

**FDII SUBMISSION TO**

**THE DEPARTMENT OF ENTERPRISE, TRADE & EMPLOYMENT**

**GROCERY CODE OF PRACTICE CONSULTATION**

**September 2009**



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## Definitions

What follows are a number of definitions describing the groups that the code of practice will govern.

**Grocery Goods Undertakings:** are all undertakings that are engaged for gain in the production, supply or distribution of grocery goods, whether or not the undertaking is engaged in the direct sale of those goods to the public.

**Supplier:** means a grocery goods undertaking carrying on (or actively seeking to carry on) a business in the direct supply to any retailer of groceries for sale or resale to the public.

**Retailers:** for the purposes of this submission are defined as the 'grocery chain customers' of suppliers and are undertakings that sells or resells grocery goods in the Republic of Ireland. This group includes inter-alia: multiple retailers, wholesalers, buying groups, independent retailers, independent retailers represented by buying groups and retailers with headquarters in foreign jurisdictions

## Introduction

The Irish grocery sector is an integral part of Ireland's food and drink industry. More than half of the food and drink industry's €20 billion output is consumed in Irish homes.

The importance of the Food and Drink Industry to the Irish economy is underlined by the fact that<sup>1</sup>:

- Exports in 2008 were over €8bn accounting for 2/3 of total exports by indigenous industries
- Almost 50,000 people are directly employed with a further 60,000 employed indirectly across the country
- It provides the highest Gross Value Add per employee in the EU and one of the highest turnovers per capita
- Food and drink companies purchase for 90% of the output of the agricultural sector meaning that 120,000 farmers depend on the sector for their livelihoods
- It accounts for €8.3bn or almost half of the goods and services sourced in Ireland by the manufacturing sector
- Due to the diverse nature of the sector, it provides employment in villages, towns and cities in every county in Ireland.

From a consumer perspective, a functioning grocery sector delivering a range of safe, high-quality food products at affordable prices is essential today and into the future. Competition between suppliers and between their grocery chain customers, hereafter referred to as retailers, in the Irish market is intense, delivering many benefits to consumers and providing thousands of jobs throughout Ireland. Furthermore given the reality that consumers need jobs to generate income, consumer interest is not only focused on grocery spending but is deeply linked to a competitive grocery supply sector.

However, there is an unsustainable imbalance in the relationships between retailer and supplier. Ultimately, this will affect every household through the choice, quality and prices of products available. Ireland has one of the highest levels of concentration in the grocery sector in Europe. The larger market operators have turnovers and hence buying power which is many times that of even the largest food and drink suppliers. This imbalance has meant that the vast majority of growth in the sector has flowed towards larger retailers to the detriment of suppliers, farmers, smaller retailers.

Left unchecked, this will have long term consequences for:

- thousands of food sector employees as suppliers downsize
- Ireland's economic growth as smaller retailers and suppliers shut down

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<sup>1</sup> Sources – CSO, Eurostat, Dept of Agriculture, Fisheries and Food, Bord Bia, Forfas

- primary producers and processors due to the lack of economic sustainability especially now when CAP supports are a diminishing source of revenues to the food sector
- rural communities where suppliers can no longer serve retailers and farmers have no market for produce
- Ireland's reputation as a 'food island' as we become net importers of food over the coming decades
- consumers through less choice and less competition amongst retailers
- the health of the Irish population as Irish food is replaced by imports
- the capability of food companies to invest in new product and process development through diminished opportunity to test market domestically

Retailers are enabled by their 'buying power' to transfer excessive risk and unexpected costs onto their suppliers through various unregulated and unsustainable commercial practices. These practices depress supplier's ability to invest, innovate, retain staff, export and improve their efficiency. Left unchecked retailers will continue to accumulate buying power which will act as a significant barrier to entry for suppliers and retailers to enter the market and will, ultimately, be detrimental to the consumer in terms of choice, price and income generation.

Food and Drink Industry Ireland (FDII) welcomes the Tanaiste's commitment to introduce a Code of Practice (COP) into the grocery retail sector. An effective code can prevent retailers transferring excessive risks and costs of doing business onto suppliers without placing undue burdens on retailers and will not curtail the passing on of lower prices to consumers. Rather it can ensure that the risks and costs of responding to changing consumer demands are not placed wholly on suppliers by retailers - allowing both to grow sustainable businesses.

In addition, it will ensure that normal commercially negotiated demands placed by retailers on suppliers result in consumer benefits only. Too often suppliers meet these demands with money otherwise destined for the consumer in the form of new products, higher quality products, lower prices, stronger brands and the basic availability of products on shelves.

