

# **The supermarkets code of practice**

Report on the review of the operation of the code of practice in the undertakings given by Tesco, Asda, Sainsbury and Safeway to the Secretary of State for Trade and Industry on 18 December 2001

February 2004

OFT697

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# CONTENTS

<i>Chapter</i>		<i>Page</i>
1	Purpose of the report	1
2	Summary, findings and recommendations	2
3	The supermarkets code of practice	6
	Background	6
	Purpose of the code	7
	Scope of the code	8
	The mediation process under the code	8
	Dealing with complaints about breaches of the code	9
4	The process of our review	10
5	Views expressed by suppliers and their trade bodies	11
	Whether the code has changed the behaviour of the supermarkets	12
	Fear of complaining	12
	Alleged breaches of the code	13
	Use of the term reasonableness	16
	Mediation process in the code	17
	Action taken by suppliers to improve supermarket-supplier relations	18
	Internet auctions	18
	Other views and information provided in our review	18
	Suppliers' and retailers' views on the code expressed in the Competition Commission's 2003 report	20
6	View expressed by the supermarkets	22
	Tesco	22
	Asda	22
	Sainsbury	22
	Safeway	22

7	Analysis of the issues	24
	Supplier- supermarket relationships	24
	Fear of complaining	25
	The concept of reasonableness	26
	Complaints about possible breaches of the code	27
	The supermarkets' views	28
	Suggestions for improving the effectiveness of the code	28
	Further action the OFT intends to take	29

*Annexe*

A	Undertakings and the supermarkets code of practice	32
B	List of organisations the OFT wrote to on 17 February 2003 to seek views on the code	46
C	Test of the letter sent to the supermarkets	48
D	Text of letter sent to suppliers' organisations	50

# 1 PURPOSE OF THIS REPORT

- 1.1 The supermarkets code of practice ('the code') forms part of statutory undertakings given to the Secretary of State for Trade and Industry under section 88(2) of the Fair Trading Act 1973 following the Competition Commission's (CC) report on the supply of groceries from multiple stores in the United Kingdom published in October 2000 ('the 2000 CC monopoly report'). Tesco plc ('Tesco'), J Sainsbury plc ('Sainsbury'), Safeway Stores plc ('Safeway') and Asda Group Limited & Asda Stores Limited ('Asda') (together referred to as 'the supermarkets') have each given statutory undertakings to comply with the code.
- 1.2 The Government's response in December 2002 to recommendation 9 in the report of the Policy Commission on the Future of Farming and Food (Cm 5709) committed the Office of Fair Trading (OFT) to preparing an annual report on how the code has been working, particularly in relation to dispute resolution. This is the first such report.
- 1.3 This report has been published pursuant to section 4(4) of the Enterprise Act 2002.

## 2 SUMMARY FINDINGS AND RECOMMENDATIONS

- 2.1 As stated in Chapter 1, the code forms part of statutory undertakings given to the Secretary of State for Trade and Industry under section 88(2) of the Fair Trading Act 1973 following the 2000 CC monopoly report. The code provides for dealings between the supermarkets and their suppliers of groceries (as defined in the code) to be on a clearer and more predictable basis. More details on the code are in Chapter 3 and it is reproduced at Annexe A.
- 2.2 Our review of the code began on 17 February 2003<sup>1</sup>. The process of our review leading up to this report is described in Chapter 4. The review took longer than it would otherwise have done owing to the need to be able to take on board the findings, facts and views in the CC's report on the bids by Tesco, Sainsbury, Asda and Wm Morrison supermarkets plc (Morrison) for the acquisition of Safeway which was published in September 2003 ('the 2003 CC merger report'). We wrote to 61 trade associations representing grocery suppliers and other interested suppliers as well as the supermarkets. Thirty-five organisations replied. Individual grocery suppliers were encouraged to respond but only five did so. In addition, we received 16 submissions from individual grocery suppliers and other bodies. Of the 51 supplier respondents, 40 represented, or were, grocery suppliers. All four of the supermarkets responded.
- 2.3 The information we have received in response to the consultation has come from a relatively small number of organisations<sup>2</sup>. This is discussed in Chapter 5. However, with one exception (household goods), between them, these organisations represent suppliers which supply a large proportion of their respective grocery sectors. We are therefore confident that the views expressed are broadly representative of those of grocery suppliers overall. However, the information received is anecdotal in nature with respondents asserting breaches of the code but no details being given. Accordingly, it has been difficult to draw any firm conclusions as to how individual supermarkets are operating under the code and, in particular, whether (and, if so, the extent to which) any of the supermarkets are in breach of the code. 20 supplier respondents, many of whom represent a large number of suppliers, alleged breaches of particular provisions of the code. However, none of these respondents provided any detailed information sufficient to enable us to ascertain whether, for example, there is more concern with particular supermarkets than others on particular code provisions, let alone the extent to which the allegations are well-founded. 13 organisations responded which do not primarily represent suppliers covered by the code: the views of some of these organisations are reported separately in paragraphs 5.30 – 5.33.
- 2.4 The consultation exercise carried out as part of this review revealed a widespread belief among suppliers that the code is not working effectively. Of those suppliers (including trade associations) which responded to our

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<sup>1</sup> See OFT press release of 17 February 2003 (PN 16/03).

<sup>2</sup> i.e. trade associations, individual suppliers and other interested bodies

consultation, most believed that the code had not brought about any change in the behaviour of the supermarkets. One trade association representing one significant grocery sector even said that the situation had worsened since the publication of the 2000 CC monopoly report.

- 2.5 The principal reason given by respondents for the perceived lack of effectiveness of the code was the fear among suppliers of complaining. Suppliers, both large and small, were concerned at being de-listed by the supermarkets or being required to trade with them on worse terms if they made complaints. While we have found no evidence of the supermarkets behaving in this way, this climate of apprehension among suppliers when dealing with the supermarkets extended to not allowing even their trade associations to raise matters on their behalf. Four of the trade association respondents and three individual supplier respondents to our consultation refused to allow us to reveal their names or even the sectors in which they are involved.
- 2.6 A further major reason given by respondents for the perceived lack of effectiveness of the code was the use of the concept of 'reasonableness' in many of its provisions. Respondents considered that the concept enabled the supermarkets to interpret the code at will. This lack of certainty with some of the key provisions of the code has, it seems, increased suppliers' reluctance to complain under the code. There were also a number of complaints that the code was too narrow in scope, in particular in terms of the definition of 'groceries'.
- 2.7 No cases have gone to mediation formally under the code and we have received only one written complaint concerning a particular instance of an alleged breach of the code. This was found to be outside the scope of the code as the contract was made before 1 November 2001<sup>3</sup>. We have received no requests for guidance of any kind on the code since it took effect from either the supermarkets or from suppliers or their trade associations. Moreover, following the giving of the undertakings, recognising the concerns of suppliers, we encouraged the trade associations to build up dossiers of alleged breaches of the code on behalf of their members that could potentially be a means for us to take action. It was suggested that trade associations do this every six months. Although several expressed interest in the concept when it was put to them, none have in fact done so.
- 2.8 The above findings are broadly in line with the views expressed by third parties on the code in the 2003 CC merger report. In particular, the CC found that there remained a fundamental imbalance of negotiating strength between supermarkets and most of their suppliers and that the balance of responses to its surveys indicated that suppliers' negotiating strength across all sectors had weakened since the 2000 CC monopoly report (see paragraphs 6.72 - 6.89 and 6.98 - 6.102). In its surveys of suppliers<sup>4</sup>, 79 to 94 per cent reported that the code had not changed their dealings with the supermarkets and six to 15 per

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<sup>3</sup> See paragraph 1(2) of the undertakings (reproduced at Annexe A)

<sup>4</sup> Tables 6.13 and 6.14 in the 2003 CC merger report.

cent said matters had worsened. There was no distinction between large and small suppliers in this context. In respect of Asda and Tesco, more than half of respondents reported reductions in the relative bargaining power of the suppliers.

