new provisions for suppliers and retailers.

This briefing note provides an overview of the key aspects of the Code, an explanation of the obligations placed on retailers as well as guidance for suppliers on how to deal with retailers under the Code.



Overview of the groceries regime

The Code was established by the Groceries (Supply Chain Market Practices) Market Investigation Order 2009 which came into force on 4 February 2010 (the 'Order'). Retailers are subject to obligations under both the Order and the Code. The Order places general obligations on retailers concerning the adoption of the Code and implementation of compliance measures, whilst the Code deals in detail with specific commercial issues that arise between suppliers and retailers.

In addition to the introduction of a strengthened code of practice, the Competition Commission recommended that it should be overseen and enforced by an independent ombudsman. Originally the intention had been to establish this on the basis of voluntary agreement between the large grocery retailers. Such a voluntary agreement has not been forthcoming and therefore the Government currently proposes to introduce the Groceries Code Adjudicator using legislation. The current status of the proposed Groceries Code Adjudicator is discussed below.

The Order and the Code apply to the sale of Groceries: which goods are 'Groceries'?

Groceries are defined to include food, pet food, drinks, cleaning products, toiletries and household products.

The definition of groceries does not cover petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers, 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.

Which retailers are subject to the Order and the Code?

The obligations in both the Order and the Code apply only to the 'Designated Retailers'. Currently these are Asda, The Co-operative Group, Marks & Spencer, Wm Morrison Supermarkets, J Sainsbury, Tesco, Waitrose, Aldi, Iceland and Lidl. Any reference to 'retailer' below refers only to Designated Retailers.

More retailers can be designated if they hit the requisite £1 billion turnover threshold with respect to the retail sale of groceries.

What are the obligations of the Designated Retailers under the Order?

It is important to draw a distinction between the provisions of the Order and those included in the Code. The Order places five main obligations on the Designated Retailers:

- To incorporate the Code into supply agreements: Designated Retailers are required to incorporate the Code into supply agreements before entering into or performing such agreements. The effect of this is that the Code becomes part of the terms and conditions and if broken, would lead to a breach of contract (although any breach does not affect the retailer's obligation to accept and pay for goods).
- To provide information to suppliers: Designated Retailers must ensure that suppliers have a written copy of the supply agreement, as well as providing any subsequent agreements or contractual arrangements made under or pursuant to that agreement in writing. Any oral arrangements must be confirmed by the retailer within three working days of such arrangements being agreed.
- To provide information to the Office of Fair Trading (OFT): Designated Retailers are required to provide certain information to the OFT for monitoring purposes.
- To implement compliance measures: Designated Retailers are required to:
 - train staff with respect to the Code
 - appoint an in-house Code Compliance Officer (CCO) – the role of the CCO is to act as an internal point of reference for the retailers and to act as a point of contact for suppliers. The CCO is required to be independent of, and must not be managed by, any member of a retailer's buying team

- provide an annual compliance report to the OFT detailing any breaches and alleged breaches of the Code as well as any disputes between the retailer and its suppliers.
- To adhere to the dispute resolution scheme: Designated Retailers are required to follow the dispute resolution procedure set out in the Order. This is described in more detail below under 'Disputes and complaints'.

Do the terms of supply of the Designated Retailer prevail over those of a supplier?

No. The official explanatory notes which accompany the Order are explicit that the Designated Retailer's terms of supply do not automatically prevail. The terms and conditions of either the supplier or the retailer can govern the relationship between the parties, although Designated Retailers will refuse terms and conditions which do not include the Code. Thus suppliers should ensure the Code is incorporated into their terms and conditions.

What constitutes a 'supply agreement'?

Designated Retailers are obliged to incorporate the Code into all supply agreements with suppliers.

'Supply agreement' is defined broadly to include any agreement for the supply of groceries for resale by the retailer including 'spot buy' and 'sale or return' arrangements. There are a very wide range of supply arrangements between retailers and suppliers. For instance, it is common that there is an overarching agreement which provides for general terms and conditions and for subsequent orders to be placed pursuant to those terms and conditions. Alternatively each separate order may be placed pursuant to a separate agreement. The obligations in the Code apply to all types of supply agreements.

Aside from the standard terms and conditions governing issues such as delivery, title and risk, many suppliers enter into trading or marketing agreements covering rebates, promotions and category management support. Retailers will also usually require suppliers to complete other forms, particularly using on-line systems. And lastly, there can be a significant number of ad-hoc agreements reached over the telephone or in email exchanges.