These demands also threaten the viability of Irish food companies and if unchecked will continue to contribute to the ongoing loss of thousands of Irish jobs in the food and drink sector and a significant reduction in choice, quality and convenience for the Irish consumer.

Ultimately, if left unchecked, suppliers will be unable to develop new products and to service more remote parts of the country. It will harm the viable but delicate social fabric of farmers, processors, manufacturers and suppliers across the country and the world class offer in terms of quality, variety, value, proximity, convenience and food safety that the Irish FMCG<sup>2</sup> sector gives consumers.

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<sup>2</sup> Fast Moving Consumer Goods

## COMPETITION LAW AND THE GROCERY MARKET

The narrow focus of competition law can't fully protect Irish food suppliers and producers from retailer buying power. Section 5 of the Competition Act 2002 and the amendments to the Act made in 2006 are effectively designed to prevent the abuse by an undertaking of a dominant position in a market. However as the Department of Enterprise, Trade and Employment acknowledged in 2005<sup>3</sup> *"its seems unlikely that a firm will be considered to be dominant in a market if it holds less than 35% market share. On that basis no grocery retailer would be considered dominant in the national Irish market"*.

As no grocery retailer in Ireland passes this threshold, the unfair 'non-contractual demands' outlined previously are not considered illegal or an abuse of a dominant position under current legislation. The European Commission recognises these practices, arising from a dominant position or otherwise, as unregulated and unsustainable commercial practices. They are also the supply chain practices identified among the adverse findings of the UK Competition Commission in its investigation of the UK grocery sector

A clear view of buying power in the Irish grocery market was highlighted in the recent judgement by the High Court (March 2009) overturning the decision of the Competition Authority to prohibit a merger brought about by the Kerry Group acquisition of the food brands of Dairygold Co-operative. The High Court ruled that large retailers had sufficient buying power accompanied by the threat to de-list brands to resist indefinitely any price increases by the merged entity.

It is clear that legislation is required to provide a framework for a balanced relationship between suppliers and retailers in the grocery sector that ensures the long-term viability of the Irish supply sector and the 230,000 jobs directly and indirectly linked to sector.

### Buying Power in other Countries

Currently, many EU countries are creating national initiatives to address the effects of retailer buying power. The EU in December 2008 released a Communication on Food Prices in Europe and six Directorates in the Commission are now undertaking initiatives on foot of this<sup>4</sup>. Such is the power of retailers in certain countries, the Commission concluded that this power distorted the internal market.

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<sup>3</sup> Restrictive Practices (Groceries) Order 1987 - A Review and Report of Public Consultation Process, Department of Enterprise, Trade and Employment 2005

<sup>4</sup> DG Ecfm – overall co-ordination; DG Agriculture – Price Monitoring Survey; DG Markt – Retail Market Monitoring; DG Ent – Impact of Private Labels Study; DG Competition – Assessment of Structure and Functioning of the Food Supply Chain; DG Sanco – Price Observatory with more emphasis on food

The Commission found;

*“practices which distort the relationship between suppliers and retailers should be discouraged. This is for example the case for late payments, unjustified or excessive fees paid by suppliers for services provided by retailers or tempting consumers with misleading offers. In this context, the introduction of codes of conduct would be welcome as an expression of retailers' social responsibility and national codes of conduct should be reviewed.”*

Moreover, it called for;

*“Better regulation and ensuring a vigorous and coherent enforcement of competition and consumer protection rules as this could help rebalance the bargaining power in the food supply chain.”<sup>5</sup>*

In July 2009, the High Level Group on the Competitiveness of the Agro-Food Industry (consisting of EU Commissioners, Member States and Stakeholders) recommended the setting up of a European Forum to discuss the improvement of commercial relations among the players of the food chain with the aim to adopt an EU-wide Code of Conduct<sup>6</sup>.

The UK's Competition Commission completed a market investigation into the grocery sector in 2008. This found that *“the principal manner in which excessive risks or unexpected costs could be transferred from grocery retailers to suppliers was through retailers making retrospective adjustment to the terms of supply.”*

In addition, the UKCC found; *“that the extent of risk transferred (from retailer to supplier) was excessive”*.<sup>7</sup>

These policies have long term costs such as reduced investment by suppliers, lower product quality and less product choice. In addition, they may have the effect of weakening competition at the retail level leading to potentially higher prices in the longer term.

The situation in the Irish market mirrors the conditions in other countries' grocery sectors. Many suppliers have struggled to cope with these increased demands which have fed into job losses of 3,000 in the sector. This activity threatens the viability of the Irish food and drink sector.