- 2.9 The supermarkets have told us that they are committed to the code and that relations with their suppliers are generally good. Similar submissions were made in the CC's investigation leading up to the 2003 CC merger report. However, the supermarkets also commented that their practices had not changed significantly since the introduction of the code. In addition, Morrison submitted to the CC that it did not consider that the code, even if strengthened, would be sufficient to address potential concerns regarding suppliers as the code was dependent on suppliers being prepared to make complaints which they were not always able or willing to do (paragraph 7.231).
- 2.10 While our review of the code has shown significant concerns amongst suppliers and their trade associations and has prompted anecdotal evidence of breaches, without more detailed evidence of breaches of the code, even on an aggregated basis, we cannot pursue matters with the supermarkets under the code. While we recognise the fear among suppliers, there is little that can be done under the current code, or indeed any code of this nature, however rigorously drafted, if suppliers are not prepared to assert their rights under it. No enforcement mechanism, whether in the form of an ombudsman or a regulator or changes to the current mechanism such as access to mediation without prior complaint to the supermarket, will have any effect if suppliers fail to use the code. Moreover, as a general rule, any party alleged to be in breach of the code should be given notice of the allegations against it and a fair opportunity to be heard. This should be the case whatever mediation process is provided for, or indeed any system, whether a code or otherwise, that requires the supermarkets to behave in a particular way.
- 2.11 We remain willing to discuss with suppliers and their trade associations on a confidential basis alleged breaches of the code and/or our views as to the interpretation of particular provisions of the code. Following such discussions, it is open to suppliers to decide whether to take matters further, for example through the complaint procedures under the code. In addition, we reiterate our invitation to trade associations to build up and submit to us dossiers of alleged breaches of the code on behalf of their members. We are also on hand to give a view to any of the four supermarkets on any matters to which the code might apply.
- 2.12 To identify any key problems and formulate solutions, we would need detailed information from the primary source, namely the suppliers, but we have not received this. The extent of the general concern about the code's effectiveness and the level of, albeit, non-specific complaint about the supermarkets' compliance with the code lead us to conclude, however, that further investigation is required. As noted above, the ongoing climate of apprehension among suppliers would seem to preclude them as a source of the necessary

information. We therefore propose to obtain the information required from the supermarkets themselves by carrying out a focused compliance audit of the supermarkets' dealings with suppliers using our monitoring powers in paragraph 2 of the undertakings.

2.13 In view of the very large number of suppliers, the scope of the audit must be based on a sample. We intend that each of the four supermarkets that have given undertakings will be audited. In each case, a sample of the supply agreements will be examined, covering both smaller and larger suppliers, across various grocery sectors during a given time period.

2.14 We expect the audit to concentrate on those clauses in the code where claims of breaches are more frequent. Based upon the information received during this review, and the 2003 CC merger report, we consider the clauses in question to be the following:

- Clause 3 - payment times
- Clause 4 - retrospective reductions in price during the period of a contract
- Clause 5 - supplier contributions to marketing costs (whether or not ostensibly of the supplier's own volition)
- Clause 9 - lump sum payments as a condition of supply
- Clauses 19 – 21 - payments in respect of consumer complaints
- Clause 22 - tying of third party goods/services.

2.15 The findings of the audit work will be made public.

### 3 THE SUPERMARKETS CODE OF PRACTICE

#### Background

- 3.1 The 2000 CC monopoly report contained many allegations from suppliers about the behaviour of the supermarkets in the course of their trading relationships. The CC said (at paragraph 2.437 of that report) that 'almost all the complainants were extremely reluctant to be named, or indeed to name the multiple or multiples that were the subject of their complaints.' There appeared to the CC to be a climate of apprehension among many suppliers in their relationship with supermarkets. Accordingly, it put a list of 52 alleged practices to the main parties and asked them to indicate which of them they had engaged in during the last five years. It found that most of these practices were carried out by many supermarkets. They included requiring or requesting from some of their suppliers various non-cost-related payments or discounts, sometimes retrospectively; imposing charges and making changes to contractual arrangements without adequate notice; and the unreasonable transferring of risks from the main party to the supplier. The CC believed that, where the request came from a supermarket with buyer power, it amounted to the same thing as a requirement (paragraph 2.470 refers).
- 3.2 These practices, when carried on by any of the supermarkets, were found to affect adversely the competitiveness of some of their suppliers with the result that the suppliers were likely to invest less and spend less on new product development and innovation, leading to lower quality products and less consumer choice. This was thought likely to result in fewer new entrants to the suppliers' markets than otherwise. Certain of the practices were also found to give the supermarkets substantial advantages over smaller retailers, whose competitiveness was likely to suffer as a result, again leading to a reduction in consumer choice. The CC took into account the advantages that can result from buyer power in relation to those suppliers with market power, and other offsetting benefits in relation to certain of the practices. Nonetheless it concluded that the exercise of 27 of these practices by the five supermarkets which, at the time, met the eight per cent market share criterion, operated against the public interest (see Table 2.14 of the CC's 2000 monopoly report).
- 3.3 The CC was concerned that the adverse effects it had identified in relation to the trading relationships between suppliers and supermarkets were such that there was a danger that competition between suppliers might be reduced. It noted (at paragraph 2.440) that 'where buyer power exists, retailers are able to affect the competitiveness of their suppliers – for good or ill.' It went on to say, in paragraph 2.441 of its report, that 'even in a competitive market, buyer power, if exercised inappropriately, may damage the competitiveness of smaller suppliers in the long run and this may have adverse effects on consumers.' Overall, the 2000 CC monopoly report said (at paragraph 2.440) that there was a climate of apprehension among many suppliers in dealing with supermarkets which was founded on the imbalance of market power between them.