In principle, most of these are likely to be covered by the Code where such agreements or arrangements are made under or pursuant to a supply agreement.

What constitutes 'in writing'?

Designated Retailers must ensure that all the terms of any supply agreement and any subsequent contractual agreements or arrangements (including oral arrangements) made under or pursuant to that agreement are recorded in writing.

It is acceptable for retailers to satisfy this requirement by sending emails. It is also acceptable for retailers to use shared computer systems/websites or restricted access web pages which are available to the supplier. However, merely including terms and conditions on a public website will not be sufficient to meet this requirement, and any electronic method must allow a facility for changes agreed between the parties to be recorded.

The Code

The Code can be found at Schedule 1 of the Order.

What are the obligations of Designated Retailers under the Code?

The Code is divided into different sections which relate to different aspects of the retailer/supplier relationship.

A misconception surrounding the Code is that it prohibits certain practices and commercial arrangements between the Designated Retailers and Suppliers. In fact, whilst it does prohibit some practices, for most of the practices covered by the Code, the obligation on the Designated Retailers amounts to not forcing certain arrangements on suppliers.

This is because the Code frequently uses the term 'require' when referring to actions by the supplier which the retailer will often request or suggest. 'Require' is defined as a situation where a supplier does not agree to undertake an action in response to 'ordinary commercial pressures'. Ordinary commercial pressures are those which do not constitute or involve duress including economic duress and which are objectively justifiable and transparent. The retailer must show that it did not 'require' an action from a supplier. This is an important concept, but difficult to define. Given the nature of the commercial pressures on suppliers, in practice it is difficult to draw a clear distinction between ordinary commercial pressures and undue pressure.

The practical effect of this is that the retailers may still request certain actions or arrangements, can apply ordinary commercial pressures to requesting such actions or arrangements, but cannot exert any undue pressure on suppliers to secure agreement.

The summary of the main provisions of the Code below identifies which obligations are 'require' type obligations with the use of an emboldened '**require**'.

Fair dealing

There is an overarching fair dealing principle obliging retailers to deal at all times with its suppliers fairly and lawfully. This gives

context to the GSCOP, emphasises its key points (no duress, certainty for suppliers regarding risk) and constrains the behaviour of retailers whilst also allowing flexibility.

Variation

The Code sets out a number of obligations on retailers with regard to variations of supply agreements:

- Retrospective variations of supply agreements are not permitted unless the ability to make such variations is included as part of the trading arrangement from the outset.
- A Designated Retailer must not **require** significant changes to supply chain procedures without reasonable notice in writing or full compensation for costs incurred as a result of the failure to give reasonable notice.

Prices and payments

- Payment for goods must be made in accordance with the relevant supply agreement, and in any case, within a reasonable time after invoice. In the absence of any period set out in a supply agreement, the guidance to the Code makes reference to the EU Late Payments Directive which considers that payment will be considered late if it is not made within 30 days of receipt of the invoice requesting payment.
- A retailer may not **require** a supplier to contribute to the retailer's marketing costs unless provided for in the supply agreement.
- No supply agreement is to include obligations on the supplier in a supply agreement to compensate the retailer for shrinkage. Shrinkage covers any loss of goods after they have been delivered to the retailer.
- A retailer may not **require** suppliers to make payments for wastage unless due to the supplier's default or negligence, or as provided for in the supply agreement.
- A retailer may not **require** suppliers to pay for shelf space, although payments may be required for promotions or new product listings, where the payments are proportional to the risk incurred by the retailer in stocking the new line.



- Retailers must inform suppliers of the basis on which forecasts are produced and will be obliged to compensate suppliers for forecasting errors where those errors are attributable to the retailer. However, no compensation will be payable where the retailer has prepared the forecast in consultation with the supplier, or where the supply agreement includes an express and unambiguous provision that full compensation is not appropriate.
- A retailer must not **require** a supplier to obtain goods from any third party where the retailer gains from this.

