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Grocery Code of Practice Consultation
Competition and Consumer Policy Section
Department of Enterprise Trade and Employment
Earlsfort Centre
Lower Hatch Street
Dublin 2

8 October 2009 **YOUR REF:** **OUR REF:** TB/EJK
MHC-2894869-1

MATTER: **Submission in relation to the Code of Practice for Grocery Goods Undertakings**

Dear Sir/Madam,

We set out in the following paragraphs a response to the Department of Enterprise Trade and Employment Consultation Paper relating to the proposed Code of Practice for Grocery Undertakings the ("Consultation Paper").

As a commercial legal practice, MH+C has a particular interest in this area, having represented a large number of entities in the grocery sector over the last 30 years. In particular, MH+C has a long history of acting for suppliers in the food sector, with a client base including both national and international grocery brand names. We are thus very familiar with the challenges faced by suppliers in this sector, particularly in a situation where competition law may not be of assistance if dominance cannot be established. In this context, the submission is being made by the firm's competition specialists, Tony Burke and Emma Keavney.

We therefore welcome the opportunity to comment on the Consultation Paper. However, we would note that the views in this submission are the views of MH+C and should not be read as constituting or representative of the views of any of our clients.

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1. General Comments

1.1 As a general note, we consider that the introduction of a Code, if implemented correctly, has the potential to be a very positive step for the Irish grocery market. In our experience, suppliers (even larger suppliers) often have no legal options when faced with the practices engaged in by certain retailers, particularly the top four retailers, who essentially act as gatekeepers to the Irish retail grocery market with over 65% of the total grocery market and over 80% of the chilled food sector.

1.2 This, in our view, can have a knock-on effect on choice and price for the consumer, as certain practices may cause suppliers to incur unnecessary costs, to withdraw product ranges or to be inhibited in new product innovation (as discussed below), and sometimes ultimately to exit the market. It also increases barriers to entry for new entrants.

1.3 Notwithstanding this, we would consider it vital that if such a Code is to be introduced, in order to be effective it should be introduced not only on the basis of clear legislative authority (i.e. the introduction of new primary legislation, see further below in this regard) but also on the basis of published and detailed justification for the introduction of such a Code. Naturally any Code should be transparent and fair with regard to retailers and suppliers.

1.4 Whilst we fully support the approach of benefitting from the UK experience in this matter, it is important from both a legal and political perspective that the introduction of the Code can be justified by reference, and tailored to the Irish market. Otherwise, we would envisage push-back and political lobbying from those who oppose the introduction of what will essentially operate as a regulatory intervention.

1.5 The Consultation Paper indicates that suppliers and distributors have contended that there is a significant imbalance in the relationship between retailers and suppliers. This imbalance of power would seem to be the main reason for the implementation of a Code of this nature. Whilst we agree that our experience is that such an imbalance of power appears to exist, we would suggest that in order to justify the introduction of the Code, there would have to be a stronger statement to this effect by the Department and/or the Competition Authority.

1.6 It might be borne in mind that in the UK the introduction of the first Supermarket Code of Practice ("SCOP") followed extensive investigations by the OFT, which specifically addressed the practices of retailers and resulted in findings that certain of those practices were impacting competition in the

sector. This has been reviewed and refined into the recently published Grocery Supply Code of Practice ("GSCOP"), following further extensive review of the sector by the Competition Commission.

1.7 In Ireland, notwithstanding the various studies on the grocery and retail sectors, there is a distinct lack of public domain, objective information on the issue of supplier/retailer relationships. The issue is not directly addressed in the Competition Authority's Grocery Monitor Series which deals more with the structure of the market, or in its recent report on the Import/Distribution sector, except to recognise that the retail sector is concentrated, without further comment.

1.8 It is our view that the reason for this lack of transparency is a possible fear amongst suppliers to 'inform on' the practices of certain retailers, for fear of repercussions from those retailers. From our experience, this is a very real concern. The merger notification process and resulting High Court judgment in Kerry Group plc and Rye Investments Limited v. Competition Authority would appear to be the first time that concrete examples of retailer buyer power in practice were provided by industry participants. In previous merger notification procedures, although we have often acted for parties who have pleaded the countervailing buyer power of supermarkets as mitigating any potential market power on the supply side, we have found that suppliers have never before been willing to give concrete examples of such buyer power in operation. In fact, during the Competition Authority's investigation in the Kerry case, one of the merging parties' competitors commented in response to an interview by the Competition Authority that "You would love to blow the lid on the retailers, but they would deny it all the way".