- 3.4 The CC believed that the most effective way of addressing these adverse effects would be a code of practice. It did not believe that a voluntary code would be adequate. It recommended that any supermarket meeting the eight per cent criterion should be required to give undertakings under section 88 of the Fair Trading Act 1973 to comply with the code, which should be designed to meet the concerns identified. It thought it highly desirable that the other main parties should be involved in the process and comply with the code.
- 3.5 In discussions with the supermarkets during the drawing up of the code between October 2000 and January 2001, we agreed that the wording of the code as envisaged by the CC would have inhibited significantly the ability of the supermarkets to decide not to do, or stop doing, business with a particular supplier. We considered that it could not be for the public authorities to tell the supermarkets which supplier they should deal with, and the terms offered by suppliers were seen to be a major and legitimate factor in the supermarkets' decisions in this respect. This led to the code being drafted so that stress was laid on transparency and reasonableness. The concept of permitting what was reasonable in the circumstances placed emphasis on the role of dispute resolution through independent mediation.
- 3.6 Recognising suppliers' fear of complaining, the intention was that our monitoring of the code would be based largely on what we were told in the proposed six monthly reports by trade bodies to us on the operation of the code. No such reports have been received, and no cases have gone to mediation.
- 3.7 Since the code came into force on 17 March 2002, we have received only one formal complaint about a breach of the code. This was made in December 2002 by Express Dairies Limited which complained that Safeway had breached Clause 2 of the code (see Annexe A) by unreasonably failing to give adequate notice of its decision to cease taking supplies of fresh milk from it. We were unable to pursue the complaint on the grounds that it concerned a supply contract that had been made before 1 November 2001 and was therefore outside the scope of the code. Safeway stopped taking supplies of milk from Express in January 2003. We are aware of other unsubstantiated complaints reported in the press about Safeway demanding lump sums from suppliers merely to be able to continue doing business with it, allegedly in breach of clause 9 of the code (see Annexe A). However, the suppliers concerned have been unwilling for us to pursue their complaints with Safeway for fear of recrimination.

### **Purpose of the code**

- 3.8 The purpose of the code is to remedy or prevent the adverse effects on the public interest which the CC identified and which arose from certain specified activities of the supermarkets (see paragraphs 2.548 and 2.550 of the 2000 CC monopoly report). The intention was that the code should be flexible enough to allow mutually beneficial agreements to be entered into freely by the supermarkets and their suppliers. It was intended to ensure that the terms of

these agreements are available in writing and are transparent and that the supermarkets give advance notice of changes or compensate their suppliers. The dispute resolution procedures in the code were meant to be an essential element in making sure that this flexibility worked as intended. In her press release of 31 October 2001, Patricia Hewitt, Secretary of State for Trade and Industry, said that 'the success of the code depends on supermarkets and suppliers being reasonable in their dealings with one another, and observing the spirit of the code. It is in all their interests that they do so. The code can set a standard for the industry as a whole, enabling it to put its commercial relations on a better footing.'

### **Scope of the code**

- 3.9 The 2000 CC monopoly report recommended that any supermarket meeting the eight per cent of grocery purchases criterion should be required to give undertakings to comply with the code. Undertakings were given subsequently by the four leading supermarkets, Asda, Safeway, Sainsbury, and Tesco which each met the eight per cent criterion. The CC reported Somerfield as one of the five supermarkets above its eight per cent threshold but, by the time the report was published and the remedies were sought, its market share had fallen below eight per cent. Accordingly, undertakings were not sought from Somerfield at that time and its share has since remained below eight per cent. The CC also hoped that the principles in the code would be adopted voluntarily by other supermarkets and others in the food supply chain.
- 3.10 It is important to note that there is no power to require an extension of the code either beyond groceries (defined in the 2000 CC monopoly report as including only food, drink, cleaning products, toiletries and household goods – for a detailed description, see paragraph 32 in Part 8 of the code at Annexe A) or to any supermarket chains that have less than eight per cent of the market for the purchase of groceries for resale from their stores. The scope of the code could potentially be extended only if a market investigation reference under the Enterprise Act 2002 was made, assuming that the reference test in section 131 of that Act was met.
- 3.11 The code applies only to contracts between supermarkets and suppliers that were signed on or after 1 November 2001. Supermarkets may apply the code to contracts signed before this date but suppliers cannot make them do this. We cannot take any formal action in relation to alleged breaches of the code which took place before 1 November 2001.

### **The mediation process under the code**

- 3.12 The first recourse on a dispute arising is to invoke the dispute resolution procedures in the code. Under these procedures, in the event that bi-lateral negotiations (assuming it concerns an alleged breach of the code) cannot resolve a dispute within 90 days, the supermarket must offer the services of a mediator

at its expense. The mediator must be acceptable to the supplier and suppliers cannot be compelled to agree to mediation. If a supplier wants a case to go to mediation then the supermarket concerned cannot refuse. We have asked the supermarkets to ensure that suppliers have access to information on the mediation process from a neutral mediator/ mediation service. Supermarkets must tell us when a mediation has failed to resolve a dispute within 30 days of the mediation. This gives time for a possible settlement of the dispute after mediation has taken place. If mediation has failed, and the supplier wishes to pursue the case, this is normally the point at which we would take up the issue.

### **Dealing with complaints about breaches of the code**

- 3.13 It is open to a supplier to complain directly to us at any stage, either about an alleged breach of the code, or about any matters to which the code does not apply and which appear to raise competition concerns. To help us get a fuller picture, we would need to determine whether any part of the mediation process outlined above had been followed and would be interested to hear from the supplier in question its views on the effectiveness of the mediation process, whether it has been thinking of using the mediation process or why it considers it should not be used. We will pursue vigorously any cases where a breach of the code has been alleged.

## 4 THE PROCESS OF OUR REVIEW

- 4.1 We announced the start of our review of the code on 17 February 2003. On that day, we wrote to 56 trade associations representing grocery suppliers and five other trade bodies representing interested suppliers as well as the four supermarket signatories to the code. The trade bodies were encouraged to ask their members to put in individual submissions but few suppliers did so. Thirty-five of them replied. In addition, we received 16 submissions from individual grocery suppliers and other bodies. Each of the supermarkets responded. Copies of the texts of the letters we sent are at Annexes C and D.
- 4.2 We followed up a number of the responses from suppliers' organisations with meetings to clarify some of the points made and we also met each of the supermarkets. The process of the review was delayed while the CC considered the bids from Tesco, Sainsbury, Asda and Morrison to purchase Safeway. To have announced the results of a review in the middle of this process and taken a view on the future of the code, in particular on the question whether there had been a change of circumstances, would have been premature in the light of the probable restructuring which might follow these bids. A restructuring of the market could amount to a change of circumstances such that the code needs to be varied or superseded.
- 4.3 Furthermore, we wanted to consider what the CC said in the 2003 CC merger report about the nature of relationships between the supermarkets and their suppliers.

## 5 VIEWS EXPRESSED BY SUPPLIERS AND THEIR TRADE BODIES

- 5.1 We wrote to 61 bodies (excluding the supermarkets) on 17 February 2003<sup>5</sup> to seek views on the operation of the code. Fifty-six of these represented grocery suppliers. The other five bodies did not represent grocery suppliers directly but had a close interest in the supply of goods to the supermarkets. In our letter, we invited comments from individual members of these organisations.
- 5.2 Of the 61 bodies we wrote to, 35 provided comments on the operation of the code. Of the remaining 26, three acknowledged our letter but declined to provide comments and 23 did not respond at all. A further 16 organisations (which we did not contact directly) responded to the general invitation to comment made in our letter of 17 February 2003, making a total of 51 respondents overall.
- 5.3 Of the 51 respondents, 11 were not, or were not directly representative of, grocery suppliers within the meaning of the code. Six of these organisations made allegations of breaches of particular clauses in the code and these are recorded at paragraphs 5.30 – 5.33 below. The other five made more general comments, mostly on reasonableness and the general behaviour of the supermarkets.
- 5.4 Of the 40 respondents that did represent, or were, grocery suppliers, 20 made allegations of breaches of particular clauses in the code: their views are recorded in paragraphs 5.13 – 5.20 below. The remaining 20 made only general comments about the operation of the code – mostly relating to whether the code has change the behaviour of the supermarkets, reasonableness, fear of complaining and the mediation process. These comments are discussed below in paragraphs 5.8 – 5.12 and 5.21 – 5.27 and incorporate the views of all the other respondents on these matters.
- 5.5 Although we invited comments from members of the trade bodies to which we sent letters, only five individual grocery suppliers offered views, of which four were in the group of 20 organisations which made allegations of breaches of individual clauses of the code.
- 5.6 We have no evidence that any one supermarket is worse than others in relation to alleged breaches of the code or other matters because the supermarkets were not generally named individually. We have not been able to draw distinctions in the views expressed between small and medium-sized enterprises and larger companies. This is because respondents did not distinguish between the two and the number of individual supplier respondents which commented on the code was too small to draw any meaningful conclusions on this point.
- 5.7 Four of the trade association respondents and three individual supplier respondents to our consultation refused to allow us to reveal their names or even