Promotions

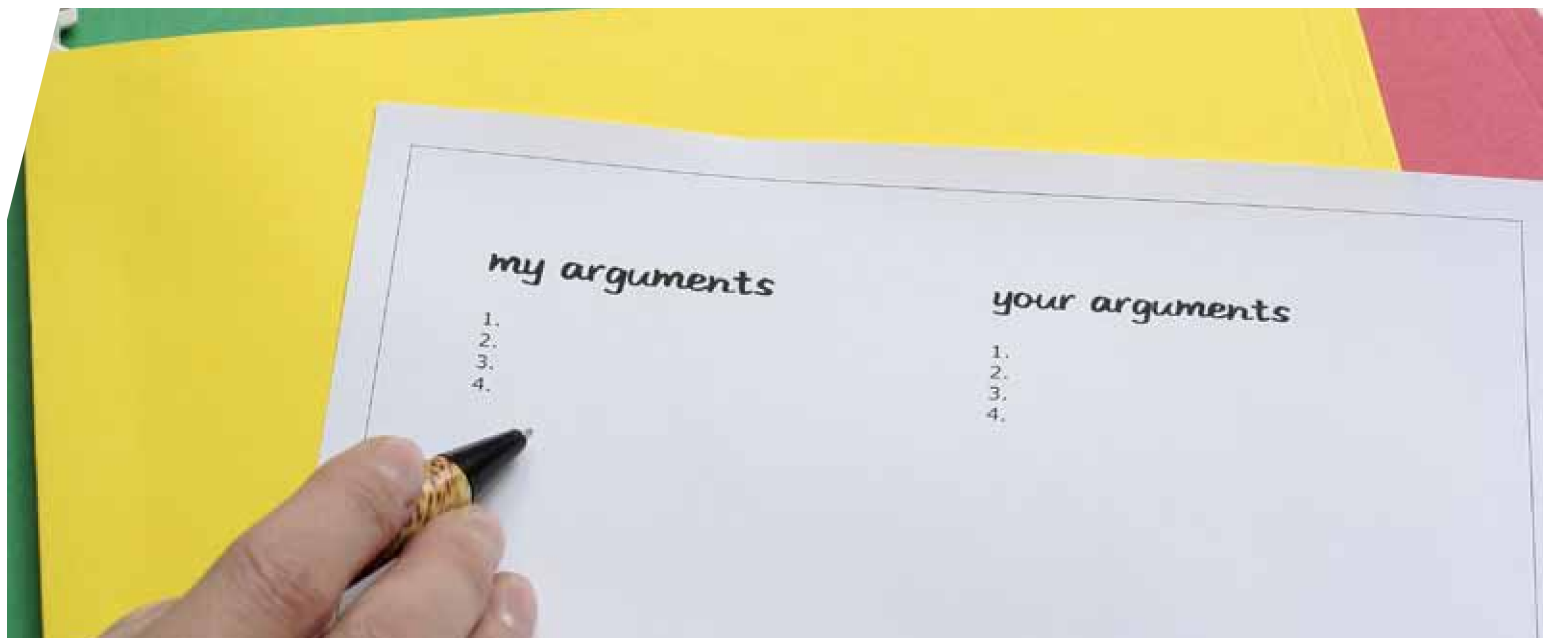
- Retailers may not **require** suppliers to pay for shelf space allocations or positioning unless made in relation to a promotion.
- Retailers may not **require** suppliers 'predominantly' to fund the costs of a promotion, and any promotion in which a supplier makes a payment must only be held after reasonable notice has been given to the supplier. The guidance explains that the ordinary meaning of 'predominantly' suggests an amount greater than half the costs of a promotion. Thus in practice, retailers will be able to require suppliers to fund up to half the costs of a promotion.
- Retailers must take care not to over-order promotionally priced goods and to order only so much of the products as to cover expected sales. If a retailer does not take such precautions, the retailer is required to compensate the supplier for any product purchased from the supplier at the promotional price, but sold by the retailer at a higher non-promotional price.

Consumer complaints

- Where customer complaints are received in-store, a retailer must not **require** a supplier to make any payment for resolving such a complaint unless certain specified conditions are met.

De-listing

- There are a number of duties placed on retailers in relation to de-listing, in particular that this must be for genuine commercial reasons and that a procedure should be followed.
- 'De-list' is defined under the Code as to cease to purchase or significantly to reduce the volumes of purchases made from a supplier. Whether a reduction in volumes purchased is significant will be determined by reference to the total amount of Groceries supplied by a supplier to the retailer, rather than the total volume of Groceries purchased by a retailer from all suppliers. In practice, whether or not a de-listing is significant is unclear. This was intentional to give the ombudsman flexibility to decide on a case-by-case basis. However, the requirement for reference to be made to the total amount of groceries supplied by a supplier means that, in practice, for those suppliers with a large number of lines listed, the definition may not provide any protection in circumstances where only one or two SKU's are de-listed.
- 'Genuine commercial reasons' is similarly unclear. However, the guidance states that de-listing will not be considered to have been made for genuine commercial reasons where it is a consequence of a supplier exercising its rights under the Code or its supply agreement with a retailer.
- The Code sets out a procedure for de-listing. Prior to de-listing, the retailer must give the supplier reasonable notice of its decision. Written reasons for the decision must be provided to the supplier. The supplier can ask for the decision to be reviewed by a senior buyer and can request an interview with the retailer's Code Compliance Officer to discuss the decision.
- 'Reasonable notice' is not defined and will vary according to the relevant circumstances. However, such notice must include sufficient time for the supplier to meet with the senior buyer and Code Compliance Officer.