1.9 In the Kerry case, a folder was submitted to the Competition Authority, and ultimately to the High Court, containing 30 recent emails from the top multiple retailers and symbol groups which demonstrated how they systematically refuse price increases, threaten to de-list products (even well-known brands), make demands for support of promotional activity and operate a policy of demanding the de-listing of existing products in order to introduce new products ("one new in one out"). We would refer the Department to the judgment of Cooke J in the Kerry case (*Rye Investments Ltd and the Competition Authority*) (copy attached) in which Judge Cooke analyses examples of, and comments on, certain practices of the larger retailers. This judgment is, as far as we are aware, one of the only public record documents which deals with the practices of certain retailers in the Irish market and may be of assistance in developing the reasoning for introduction of a Code in this jurisdiction.

1.10 In summary, in order to pave the way for the introduction of such a Code in Ireland, we consider it would be important that in the course of this consultation, the Department might clearly identify the issues which need to be addressed in the Irish market. We would suggest that this process should not be limited to the receipt of written responses to the consultation paper, but we would recommend that the Department might interview stakeholders and encourage them to give concrete examples of their experiences, with appropriate assurances of confidentiality (evidence might then be published on a strictly anonymised basis).

1.11 We also consider this is a situation where a Regulatory Impact Assessment (RIA) should be carried out early in the process and might be published in draft form as part of the consultation process. Again, we suggest this to seek to ensure the robustness of the process which we support.

2. Consultation Questions

We will now deal with each section of the Consultation in turn:

2.1 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?

2.1.1 We consider that in order to be effective, any Code should be introduced on a statutory basis. The nature of the sector, and the very imbalance of bargaining power to which the Consultation Paper refers, would seem to make it unsuited to self regulation.

2.1.2 The UK experience is very informative here. The Supermarket Code of Practice (SCOP) was initially introduced in the UK by way of statutory undertakings given by the four supermarket chains to which it applied. The Competition Commission has recently passed a statutory Order setting out the new “Groceries Supply Code of Practice” (GSCOP) which essentially extends the scope and terms of the SCOP. The introduction of the GSCOP arises as a result of the Competition Commission’s investigations into the grocery sector in the UK. The Competition Commission found that there was a lack of confidence in the industry in terms of compliance with the Code and that the terms, scope and provisions for enforcement of the code needed to be strengthened.

2.1.3 The market in Ireland is arguably even more concentrated than in the UK. If statutory undertakings were not sufficient to effectively manage practices of retailers in the UK, we consider that a voluntary code is unlikely to have any

impact at all in this jurisdiction. This is particularly the case given the robust approach of undertakings in this sector in commercial negotiations.

2.1.4 We do not consider that there is sufficient incentive for grocery goods undertakings ("GGU"s), in particular retailers, to agree to sign up to a voluntary code of practice. As noted above, in the UK the SCOP was first introduced by way of statutory undertakings given by the affected retailers. These undertakings were given to address the findings of a potential restriction of competition by the OFT. However, there has been no finding of any breach of competition law here, nor is there any indication that such could be alleged or established. Thus, arguably there is no incentive for undertakings to agree to obligations over and above the existing legislation. The answer to this is not, in our view, to seek to make the Code more attractive to any one grouping, as the purpose of the Code must be limited to addressing any imbalance of power which exists.

2.1.5 Again, by way of reference to the UK, the Competition Commission has over recent months sought to get retailers in the UK to agree to appoint an ombudsman themselves rather than having a statutorily appointed ombudsman imposed upon them. The retailers have failed to agree to appoint their own ombudsman. We would take the view that any attempt to introduce a voluntary code is likely to similarly meet with significant delays and ultimately is unlikely to be successful.