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<sup>5</sup> The 61 bodies are listed at Annexe B and a copy of the text of our letter to them is at Annexe D.

the sectors in which they are involved. They were very sensitive about confidentiality and they did not wish the published version of comments to reveal details of actual or potential individual complainants or even the trade bodies or the sectors they represented, even when they were made aware that taking such a stance would make it hard for us to follow up allegations of breaches of the code.

### **Whether the code has changed the behaviour of the supermarkets**

- 5.8 Of the 40 respondents that represented, or were, grocery suppliers, only one said that the behaviour of the supermarkets had improved since the introduction of the code. Five did not comment and 34, accounting for 85 per cent of these respondents, indicated that the behaviour of the supermarkets had not improved and that the code had therefore not remedied or prevented the adverse effects specified in the 2000 CC monopoly report which it had been intended to remedy or prevent. One of these 34 respondents even went so far as to say that, since the introduction of the code, the supermarkets had behaved less reasonably towards suppliers and another of these respondents said that the code was 'worse than useless' because it has had the effect of legitimising the practices which the CC had sought to remedy or prevent. Of all 51 respondents, only two (one grocery supplier trade association and one non-grocery trade association) said that the behaviour of the supermarkets had improved, eight offered no comment and 41 (80 per cent of the total) said that the behaviour of the supermarkets had not improved.

### **Fear of complaining**

- 5.9 Of all 51 respondents, 37 (73 per cent of the total) said that there was a fear of complaining among suppliers. None said there was no fear of complaining. 27 of the 40 respondents that represented, or were, grocery suppliers (accounting for 68 per cent of such respondents) indicated that there was a fear of complaining among suppliers. The other 13 offered no view. None said or implied that there was no fear of complaining about the supermarkets. Of the 27 which said that there was a fear of complaining, twenty indicated specifically that suppliers feared retribution from the supermarkets if they complained (e.g. de-listing and/or loss of business to a competing supplier). None of either the grocery supplier or non-grocery supplier respondents provided substantive evidence of de-listing or any other form of retribution from a supermarket following a complaint.
- 5.10 One trade association said that, 'the code as drafted is practically useless, particularly for smaller suppliers who cannot afford to lose the investment they have to make to gain the business in the first place. Hence the extreme reluctance to jeopardise their position by taking the customer [the supermarket] to arbitration.' Another trade association, whose membership comprises a mix of large and small enterprises, said that its members were afraid to be placed in a position of having to complain about the supermarkets to the potential detriment

of commercial relations. An individual supplier said that even if it took the risk of complaining formally, it was 'pessimistic about what can be achieved given the position which these few organisations [the supermarkets] have now established.' Another respondent said that negotiations with the supermarkets were conducted in a climate of fear and another said that even multi-billion pound turnover companies were afraid to complain about the supermarkets.

- 5.11 These comments are typical of the kind that have been made by the 37 respondents who said that there was a fear of complaining among suppliers and they seem to be made by small and large enterprises with equal vigour.
- 5.12 Our review and consultation of suppliers' organisations have not encouraged any of them or their members to come forward with specific complaints about possible breaches of the code. None have thus far invoked the mediation procedure set out in clauses 26 – 30 of the code. This in itself suggests that a strong fear of complaining persists, a concern that was also highlighted in both the 2000 CC monopoly and 2003 CC merger reports.

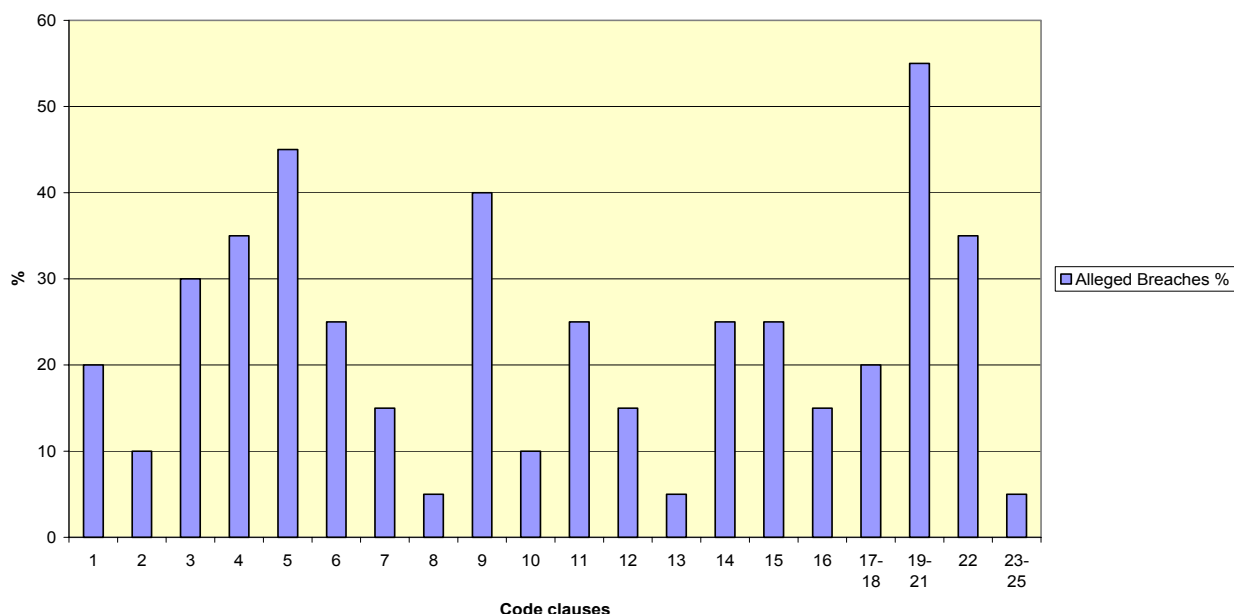
### **Alleged breaches of the code**

- 5.13 There is widespread anecdotal evidence of breaches of the code in the responses to our consultation but no supplier or trade association has produced evidence which would make a case capable of being taken to mediation or of formal action by the OFT.
- 5.14 None of the 40 respondents that represented, or were, grocery suppliers said that there had been no breaches of the code. 16 offered no comment and the other 24 (60 per cent of the total) indicated that there had been breaches of some kind. 20<sup>6</sup> of these 24 respondents alleged breaches of particular clauses of the code. Chart 1 below shows, for each clause or group of clauses, the percentage of these 20 grocery supplier respondents that alleged breaches of that clause or group of clauses. It should be noted that this chart potentially under-estimates the concerns of these respondents as a number of them commented adversely on the definition of reasonableness without necessarily specifying those provisions of the code towards which their concern was particularly directed. Of all 51 respondents, none said that there had been no breaches of the code, 20 offered no comment and 31 (61 per cent of the total) said that there had been breaches.