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<sup>5</sup> European Commission Communication on Food Prices, December 2008

<sup>6</sup> Roadmap of Key Initiatives of the High Level Group– published July 2009

<sup>7</sup> The Groceries (Supply Chain Practices) Market Investigation Order 2009

## The Ombudsman

Any Code of Practice will be irrelevant and pointless without an effective watchdog to enforce compliance in the sector. The UK Competition Commission (CC) has recognised the importance of such a body to enforce the code, curtail buying power and protect the long-term interests of consumers. In executing their task effectively they ensure that suppliers and retailers can build sustainable businesses while meeting consumer demands.

The CC argues that consideration of customer or consumer benefits includes both the interests of present and future customers. It is clear that consumer's ability to access quality grocery products at affordable prices in a sustained way should not be jeopardised by allowing larger stakeholders to irreversibly damage the supply chain for short term gains. Consumers' interests in the long term may often be more important than the short run and hence require careful consideration.

Any Ombudsman established in Ireland must:

- Be established on a statutory footing with powers to proactively investigate compliance levels amongst retailers and make conclusive findings within a short prescribed period of time.
- Have the authority to pro-actively investigate designated retailers' compliance with the code at their discretion.
- Have the legal capacity to provide 'whistleblower' protection to suppliers who come forward to make a complaint.
- They must be able to impose a range of agreed penalties on retailers who transgress the code.

A strong code and Ombudsman will inject some certainty into the relationship between suppliers and retailers. This will allow suppliers to forecast and plan accurately, invest in R&D, and improve service levels to their customers.

The code and Ombudsman should seek to balance the need for minimum standards in supplier/retailer agreements with the need to maintain scope for commercial negotiations that are mutually beneficial. The code should not hinder genuine co-operative efforts between suppliers and retailers to respond to rapidly changing consumer demand.

**Q.1 Should the introduction of any Code be on a voluntary or statutory basis? Who should draw-up such a Code? How do you see compliance costs varying between a voluntary and a statutory Code?**

**1.1: *Should the introduction of any Code be on a voluntary or statutory basis?***

The Code must be established on a statutory basis. The competitive pressure in the market and the lack of viable regulation has created a culture where arbitrary financial demands are placed on suppliers. A voluntary code will be insufficient to compel retailers to forgo this income.

The UK Competition Commission has sought to establish a voluntary code of practice since 2002. In 2009, the CC recommended that, as retailers had failed to agree a code of practice, the Office of Fair Trade should establish a statutory code and nominate an Ombudsman to enforce the code under the 2002 Enterprise Act.

**1.2: *Who should draw up such a code?***

The Department of Enterprise, Trade and Employment should draw up a statutory code with immediate effect after consideration of submissions.

The Department of Enterprise, Trade and Employment should be tasked with drawing up the code using best practice from other European countries that are appropriate to the Irish market. The code must be introduced into the market promptly to ensure that no further jobs are lost unnecessarily from supplier companies in the sector.

**1.3: *How do you see compliance costs varying between a voluntary and a statutory Code?***

A voluntary code would represent poor value for money for the taxpayer as whatever costs incurred would have minimal impact on the effectiveness of grocery market.

FDII supports a statutory code and believes that this will prove to be value for money for the taxpayer.

In the UK, where the cost of the code will be borne by retailers, the estimated costs of a statutory code *and* an Ombudsman will be minimal against the combined turnover of the top ten retailers who all have a turnover of over 1 billion pound sterling per year.

## Question 2

**2.1 Depending on whether any Code is voluntary or statutory, how should it be enforced?**

**2.2 How should such enforcement be funded?**

### ***2.1 Depending on whether any Code is voluntary or statutory, how should it be enforced?***

The Code must be made statutory to be effective and to provide any basis for enforcement. The Department of Enterprise, Trade and Employment could establish a statutory body with sufficient power to investigate retailers relationships with suppliers.

Legislation should be drafted that outlines the establishment of the code and its enforcement under the aegis of the Department of Enterprise, Trade and Employment or a nominated body such as an Ombudsman.

FDII believes that the only effective way to enforce this code is through the appointment of an Ombudsman. Suppliers are unable to exercise their rights even through existing statutory legislation. A code without an Ombudsman will effectively render the code obsolete. We outline the enforcement role of the Ombudsman in the next section.