Disputes and complaints

What should I do if I think that a retailer has breached the Code?

In the first instance, you should raise your concern with your contact at the relevant retailer. This is likely to be the buyer.

If the buyer cannot resolve your issue, you should write to the retailer and ask for a review by the retailer's senior buyer. This is because the Code contains an obligation on retailers to ensure that a senior buyer will, on receipt of a written request from a supplier, review any decisions made by the retailer in relation to the Code or the Order.

If the matter is not resolved after review by a senior buyer, a supplier may refer it to the retailer's Code Compliance Officer and ask the Code Compliance Officer to review the matter. If this is not successful, the supplier has a number of options: it is entitled to initiate the formal dispute resolution procedure under the Order or it could consider making a claim for breach of contract. Should the Groceries Code Adjudicator be appointed, suppliers will also be able to submit complaints to the Adjudicator directly.

The formal dispute resolution procedure

This process commences when a supplier informs the retailer's Code Compliance Officer that it believes the retailer has not fulfilled its obligations under the Code and wishes to escalate the complaint and invoke the dispute resolution procedure.

The parties then have a period of 21 days to resolve the dispute. It should be noted that the Order requires the retailers to negotiate in good faith with suppliers to resolve any disputes.

If the matter has not been resolved by the end of the 21 day period, the supplier is entitled to refer the dispute to arbitration. Whilst the intention of the dispute resolution scheme was that any arbitration would be handled by the

ombudsman, in the absence of such an ombudsman, the Order provides that the arbitration will be administered by a single arbitrator appointed in accordance with the Rules of the Chartered Institute of Arbitrators.

All costs of the arbitrator will be borne by the retailer, unless the arbitrator decides that the supplier's claim is vexatious or wholly without merit. The decision of the arbitrator will be binding and final on both parties.

A claim for breach of contract

Since it is a requirement of the Order to incorporate the Code into supply agreements, a breach of the Code's obligations may also amount to a breach of contract. It is therefore open to suppliers to bring a claim for breach of contract and seek injunctive relief or damages. In practice, suppliers may be reluctant to do this if it risks jeopardising the commercial relationship with a retailer.

Making a complaint to the Adjudicator

A draft of the Groceries Code Adjudicator Bill (the 'Bill') was published in May 2011 and it is anticipated that this will be taken forward in the 2012-2013 Parliamentary Session. As well as acting as arbitrator in disputes between suppliers and retailers, the Bill provides that suppliers will be able to submit complaints to the Adjudicator and that the Adjudicator will conduct investigations if the Adjudicator has reasonable grounds to suspect that a retailer has breached the Code.

This draft Bill has yet to pass through Parliament and thus the current text will be subject to parliamentary changes. However, the ability to receive complaints and for the Adjudicator to investigate these is a core objective in establishing the Adjudicator and we do not foresee these duties changing. As such, the appointment of the Adjudicator will provide suppliers with a potential valuable tool in dealing with disputes with retailers.

Can I make a complaint or refer a dispute about a retailer's actions under the Code to the Office of Fair Trading?

No. This is because the OFT only has power to monitor and enforce the requirements set out in the Order. Thus if a retailer has failed to comply with the obligation in the Order to incorporate the Code into its supply agreements, the OFT can take enforcement in respect of this breach.

However, the OFT does not have any powers to investigate, intervene or resolve any disputes under the Code between retailers and suppliers. This means that the OFT is not able to intervene where the alleged breach concerns a failure to comply with an obligation in the Code, for example, where a supplier complains that it has come under undue pressure from a retailer to contribute to marketing costs, or has not been given reasonable notice or the reasons for being de-listed.

It is also open for suppliers to bring an action for damages if they have suffered loss or damage due to a breach by a Designated Retailer of their duty to comply with the Order.