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<sup>6</sup> The same 20 that were referred to at the beginning of paragraph 5.4

**Chart 1: Percentage of the 20 grocery supplier respondents who alleged breaches of particular clauses of the Code**



5.15 In order of the percentage of those 20 grocery supplier respondents who complained about breaches of particular clauses in the code, top of the poll by a sizeable margin were clauses 19-21 (liability for the costs of consumer complaints), second was clause 5 (contributions to marketing costs) and third was clause 9 (limited circumstances for lump sum payments for being a supplier). Breaches of clauses 3 (no undue delay in payments), 4 (no retrospective reductions in prices without reasonable notice) and 22 (dealing with the tying of third party goods and services for payment) were also significant areas of concern. These six issues and issues covered by some other clauses (namely clauses 6, 7, 11, 12, 15 and 16) relate to matters where prices and terms of supply can be changed outside the initial terms of the supply contract.

5.16 Table 1 below shows the reported breadth of concern about breaches of the code. This is greatest in relation to alleged breaches of clauses 19-21 (liability for the costs of consumer complaints) in that this arises in seven of the eight sectors indicated in the table. Concern about breaches of clauses 5 (no obligation to contribute to marketing costs) and 9 (lump sums) arise in six out of eight sectors in the table. These three sets of clauses are also the ones where the most concern has been expressed about alleged breaches by the 20 grocery supplier respondents who alleged breaches of particular clauses of the code. The sectors concerned cover most grocery products and are described in the footnotes to the table. Inevitably, some sectors overlap; for example, farmers and fresh produce, packaged foods and multi-sector organisations.

TABLE 1 – BREADTH OF CONCERN EXPRESSED ABOUT ALLEGED BREACHES OF PARTICULAR CLAUSES OF THE CODE

Part	Clause	Packaged foods	Drink	Household goods	Large multi-sector orgs	Fresh produce	Meat	Farmers	Eggs
1	1								
1	2								
1	3								
2	4								
2	5								
2	6								
2	7								
2	8								
2	9								
2	10								
3	11								
3	12								
3	13								
3	14								
4	15								
4	16								
4	17-18								
5	19-21								
6	22								
7	23-25								
No. of clauses each sector is concerned about		19	14	11	9	7	5	4	3

**Notes to the table:**

Top six clauses of concern – see Chart 1 above

**Packaged foods:** Three organisations representing suppliers of food in tins, packets and boxes plus two individual suppliers

**Drink:** Two organisations representing most drinks suppliers other than suppliers of beer and cider

**Household goods:** An individual supplier of household goods (cleaning products etc)

**Fresh produce:** Three organisations representing suppliers of fruit and vegetables plus one individual supplier.

**Large multi-sector organisations:** Two organisations which represent many suppliers and other trade associations involved in the supply of food and drink of all kinds. These overlap with many other sectors.

**Farmers:** Three organisations representing farmers in England and Wales only

**Meat:** One organisation representing meat suppliers

**Eggs:** Two organisations representing egg suppliers

- 5.17 The dataset we have which we have used to create Table 1 (namely 20 respondents) appears to be small but, in seven out of the eight sectors in Table 1, those respondents between them represent a large number of individual suppliers which supply most of the produce in their particular sectors. Household goods is the only sector where we were not able to obtain views on individual clauses in the code representing those of an appreciable number of suppliers. It should also be noted that the views of farmers in Scotland and Northern Ireland are not represented in Table 1 in the farmers' sector as organisations representing Scottish farmers specifically either did not reply to our request for comments on the code or did not provide comments on specific clauses in the code. Milk is not specifically included as a sector as we did not obtain allegations of breaches of particular clauses of the code from bodies in that sector dedicated to the interests of milk suppliers. However, the large multi-sector organisations, among other things, represent at least some of those which supply milk direct to the supermarkets.
- 5.18 While the data in Chart 1 and Table 1 are, in our view, representative of the issues and problems with alleged breaches of the code, many of those organisations which did not comment on specific clauses may have members who are concerned about potential breaches. For example, concern was expressed in the milk sector about the way in which the supermarkets were interpreting the meaning of reasonableness.
- 5.19 We have considered whether there are any trends or vulnerability of certain sectors to certain types of breach of the code and there are two areas worthy of comment. In the packaged food sector, four out of the five respondents alleged breaches of clause 9 of the code whereas in the farming sector this did not seem to be a problem. Surprisingly perhaps, farmers and fresh produce groups did not allege breaches of clause 3 (delays in payments) as a problem, although these are areas where there are many small businesses which might be affected by delays in payments for goods supplied.
- 5.20 None of the respondents to our consultation provided views on whether breaches of certain clauses of the code would be more serious than others in terms of their impact on the supplier's business.

### **Use of the term reasonableness**

- 5.21 The perceived vagueness in the wording of the code, especially as far as the use of the term reasonableness and its derivatives is concerned, appears to have added greatly to the fear of complaining since suppliers consider that there is too high a risk that the Supermarket's definition of reasonableness would prevail, to the detriment of the supplier.
- 5.22 12 respondents said that the wide use of the term reasonableness in the code had made it ineffective because the supermarkets were all too easily able to

impose their definition of what is reasonable on suppliers in the knowledge that it is unlikely to be questioned.

- 5.23 Many respondents wanted the code to define more specifically what the supermarkets could or could not do. In particular, they wanted the definition of reasonableness either tightly defined, removed altogether and replaced by the supermarkets committing themselves to operating best practice (a vaguer concept in our view), or just removed altogether so that the code was moved back more into line with what the CC had envisaged in its 2000 monopoly report. Standardisation of definitions across sectors (e.g. guidelines on what constituted promotional support, on consumer complaint criteria and on the circumstances in which retrospective adjustment to prices could be made) and the eradication of all ambiguities in the code was suggested.

### **Mediation process in the code**

- 5.24 The seven respondents that commented on this specifically felt that the mediation process was too long-winded and that it exposed the complainant to a long period of uncertainty before the complaint was resolved. Moreover, respondents felt that it deterred complaining even further as suppliers had first to complain to the supermarket concerned before being able to take their case to a mediator.
- 5.25 An overhaul of the processing of complaints about the supermarkets was also sought by these respondents, with one suggesting a shortening of the negotiation period in the mediation process from 90 to 15 days, the introduction of the ability to consider anonymous complaints and putting the onus on the supermarkets to prove that they were complying with the code rather than it being on suppliers to prove a breach.
- 5.26 On supermarket - supplier relationships, there was a call from two respondents for us to take a more pro-active role in the monitoring of abuses by the supermarkets, including random spot checks, six-monthly visits by the OFT or an independent auditor and requests for written information from the supermarkets. Respondents also wanted us to act on anonymous complaints.
- 5.27 Five respondents said they would like to see an independent regulator or ombudsman to deal with supermarket - supplier relationships. They thought that this would help to overcome suppliers' fear of complaining about the supermarkets by providing a mechanism whereby the details of complaints could be kept confidential. It was thought that such a body could monitor the relationships between the supermarkets and their suppliers actively by spot-checking the supermarkets' dealings with suppliers. One respondent said that a statutory industry regulator would be needed to ensure compliance with the code.