2.1.6 From a practitioners' perspective, a Code introduced on a statutory basis would more provide legal certainty in advising our clients. We would agree that new primary legislation would need to be introduced to confer the power on the Minister for Enterprise Trade and Employment (the "Minister"). Whilst primary legislation may take time to draft and finalise, it would, in our view, minimise the risk of later challenge to the validity of any Code. The proposed legislation providing for the merging of the Competition Authority and the National Consumer Agency would seem be an appropriate place to house any new legislation.

2.1.7 We would take the view that the provisions of the Code itself should not be "hard-coded" into primary legislation and it would be preferable to introduce the Code, by way of annex to an SI or Ministerial Order. This might also set out a basis, and/or procedure for review of the Code on a periodic basis and amendment of its terms without there being a requirement for new primary legislation to amend the Code. If the primary legislation is enabling only, the Department would then have more time to consider the provisions and reasoning for introduction of this proposed Code before implementing the relevant SI or Order.

2.1.8 It would be important that such enabling legislation should be carefully drafted and allow an appropriate degree of discretion to the relevant authority to introduce a code of practice, as otherwise any attempt to introduce the Code might be deliberately delayed by opponents to the Code in challenging the basis for its introduction. This links in with our previous comment that in our view there would have to be a clear basis for introduction of each element of the Code by reason of the results of analysis of the Irish market.

2.2 Depending on whether any Code is voluntary or statutory how should it be enforced? How should such enforcement be funded?

2.2.1 As noted above, we would favour a statutory basis for any Code. However if it is to be voluntary, guidance can be helpfully taken from the operation of other voluntary codes such as the ASAI Manual of Advertising Self Regulation which provides for the imposition of fines and penalties, in addition to "naming and shaming" of offenders.

2.2.2 If the Code is to be introduced on a statutory basis, enforcement of the Code would seem to naturally fall within the remit of the Competition Authority (combined with the NCA). The Consultation Paper provides for the possibility that the Competition Authority might impose sanctions under the Code. However, as the Department will be aware, the Authority does not currently have the power to impose sanctions for breaches of competition law. It may instigate investigations and can institute civil or criminal proceedings, but sanctions may only be imposed by the Courts (unless the entity or entities involved voluntarily give undertakings to the Competition Authority in the context of potential proceedings).

2.2.3 We would envisage that a lengthy consultative and legislative process would be required to introduce the possibility for the Authority to impose sanctions, which would require the consideration of constitutional issues. This would most likely have to be undertaken in the context of a broader question of whether the Competition Authority should have the power to impose sanctions for breaches of the Acts in a more general sense and not just for breaches of the Code (or related legislation). This issue would appear to fall outside of the current consultation process, although it is our general view that the current separation of functions between the Authority and the Courts is effective.

2.2.4 That said, we would envisage that if the only mechanism for dealing with breaches of the Code were to be civil litigation under the relevant legislation by the Authority and/or aggrieved GGUs that this might (i) be unduly

burdensome on GGUs, (ii) place undue financial burden on the State and (iii) significantly impede effective enforcement of the Code. Given the nature of the Code and, from our experience of clients in the sector, the frequency and range of severity of occurrence of the practices covered by the Code, we consider it would be vital to have a faster and more efficient mechanism for dealing with breaches of the Code.

2.2.5 Thus, we would suggest, as currently provided for in the draft Code, that the terms of the Code should be automatically be incorporated, by operation of law, into all contracts between suppliers and retailers covered by the Code. The terms of the Code (or legislation) could then provide for a dispute resolution mechanism, possibly with referral of disputes that cannot be resolved amicably to arbitration. Whilst we appreciate that ideally a specially appointed ombudsman might arbitrate such disputes, we do not consider that this is necessary. We would envisage that this area would attract specialised arbitrators, particularly with the UK getting a head-start in this area.

2.2.6 An alternative approach to referring disputes to arbitration would be to detail the full dispute resolution mechanism in the Code (including timings) and to provide for a specialised panel of experts to be available to arbitrate on disputes, the costs of the panel to be borne by the parties in accordance with the terms of the dispute resolution. This would enable the appointment of specialised arbitrators, without having the full time costs of an ombudsman. This could draw on the dispute resolution mechanism in the electricity market (which is written into the Trading and Settlement Code).