The proposed adjudicator

Some three years after an ombudsman was proposed by the Competition Commission, the Government published in May 2011 a draft Bill for the creation of such a body.

It is proposed that the ombudsman will be known as the Groceries Code Adjudicator whose principal responsibility will be to enforce the Order and the Code. The Adjudicator's proposed duties can be summarised as follows:

- To arbitrate in disputes arising under the Code between retailers and suppliers.
- To receive complaints alleging Code breaches and where necessary to conduct investigations.

- To publish reports at the end of investigations.
- To make recommendations to relevant retailers on how to improve compliance with the Code and to monitor the progress of such recommendations.
- To publish guidance on the operation of the Code provisions.
- To publish an annual report on the operation of the Code, including providing details of disputes referred to it and investigations undertaken.

The appointment of the Adjudicator will be a welcome development to critics of the Code who consider that without any effective independent enforcement body, it lacks teeth. Currently the Government has rejected calls for the Adjudicator to have the power to fine retailers. The Government considers that being named and shamed will have a sufficient deterrent effect.

Whilst the Bill has undergone pre-legislative scrutiny by the House of Commons Business, Innovation and Skills Select Committee, it has not been introduced to Parliament. Should it be included in the Queen's Speech on 9 May 2012 and passed during the 2012-2013 Parliamentary Session, it is anticipated that the earliest the Adjudicator will be appointed is sometime in 2014.

Practical guidance for suppliers

- Whilst a retailer must not enter into or perform any supply agreement unless that supply agreement incorporates the Code, the supply of goods can be made on either the retailer's terms and conditions, or those of the supplier. Suppliers should not, therefore, be pressurised into accepting the terms and conditions of the retailer, but can deal on their own terms and conditions which include provisions incorporating the Code.
- Suppliers should avoid including terms which state that the supplier's terms and conditions will prevail. Case-law has not upheld such provisions. Whilst suppliers are encouraged to ensure that they fire the 'last-shot' by sending an order acknowledgment setting out the supplier's terms and conditions, suppliers should also be careful of retailers stamping delivery notes expressing that the goods are accepted on the retailer's terms and conditions. It is essential that suppliers keep records of all paperwork when supplying goods.
- Records should also be kept of all written correspondence with retailers. The requirement for any supply agreement to be 'in writing' captures any email correspondence and documents on restricted access/shared access websites. Sales teams should therefore be advised to implement document retention and filing policies to ensure that all written records are maintained centrally and can be referred to easily in the event of any dispute. Copies of any terms and conditions stored on websites should be downloaded and kept on file.
- Any oral agreements are to be confirmed by retailers in writing within three working days. It is good practice to encourage commercial personnel to make contemporaneous notes of such discussions to ensure that the written communication or agreement properly reflects the oral agreement.
- On receipt of any written terms and conditions from the retailer, the supplier should clarify any uncertainties or correct any errors without delay.
- Any instances of non-compliance by a retailer should be recorded in writing by the supplier, ideally at the same time as the instance of non-compliance occurs, so that in the event of any complaint or dispute, accurate and complete records can be referred to.
- Sales teams should be provided with training to educate them on the terms of the Code so as to give them guidance on the obligations that can and cannot be included in supply agreements, and to allow them to identify behaviour or practices of a retailer which would place it in breach of its obligations in the Code.
- Designated Retailers are required to appoint a Code Compliance Officer. For larger suppliers who deal with most of the Designated Retailers and are supplying a large number of products, it may be sensible to appoint a person with equivalent responsibilities in order to provide a centralised in-house resource when dealing with the Code.



How we can help

We regularly advise clients operating in the grocery sector and have experience of advising suppliers on their rights under the Code. In particular, we can:

- Advise on the drafting of supply agreements with retailers.
- Advise on whether a course of conduct amounts to a breach of the Code and how best to challenge a retailer over such conduct.
- Advise on the compliance of promotions, listing fees and de-listing under the Code and general competition law.
- Advise on other commercial arrangements between retailers and suppliers, including marketing support and category management activities.

For further information please contact



Susan Hankey

Partner, Competition

T +44 (0)20 7367 2960

E susan.hankey@cms-cmck.com



Caroline Hobson

Partner, Competition

T +44 (0)20 7367 2056

E caroline.hobson@cms-cmck.com



John Markham

Senior Associate, Competition

T +44 (0)20 7367 3109

E john.markham@cms-cmck.com