## **Action taken by suppliers to improve supermarket-supplier relations**

5.28 One trade body has taken positive steps to draw up its own code of practice particular to the nature of the products in its sector which it will be discussing with all supermarkets in order to improve relations with them. We have encouraged this and offered to help at any stage during the drafting of the code.

## **Internet auctions**

5.29 There was concern expressed by one trade association and one supplier (who was not a member of that trade association) about internet auctions whereby suppliers made electronic bids to do business with the supermarkets. The tactics of concern were as follows

- dummy bids (used to dishonestly drive down prices offered by suppliers)
- tied bids (i.e. refusing to allow bids unless they cover a particular range of goods or services)
- minimum entry hurdles set at unreasonably high levels (i.e. bids not accepted at above a certain price or a minimum quantity of goods to be the subject of the bid)
- disqualification from future bids if particular bids fell outside the top ten bids
- no transparency or consistency about the bidding process
- bids required are to specification rather than performance which can lead to competitors becoming aware of each other's product formulations and confusion over who owns the intellectual property rights of certain products.

## **Other views and information provided in our review**

### **FRIENDS OF THE EARTH SURVEY**

5.30 The Friends of the Earth conducted a survey among farmers (2,000 were contacted and 161 responded), the key findings of which included the following:

- Only 44 per cent of the respondents were aware of the code and, of those that were aware, most had not seen a copy
- 58 per cent of respondents did not think that the code had changed the way in which supermarkets did business with them
- all four supermarkets were named in connection with practices identified in the 2000 CC monopoly report as being of concern

- a significant proportion of respondents (e.g. 52 per cent of dairy farmers) said they were getting paid the same or less than the price of production for their produce
- there was strong support from respondents for new legislation 'to prohibit the unfair trading practices of the supermarkets, and for an independent regulator to oversee the way in which the supermarkets do business with their suppliers
- about a third of respondents who had experienced problems supplying the supermarkets said that fear of de-listing was their reason for not complaining.

## VIEWS OF PACKAGERS AND PRINTERS

- 5.31 Three packaging and printing trade associations responded to our request for views on the operation of the code. In most cases, their members supply grocery suppliers with packaging and printing and so, usually, do not supply groceries themselves direct to the supermarkets. Nevertheless, we wrote to two of them (the British Printing Industry Federation and the Graphical Paper and Media Union) because of the indispensability of their members' services to both grocery suppliers and the supermarkets. Also, of relevance to them is clause 22 of the code which deals with the tying of third party goods and services for payment and the extent to which the supermarkets are reasonable in the dealings towards them.
- 5.32 Packagers' and printers' concerns about breaches covered nearly all the clauses in the code. One trade association expressed the view that there had been no improvement in the behaviour of the supermarkets since the introduction of the code with signs that things may have got worse rather than better. The other two expressed similar views. No evidence of breaches was provided and there was no indication provided of any one supermarket being worse than the others. They all expressed considerable concern about the fear of complaining to the extent that even questioning terms and conditions could, in their view, lead to a worsening of prices and terms and conditions of supply.

## A TRADE ASSOCIATION

- 5.33 The products concerned are outside the definition of groceries in the code but this trade association was concerned about changes in prices and terms and condition without notice and costs incurred by suppliers as a result of consumer complaints.

## OTHER VIEWS

- 5.34 There was a miscellany of other views and information, the tone of which was negative towards the code and its effectiveness. These also reflected concern about the practices of the supermarkets in allegedly bullying suppliers, for example in auditing their accounts and in using their perceived dominant position

to push down ingredient prices and then using this to demand lower prices from suppliers of finished products. Some scepticism was expressed on whether the code was worth amending.

- 5.35 A number of additional specific suggestions were made for alterations to the code, including introducing provision for the supermarkets to be fined for non-compliance with the code, for the definition of groceries to be reviewed continually and for duty tax increases, where applied, to be passed on rather than having to be absorbed by the supplier and for the code to ban loss-leading by the supermarkets.
- 5.36 A number of respondents were unhappy with the scope of the code. Some wanted it to be expanded to all grocery retailers, or even to all retailers earning more than a £1 billion per annum in turnover, while some wanted it to apply to items other than groceries. Five respondents wanted the code to ban below cost retail pricing. One trade association representing grocery suppliers said that there was no case for extending the code because of the extra bureaucracy that such a move would bring.

### **Suppliers' and retailers' views on the code expressed in the Competition Commission's 2003 merger report**

- 5.37 The CC conducted two surveys of 2,500 suppliers in total<sup>7</sup> (most but not all of which were involved in the supply of groceries as defined in the code<sup>8</sup>) on a number of matters, including the efficacy of the code. Depending on the supermarket, 79 to 93 per cent of large suppliers and 80 to 82 per cent of smaller suppliers said that the code had had no impact on their dealings with Tesco, Asda, Sainsbury and Safeway. Seven to 11 per cent of large suppliers and 11 to 15 per cent of smaller suppliers said that the code had had a negative effect. One to 10 per cent of suppliers said that the code had had a positive effect on relations with the supermarkets. The attitudes taken by suppliers towards the code and its effectiveness seem to be broadly in line with those found in our consultation of suppliers' organisations.
- 5.38 **Budgens**, a grocery retailer, said that lower buying costs were brought about not only by purely economic factors but through apprehension on the part of the suppliers that preferential terms had to be offered to large retailers, irrespective of whether the economic case for them could be made.
- 5.39 **Booths**, another grocery retailer, said that it would welcome the code giving some protection from large scale manufacturers and distributors.

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<sup>7</sup> Comprising approximately 100 large suppliers (with annual sales of £73 million or more) and 2,413 small and medium sized ones (with annual sales of £100,000 to £73 million) – paragraph 6.38 of the 2003 CC merger report refers.

<sup>8</sup> The CC was unable reliably to screen out Tesco's non-grocery suppliers (paragraph 6.51 of the 2003 CC merger report refers).

- 5.40 **Waitrose**, a supermarket operator, said that it followed its own code of practice with its suppliers. It felt that the code was heavily weighted in favour of buyers and lacked enforcement mechanisms. It said there were fundamental flaws in the code. Suppliers with a complaint about a supermarket needed complete security.
- 5.41 **Ethnic Cuisine Limited**, a grocery supplier, had not noticed any change in relationships with the supermarkets since the inception of the code.
- 5.42 **Express Dairies Limited**, a major milk supplier, said that the code was not working effectively. It said it was 'enforced too slowly' and, as interpreted, it provided no benefit to suppliers additional to their normal contractual rights.
- 5.43 **Lloyd Maunder**, a supplier of poultry products, thought that, since the introduction of the code, a change had been observed in the notice period for deletions, which was important for suppliers in managing raw material and packaging more effectively.
- 5.44 **Premier Housewares**, a supplier of kitchenware and general house wares, said that 'several large retailers' were dictating to their suppliers which carrier should be used for delivery to the supermarkets' warehouses and that the supermarkets were also dictating which design agency should be used in packaging design.
- 5.45 **The Institute of Asian Businesses**, a trade association, said that there was 'plenty of anecdotal evidence' to suggest that the code had not worked and, in consequence, many small Asian retailers were struggling to stay in business.
- 5.46 **The Ulster Farmers Union** said that the code lacked teeth and that provision for an audit process was needed which could be managed by the OFT.
- 5.47 Some unnamed suppliers and trade associations said that the code had had little impact on relations with the supermarkets and one made the same allegation as Premier Housewares above.