### **Providing a platform for enforcement**

The overarching principle of fair dealing should underpin the Code. Fair dealing can be defined as *'agreements voluntarily entered into, with adequate notice and discussion, benefitting both parties and without any excessive transfer of risk or costs to one party'*

The code of practice should apply to designated retailers based on agreed criteria set out later in this submission. Retailers must notify the Department of Enterprise, Trade and Employment that they conform to the code. Failure to do so will constitute a breach of the code and legal penalties will be incurred.

The Department of Enterprise or the relevant body should have investigative powers to ascertain the relevant market data from retailers. When the code is enacted designated retailers will be required to incorporate its features into their supplier arrangements. When the code is formalised, retailers will have a six month period to ensure that existing arrangements and their buying teams comply with the code. Failure to comply as a designated retailer should result in substantial penalties.

Designated retailers will ensure that supply agreements as well as any subsequent contractual agreements or arrangements are in writing and copies are kept on record.

A statement of compliance should become part of the retailer's reporting process to audit committee and form part of annual reports where appropriate. In all instances a statement of compliance should be sent to DETE and/or the relevant body. These will create a written record of agreements in the market and provide a platform for enforcement for the Department or designated bodies.

## **2.2 How should such enforcement be funded?**

Funding mechanisms should be consistent with the funding of other regulators in the state and funded by central Government. The industry believes that this regulator will deliver significant benefits to consumers and the taxpayer. The industry also believes that this regulator should achieve cost savings in the scope of regulation and other state agencies in the consumer and competition areas. It should be noted however that in the UK, the Code will be funded by retailers (see Annex 1).

<p><b>Q.3 Should a separate Ombudsman's office be established, and, if so, how and by whom will this be funded, both on establishment and on an ongoing basis?</b></p>
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FDII believes that an Ombudsman will be the key determinant in the impact of the code of practice. The Ombudsman must be empowered to proactively identify contraventions of the code and provide suppliers within the grocery sector with protection against unregulated and unsustainable commercial practices without placing them at risk of delisting.

The Ombudsman must have the authority to use their discretion to carry out general and specific investigations based on anonymous information provided by amongst others: suppliers, trade associations and members of the Oireachtas, in addition to operating on an ad-hoc basis where appropriate. Information passed to the Ombudsman must be treated as commercially sensitive under FOI legislation to protect suppliers. (If resultant investigations find claims made against retailers are spurious, penalties can be imposed on suppliers).

The Ombudsman should seek, where possible, to address transgressions of the code by retailers and/or resolve disputes at a local level. They should aim to prevent suppliers and retailers becoming embroiled in myriad legal battles which will significantly dampen market dynamics in the sector.

All costs of the arbitration process should be borne by the retailer except in the case where the Ombudsman believes that a purposely false claim has been made by a supplier.

The Department of Enterprise, Trade and Employment should establish and allocate a relatively modest multi-annual budget to this office.

The Ombudsman's first task should be to investigate designated retailers' preparedness for compliance with the code and to support them in incorporating the code into their internal structures.

FDII believes that the appointed Ombudsman must be a person with extensive experience operating in business and in dispute resolution procedures. It is essential that the Ombudsman is tasked with taking a wider view of the sustainability of the grocery sector and associated sectors and have power to make 'class' type recommendations based on ongoing findings from individual investigations of transgressions.

***Q.4 What type of grocery chain elements should be covered by the Code? Should a threshold be introduced to limit the application of the Code? If so, on what criteria should it be based and at what level should it be set?***

#### ***4.1 What type of grocery chain elements should be covered by the Code?***

To be effective, this code must apply to all Grocery Goods Undertakings<sup>8</sup> operating in the Irish market including but not exclusive to retailer, buying groups, wholesalers, individual retailers represented by buying groups.

#### ***4.2 Should a threshold be introduced to limit the application of the Code?***

A threshold should be introduced to ensure the code applies most rigorously to those retailers who can exert buying power over their suppliers. FDII proposes that any Ombudsman or body tasked with enforcing the code would focus their efforts on retailers above this threshold.

#### ***4.3 If so, on what criteria should it be based and at what level should it be set?***

FDII notes that the UK has moved towards a COP that applies to retailers with a turnover threshold of over £1 billion sterling. A similar approach in Ireland must have a €50 million euro turnover threshold apply based on the relative strength of retailers in the smaller Irish market.

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<sup>8</sup> Competition Act 2002: "an undertaking that is engaged for gain in the production, supply or distribution of grocery goods, whether or not the undertaking is engaged in the direct sale of those goods to the public;"

**Q.5 Should any Code be limited in geographical extent and, if so, what should that limitation be and how would the provisions of the Code be enforced against grocery goods undertakings located outside the jurisdiction?**

The code should apply to all grocery goods undertakings that operate in the Republic of Ireland (ROI) regardless of their 'geographical' context. In other words, it should apply to all goods offered for sale or resale in ROI.