2.2.7 Any contractual dispute resolution mechanism should, in our view, be supported by regulatory enforcement. In this regard, we would support the suggestion of continuing the current enforcement regime, and extending the jurisdiction of the Courts to cover breaches of the Code, or at least breaches of the legislation underpinning the Code. Any new legislation should provide for the possibility of referring complaints to the Competition Authority, which might be given the power to investigate and enforce breaches through the Courts. However, it would need to be considered whether this would apply for any breach of the Code itself, and/or the legislation underpinning the Code, and/or whether there might be a materiality threshold in terms of multiple breaches, so as to avoid undue costs being incurred by the Authority in investigating reported breaches of the Code.

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2.3 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?

2.3.1 We do not consider that it should be necessary to establish a separate ombudsman's office. Ideally it might be desirable to have a separate office dedicated to this function but, as we would see it, a code would form a sub-set of existing competition laws and as such, enforcement falls within the ambit of the Competition Authority.

2.3.2 In the current financial climate and with cuts being made to existing bodies (e.g. the merger between the Competition Authority and the NCA) we would envisage that politically, a proposal to establish a new ombudsman's office is unlikely to be well received, might delay any attempt to introduce a Code and may simply be perceived as over-regulation. Further, any proposal to impose levies on the GGUs affected by the Code in order to establish such an office is likely to delay the introduction of a Code, given the likely resistance from those who may have no incentive to accept such a charge.

2.3.3 In terms of monitoring compliance, we consider that a periodic reporting mechanism for the GGUs covered by the Code would be important. Again, we would see this as a suitable role for the Competition Authority (incorporating the NCA). We also consider that there should be a facility for confidential complaints to be made by GGUs in order for there to be effective monitoring of compliance, as we have experienced that suppliers are very reluctant to disclose

2.4 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?

2.4.1 Based on our experience, the issue of an imbalance in bargaining power appears to arise at the retail level of the grocery chain. This includes both 'vertically integrated retailers' and 'affiliated retailers' (symbol groups) as defined in the Competition Authority's Grocery Monitor Report. We do not consider that there is an equivalent issue with independent retailers. However, this may be something which should be investigated by the Department directly with suppliers as part of its consultation (and RIA) process.

2.4.2 We agree that, in line with the principle of regulating only when necessary, the main provisions of the Code should only apply to those retailers who have

strong bargaining power and as such a threshold for application of the Code would be appropriate.

2.4.3 The appropriate level of any should, in our view, be set by reference to economic analysis of the Irish market. We note that the UK has moved away from a market share threshold (8%) towards a turnover threshold for "designated retailers". We would consider that the reference to threshold is a sensible and possibly more transparent means of monitoring application of the Code, as market share figures are open to interpretation.

2.4.4 The stg£1bn threshold for "Designated Retailers" in the UK equates to a threshold of approximately €70 - €80m in an Irish context, which would cover at least the top four multiple retailers. However, again, economic analysis would be required to determine the appropriate figure for this jurisdiction. Market share considerations may feed into setting the appropriate turnover level. In this regard, it is worth noting the initial UK threshold of 8% as representing the ability to exercise market power, and that the European Commission noted in the case of Rewe/Meinl[1] that 22% of turnover is the figure above which a "customer can be replaced only at the cost of very heavy financial losses, if at all". This, in our view, makes it clear that the balance of power is strongly weighted in favour of the retailers with a market share above 20%.

2.4.5 In terms of the reference market for calculating turnover, we consider that the threshold should be set by reference to turnover on the Irish market, notwithstanding that some suppliers may have global relationships with the retailers, as this is consistent with Irish competition law. Again, this should ensure that any regulatory intervention is proportionate to issues faced on the Irish market.

2.4.6 The Consultation Paper also refers to the possibility of setting thresholds for the application of the Code to GGUs other than retailers. It is not clear if this refers to a minimum threshold for the imposition of obligations, or a maximum threshold for other GGUs to benefit of the Code. In terms of benefiting from the Code, there should be no limitation on the size of GGUs, as we have seen in practice that even the larger suppliers may suffer as a result of the practices of retailers. In terms of the imposition of obligations on entities other than retailers, we refer to our response at 2.6 below.