## 6 VIEWS EXPRESSED BY THE SUPERMARKETS

### Tesco

- 6.1 Tesco was supportive of the code as a means of formalising good buying practice across the industry and it said that it was committed to establishing strong, mutually advantageous relationships with suppliers. It said it had no difficulties in implementing the code. It had had no written or oral complaints from suppliers in relation to the code. It said that the code had not resulted in any significant change in relationships with suppliers but that it had simply formalised pre-existing good practice.

### Asda

- 6.2 Asda confirmed that it was fully committed to the code and that it was important in terms of providing guidance to buyers on appropriate behavioural conduct of suppliers. It stated that the implementation of the code had been 'generally beneficial for the industry'. Asda had received two written complaints alleging a breach of the code but it thought that the suppliers concerned were using this as a 'negotiating tactic'. The first complaint related to low retail prices of products and the second raised an objection to participation in Asda's collaborative sourcing initiative whereby suppliers pool the purchase of certain products to obtain cost benefits which can be passed through to lower retail prices. Both complaints were resolved between Asda and the suppliers concerned without resorting to mediation.

### Sainsbury

- 6.3 Sainsbury believed that the code was helpful in setting out best practice in the industry but that it had had little practical effect on relationships with suppliers: it had merely codified existing practice. Any disagreements were normally resolved between buyers and suppliers' representatives but there was an internal procedure for the resolution of disputes providing for the escalation of the complaint through three levels of management. However, Sainsbury had not received any formal written complaints alleging a breach of the code.
- 6.4 Sainsbury said that it prided itself on 'good stable relations with suppliers' and it provided specific confidential examples of nine suppliers with which relations have been developed to the mutual development of each supplier and Sainsbury.

### Safeway

- 6.5 Safeway runs courses for all of its employees who are involved in buying grocery items covered by the code. All new staff are told about the code as part of their induction. Safeway has spread the principles adopted in the code through its 'Farmers Charter' which, among other things, requires suppliers to extend the

code to their dealings with third parties. The company has built the provisions of the code into its standard terms and conditions: these were posted to some 2,719 suppliers on 14 October 2002.

- 6.6 In December 2002, Express Dairies plc alleged that Safeway had breached the code by withdrawing its business without adequate notice. Express complained to the OFT. However, it was concluded that the dispute was outside the remit of the code as the contract in question had been entered into before 1 November 2001, the earliest date at which the code can apply to supply contracts. Safeway has had no other disputes which have required recourse to the mediation of provisions of the code.

## 7 ANALYSIS OF THE ISSUES

### Supplier – supermarket relationships

- 7.1 The responses to our consultation and the 2003 CC merger report (e.g. see paragraph 2.257) indicate clearly that the supermarkets are in a stronger negotiating position than many of their suppliers. On this basis, we consider that there may have been no change in supplier – supermarket relationships since the 2000 CC monopoly report and we believe that it continues to be important that the supermarkets act reasonably in their dealings with their suppliers in compliance with, and within the spirit of, the code. In this respect, we are concerned to note the views of many of the organisations that responded to our consultation (see paragraph 5.8 above) and the finding in paragraph 2.250 of the 2003 CC merger report that the responses to the CC's surveys of supermarket suppliers indicated that the code has, for most suppliers, had little or no change in impact on relations<sup>9</sup>. Moreover, there seems to be little difference in the survey results between large and small suppliers in this context. The CC's surveys found that most of those that had reported a change had said that relations had worsened. Little positive comment on the code was expressed to us or the CC: only two grocery supplier organisations said that it had been of some benefit (see Chapter 5). On balance, the indication from grocery suppliers' organisations, both to us and the CC, is that the adverse effects arising from supermarket – supplier relations recorded in the 2000 CC monopoly report continue.
- 7.2 The 2000 CC monopoly report noted that many suppliers had said that their business depended on the big supermarkets far more than these supermarkets relied on them (paragraph 2.453 refers). It said that many small suppliers are dependent on only a few supermarkets for their business to purchase their goods. As such, the supermarkets are in a good position to decide the terms on which they will be supplied and the difference in their competitive motivations from those of their suppliers is bound to bring the two levels of the supply chain into conflict occasionally.
- 7.3 Much discontent has been expressed by suppliers about the code and its alleged ineffectiveness in curbing the negotiating strength of the supermarkets (e.g. see paragraphs 5.21 and 5.22 above and also paragraphs 6.98 – 6.102 in the 2003 CC merger report). The anecdotal evidence we have indicates that the code has had no positive effects on supermarket – supplier relationships. Indeed the 2003 CC merger report (at paragraph 2.253) said that 'given that buyer power will increase as a result of the acquisition of Safeway, the situation would worsen for suppliers if the code remained substantially in its present form'.

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<sup>9</sup> Tables 6.13 and 6.14 in the 2003 CC merger report indicate that, in the case of both large and small suppliers, most of those reporting a change in relations indicated that the change had been for the worse.

- 7.4 From the viewpoint of the supermarkets, their relationships with suppliers are reported to be generally good. This is perhaps not surprising, given the clear reticence on the part of suppliers to complain and the lack of complaints made to date.
- 7.5 Where there has been a change of circumstances such that the undertakings are no longer appropriate to remedy the adverse findings identified by the CC in the 2000 CC monopoly report, the undertakings may be varied, superseded, revoked, or the parties released from them. As noted above, we believe that the adverse effects identified in the 2000 CC monopoly report (and summarised in Table 2.14 in that report) are still present. We do not have evidence of a change of circumstances at this time. As noted in Chapter 5 above, none of the respondents to our consultation provided evidence of a change of circumstances. We have also taken account of the aspects discussed in paragraphs 7.6 and 7.7 below in reaching this conclusion.
- 7.6 In a competitive market, frequent changes in the competitive strategies of the supermarkets would be expected. For example, this may lead to changes in the way promotions are handled by the supermarkets and the extent to which suppliers are asked to fund them. We do not think that the nature of such changes<sup>10</sup> amount to a change of circumstances for present purposes.
- 7.7 We do not believe that there is anything in the changes in the fortunes of UK farmers, especially the amounts they are paid for their produce, which can be linked to the code or the general behaviour of the supermarkets. It appears that much of the farming industry's misfortunes in recent years can be traced back to foot and mouth disease, BSE and the strength of the pound against the Euro (e.g. the 2003 CC merger report referred to farmers' cost levels being increasingly undercut by overseas suppliers).<sup>11</sup> However, much of this change in the balance of trade appears to relate to movement in exchange rates rather than anything done, or not done, by the supermarkets.