**Q.6 Will the provisions of the attached initial draft outline Code help to achieve a fair balance in the relationships between retailers and suppliers? Are there any specific provisions, which inhibit achieving that balance? Are there other provisions, which might help to achieve that balance?**

**6.1 *Will the provisions of the attached initial draft outline Code help to achieve a fair balance in the relationships between retailers and suppliers?***

The provisions outlined in the initial draft outline Code will only achieve a fair balance if it is made statutory and an efficiently functioning Ombudsman is established. The existence of an Ombudsman with the authority to penalise those in breach of the code will in itself bring some balance between retailers and suppliers.

To ensure that the Ombudsman remains effective into the future, they must have the capacity to apply the principle of fair dealing to the rapidly evolving relationships in the sector. The attached code seeks to achieve a balance between retailers and suppliers to ensure those in the sector can continue to meet consumer demands for price, quality and choice.

With a code of practice in place, retailers may only *request* changes to agreements or new arrangements. Suppliers can choose to accept these requests. If they do choose to do so, these arrangements cannot transfer excessive risk onto them and should be mutually beneficial. This ensures that retailers and suppliers share the risks and costs of delivering promotions or lower prices to the consumer in a sustainable way.

**6.2 *Are there any specific provisions, which inhibit achieving that balance?***

There are no specific provisions that will inhibit the balance of power between suppliers and retailers.

### **6.3 Are there other provisions, which might help to achieve that balance?**

A provision within the code should be added to ensure that payment in full becomes compulsory and that outlaws non-payment due to queries. This practice often sees the retailers stall payments for products due to minor queries in invoicing or in relation to service delivery. These queries amount to a small fraction of the overall transaction cost and places suppliers under significant cashflow pressure.

The provision should allow retailers to deduct queries in advance of discussions with the supplier but balances must be paid within payment terms.

**Q.7 What will be the impact of any Code on the consumer and prices of goods for consumers and how should any Code be framed to enhance consumer welfare and the need to ensure that there is no impediment to the passing-on of lower prices to consumers?**

The impact of the code on the consumer will be positive as its objective is to stop all requests for investment that do not end up with the consumer getting better value or added value. It does this by putting an end to unregulated and unsustainable commercial practices that are not consumer-led, thus ensuring value for the consumer.

**Q.8 Have you any specific comments to make on the contents of the draft outline Code of Practice for Grocery Goods Undertakings, appended to this document?**

The 'Current Legal situation' section of the consultation paper outlines the existing pieces of legislation that can be applied to practices in the sector. These pieces of legislation should be codified and their enforcement should come under the aegis of the Grocery Ombudsman in addition to their role of enforcing the code.

## ANNEX 1

In the UK, enforcement will be funded by the designated retailers who are covered by the code. The formula below for calculation for the costs has been created by the UK Competition Commission. The premise of the formula is to ensure that those who transgress the code most frequently bear a proportionate level of the costs of the Ombudsman:

$$\text{A party's proportion of the total cost} = \frac{a(R_p/R_a)+b(T_p/T_a)+c(A_p/A_a)+d(D_p/D_a)}{e+f+g+h}$$

$$a = 4$$

$$b = 3$$

$$c = 3$$

$$d = 1$$

R<sub>p</sub> = Number of Recommendations made to that Party by the Ombudsman

R<sub>a</sub> = Total Recommendations made by the Ombudsman

T<sub>p</sub> = That party's turnover for retail supply of Groceries

T<sub>a</sub> = Total turnover for retail supply of Groceries

A<sub>p</sub> = Number of disputes between that party and its suppliers reported pursuant to paragraph 8.1 of the scheme

A<sub>a</sub> = All disputes between Retailers and Suppliers reported pursuant to paragraph 8.1 of the scheme

D<sub>p</sub> = Number of disputes between that party and its suppliers reported pursuant to Article 10(1)(c) of the code

D<sub>a</sub> = All disputes between Designated retailers and suppliers reported pursuant to Article 10(1)(c)

e = 4 unless a(R<sub>p</sub>/R<sub>a</sub>) equals 0 then it also equals 0

f = 3 unless b(T<sub>p</sub>/T<sub>a</sub>) equals 0 then it also equals 0

g = 2 unless c(A<sub>p</sub>/A<sub>a</sub>) equals 0 then it also equals 0

h = 1 unless if d(D<sub>p</sub>/D<sub>a</sub>) equals 0 then it also equals 0