[1] Case No. IV/M.1221

2.5 Geographical extent of any code

2.5.1 We agree that in order to be effective, GGUs from outside of Ireland and who are selling into Ireland should be in a position to benefit from the Code. Similarly, if it is proposed to impose obligations on GGUs other than retailers, then it is sensible that such obligations should equally apply to GGUs outside of the State who are selling into Ireland. While legal issues concerning extra-territorial application of the legislation would need to be considered in more detail, we do not see an issue with this in principle.

2.6 How balance can be achieved in the Code between retailers and suppliers.

2.6.1 We would consider that any Code should be proportionate in terms of the issues which it is implemented to address. As noted above, any obligations should only be imposed where an imbalance of bargaining power has been clearly identified and should be proportionate and reasonable in terms of seeking to address those issues.

2.6.2 It is our experience that suppliers are in the unusual position that they have no choice but to cede to the demands of certain retailers in order to place their products on the shelves. If they cannot access the top four retailers, they cannot access the majority of consumers and this leads to the imbalance in bargaining power. The main reasoning for the introduction of a Code, as we understand it, would be to address this imbalance of power and the provisions of the draft Code appear consistent with this approach and the purpose of the Code in the UK.

2.6.3 GGUs are already subject to regulation under the Competition (Amendment) Act 2006. As noted above, there does not appear to be any justification in the Consultation Paper for imposing additional obligations on GGUs (other than retailers) and such obligations should not be artificially introduced for the purpose of achieving balance in the Code, if the imbalance of bargaining power is one-way only. As currently drafted, the draft Code is, in our view, suited only to address the practices of retailers.

2.6.4 In summary, if it is proposed to impose obligations on GGUs other than retailers, we consider that the Department would need to clearly identify what practices by such GGUs may be impacting on competition and/or price in the sector and specifically address these in the Code. This is something which would require careful consideration following investigation by the Department.

2.7 Impact of any Code on the consumer and prices of goods for consumers

2.7.1 We would consider that if the provisions of the Code are limited to addressing any imbalance of bargaining power which has been clearly demonstrated to exist, as we believe they should be, then the results of the imposition of a Code should automatically benefit the consumer, as it should assist in creating a level playing field for competition, and consumers should benefit from improved choice.

2.7.2 The danger, in our view, would be that the Code might distort competition if it is implemented without a comprehensive review of the issues which it is designed to address and it is for this reason we consider it vital that extensive research should first be carried out to establish what the issues are in the Irish market. This is particularly the case in respect of the imposition of obligations on GGUs other than retailers.

2.7.3 We would consider that this extensive research should be undertaken by experienced and independent consultants rather than the Competition Authority, given the role which the Competition Authority will play o the introduction and potentially enforcement of the Code.

3. Comments on the draft Code

As a general comment, the draft Code would appear to deal with a number of practices which we have become aware of over the years, and should provide helpful redress for GGUs affected by such practices.

We appreciate that the draft Code is very much in draft form and has been prepared as a discussion document for the purposes of the consultation. Thus, we have limited our comments to a small number of high level issues from our review and drawn on our experience of the industry which we hope may be of assistance.

3.1 De-Listing and de-ranging

3.1.1 One of the main issues we note with the draft Code is that it does not deal with the practices of de-listing or de-ranging (e.g. de-listing of individual package sizes or formats of a particular product) of products by retailers.

3.1.2 In our experience, this is one of the principal concerns faced by suppliers and is held over their heads as a constant threat by certain retailers. These retailers use the threat of de-listing to enforce many of the other practices which are referred to in the draft Code. If de-listing is not addressed in the Code, we would have a concern that the remainder of its provisions may prove useless, as other GGUs may not wish to make complaints or trigger any dispute mechanism for fear of the threat of de-listing by certain retailers. Access to the top multiples is necessary for access to the market in this jurisdiction and de-listing of products by one of the major retailers can, as we understand it, ultimately force a supplier to discontinue the product entirely.

3.1.3 We would refer to the judgment of Cooke J in the Kerry case and in particular his comments on the examples of threats to de-list by the multiples which had been given by the merging parties and by other suppliers interviewed by the Competition Authority during the merger process. Mr. Justice Cooke refers to the fact, highlighted by Kerry Group in its written submissions, that out of 11 competitors (e.g. competing suppliers) interviewed by the Authority in the course of its investigations, 10 confirmed that they had had products de-listed or de-ranged by retailers, seven of whom said that it was a frequent practice.

3.1.4 It is our understanding that certain retailers operate a “one new in, one out” policy whereby demands are made to de-list products if a supplier wishes to introduce new products. This can have the effect of inhibiting innovation by suppliers.

3.1.5 It is also important to understand the full extent of delisting. Delisting does not mean the products are delisted in their entirety. Delisting of certain lines, weights or reduced orders are all forms of delisting which can have the same effects, success or achieve the retailer's intentions or requirements in the same manner that a complete delisting would.

3.1.6 In light of this, at a minimum we would suggest that provisions equivalent to the obligations in the UK GSCOP relating to de-listing should be introduced in the Code. The GSCOP indicates that a retailer may only de-list for "genuine commercial reasons". We would consider that this phrase should be carefully considered, as the issue of whether or not a de-listing occurs for genuine commercial reasons is likely to form the basis for many disputes. Accordingly, we would suggest seeking economic advice on what are and are not "genuine economic reasons" for de-listing, and setting out more examples of this in the Code.

3.1.7 We note that in the GSCOP, the relevant provisions apply only to the de-listing of a supplier (i.e. all of its products) or de-listing a significant portion of the supplier's products. However, we would suggest that, depending on the outcome of any consultation and review by the Department, that any such provision should perhaps apply to de-listing in a general sense, and might also cover the practice of de-ranging discussed above. We have seen that certain retailers can hurt suppliers by de-listing even their smaller product ranges and will use this as leverage to negotiate in markets where a supplier may have a better market position.

3.2 References to "Terms of Business Agreement"

3.2.1 We note that a number of the prohibitions on retailer practices are qualified to the extent that the retailer is prohibited from engaging in the relevant activity, *unless* specifically provided for in the "terms of business agreement" with the relevant GGU.

3.2.2 Given that the purpose of the Code is apparently to address an imbalance of market power, we would consider that this qualification might negate the effect of the prohibition, as those undertakings with market power, and in particular certain retailers, may simply insist on including sufficiently broad provisions in their business terms. The issue faced by suppliers is the "gatekeeper" role carried on by retailers and that if suppliers wish to gain access to the market, they have no option but to contract with certain retailers on their terms. Accordingly, the use of the terms of a Business Agreement could be used to circumvent any provision of a Code.

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3.2.3 In particular, we would see a potential issue with the inclusion of this qualification in the prohibition on shrinkage payments, and payments for better positioning of goods, which arguably should be prohibited *per se* where there is an imbalance of bargaining power.

3.3 Promotions

3.3.1 The current draft of the Code does not appear to adequately deal with the issue of promotions. The main issue which we are aware of for suppliers in connection with promotions is that certain retailers frequently require suppliers to fund promotions which are introduced at the instigation of the supplier.

3.3.2 It is our understanding that suppliers are frequently required to pay the multiple retailers for participation in promotions which they did not request and did not agree to. This may require the supplier to fund a very high percentage of the retailer's promotion. We would suggest that such payments might be specifically addressed in the Code.

3.3.3 There should be a general provision in any Code that any prohibitions should be drafted as to include a proviso which would directly or indirectly offend the prohibition or any measure having a similar effect as the prohibition.

3.4 Obligations on GGUs

3.4.1 We note that certain obligations, namely those relating to the terms of business agreements, variation of agreements and changes to supply agreements apply not only to retailers but to "grocery goods undertakings". In this regard, we would refer back to our comments at 2.6 above.

3.4.2 In the absence of any evidence of an imbalance of bargaining power in favour of GGUs other than retailers, the mutual nature of these obligations may not be helpful, and may in fact operate against those GGUs which are already in a difficult negotiating position.

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