### **Fear of complaining**

- 7.8 As can be seen from paragraphs 5.9 to 5.12 above, suppliers are afraid to complain about the activities of the supermarkets. While only four of the representative bodies of suppliers from which we sought comments on the code and three individual suppliers that also commented specifically refused to allow us to reveal their identity, most of the trade bodies that replied were pessimistic about us getting any kind of meaningful response from individual suppliers because of their reluctance to complain through fear of the supermarkets. Indeed the number of individual grocery suppliers which wrote to us as a result of our invitation to comment was small (only five). However, in the course of our

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<sup>10</sup> As referred to for example in paragraph 5.108 of the 2003 CC merger report and the 2003 Keynote report on supermarkets and superstores.

<sup>11</sup> This is backed up by figures in DEFRA's publication, 'Agriculture in the UK' which indicate that the UK's trade balance in farm output worsened between 1999 and 2002 in all products.

review, we did not receive any substantive evidence of the supermarkets worsening the terms of business or cutting off business to those that had complained in the past but half the grocery supplier respondents to our consultation feared that this happened to those that complained.

- 7.9 We have no doubt that the fear suppliers have of complaining about the supermarkets is genuine given the strong level of concern that has been expressed to us in the course of our review, and to the CC in the course of the preparation of their 2000 monopoly and 2003 merger reports. However, it is hard to see any reason for this beyond a fear of what **might** happen to suppliers that complain rather than what actually **has** happened. We would be willing to consider, in confidence, information from suppliers or their trade associations on this matter and, where appropriate, advise on whether there might have been a breach of the code and whether there is scope for us to do anything else.

### **The concept of reasonableness**

- 7.10 The fear of complaining is apparently compounded by the perceived vagueness of many of the code's provisions, in particular those containing the concept of reasonableness.
- 7.11 Suppliers are concerned that the code is not effective in checking the market power of the supermarkets, their argument being that it contains no adequate definition of reasonableness, thereby giving the supermarkets the opportunity to employ their own definitions of reasonableness as they see fit. Our hope was that such definitions would be refined by use of the mediation process but this has not happened. The perception suppliers have of the vagueness of the code as a result of the extent to which the concept of reasonableness has been built into it may well have fed the fear of complaining through increasing the uncertainty of the outcome of such complaints.
- 7.12 As noted in Chapter 3 above, the mediation process in the code was meant to be an important part of it. It was anticipated that the consideration of complaints heard by a mediator should, over time, lead to the establishment of precedents on the meaning of reasonableness and that this would, in due course, lead to easier and faster mediations and resolutions of complaints and thence to better contractual relationships between the supermarkets and their suppliers. This process has not even begun to happen given the climate of fear among suppliers when dealing with the supermarkets. The supermarkets appear to be left to decide, with little interference from suppliers, what is reasonable in a trading relationship.
- 7.13 In the course of negotiating the terms of the code with the suppliers and the supermarkets, it was decided that the code should be drafted so that stress was laid on transparency and reasonableness in order that the supermarkets and their suppliers should not be prevented unduly from negotiating mutually beneficial trading terms with each other. To have introduced rigidity into the contracts

between the supermarkets and suppliers might well have made it hard for both sides to react to competition; e.g. in reaching speedy agreement on the running of a promotion to counter an improvement in an offer on a competing product supplied by a rival supermarket. While there is some potential scope for clarifying or firming up certain provisions of the code<sup>12</sup>, we consider that the key issue is the fear among suppliers of complaining. No matter how rigorously the code is drafted, if suppliers do not assert their rights under it, there is little they can gain from its application to their dealings with the supermarkets.

## **Complaints about possible breaches of the code**

- 7.14 In the absence of cases being taken to mediation, we have relied on our consultation of suppliers' trade bodies and on the comments made by third parties to the CC in its 2003 merger report (see Chapter 5 above). All the evidence of breaches we have received is anecdotal. Nevertheless, the nature of the comments made has enabled us to determine that the greatest problem areas relate largely to areas where it seems to be easiest for the supermarkets to make changes to previously agreed contracts with their suppliers. Chart 1 in Chapter 5 indicates that the six most significant areas of concern appear to be unjustified payments for consumer complaints (clauses 19 – 21), contributions to marketing costs (clause 5), the making of lump sum payments for being a supplier (clause 9), retrospective reductions in price without reasonable notice (clause 4), tying third party good and services for payment (clause 22) and dealing with undue delays in payments (clause 3). All these six issues occur across a wide spectrum of the grocery supply industry as Table 1 in Chapter 5 shows.
- 7.15 None of the respondents to our consultation provided views on whether breaches of certain clauses of the code would be more serious than others in competition terms but the common denominators between all six areas identified above are that they are all directly revenue-related. They must therefore have a direct impact on suppliers' profitability and ability to invest in and plan for the future of their businesses. In all six areas, there needs to be an agreement or an acceptance by the supplier and the Supermarket concerned of what is reasonable in the circumstances and they all relate to matters which can be the subject of change during the course of supplies being made to a Supermarket rather than matters which have to be agreed before supplies begin.
- 7.16 Currently, any improvements in the effectiveness of the code could only be brought about by encouraging all parties concerned to make use of the dispute resolution procedures. In this regard, a way needs to be found to break the cycle of fear of complaining leading to dormancy of the mediation process – which leads to no case law which fuels the fear of complaining. We appreciate that this is far easier said than done. We discuss in Chapter 2 above and below what we are willing to do to help break this cycle. Meanwhile, we have already encouraged trade associations to build up dossiers of alleged breaches of the

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<sup>12</sup> Assuming that there is a change of circumstances such that the code could be varied or superseded under section 88(4) of the Fair Trading Act 1973

code on behalf of their members that could potentially be a means of us taking action while maintaining individual supplier confidentiality. We have suggested that trade associations do this every six months but none have done so.

### **The supermarkets' views**

- 7.17 Perhaps not surprisingly, given the dearth of formal complaints, the supermarkets appear to view the code in a positive light: e.g. Asda has told us that it was fully committed to the code and Tesco has said that it is supportive of the code as a means of formalising good buying practice. Certainly it is of concern that suppliers and the supermarkets have such widely differing views on the effectiveness and usefulness of the code, although some difference is to be expected given the differences in motivations of both sides as noted in paragraph 7.2 above. Morrison expressed the view in the 2003 CC merger report (at paragraph 7.231) that it did not consider that the code, even if strengthened, would be sufficient to address potential concerns regarding suppliers as the code was dependent on suppliers being prepared to make complaints which they were not always willing or able to do.

### **Suggestions for improving the effectiveness of the code**

- 7.18 Some respondents to our consultation suggested that an ombudsman is needed to oversee the enforcement of the code through the confidential examination of complaints. It has been suggested that an ombudsman could be set up by primary legislation, or on a more informal basis by having the role assigned to someone within the OFT. In our view, such a body might only be able to keep the identity of complainant confidential in the early stages of addressing a complaint which is no different to the position we would be in when dealing with a complaint. Currently, we are willing to discuss, on a confidential basis, alleged breaches of the code.
- 7.19 Whether a complaint is investigated by the OFT, a mediator or an ombudsman, if a Supermarket is to be found in breach of the code, in the interests of natural justice, details of the allegations against the Supermarket would need to be disclosed. This may include details of the complainant.
- 7.20 At the time of the drawing up of the code, we were concerned about any kind of remedy which would ban certain practices outright or require others to be carried out. There is a danger that imposing rigidity on the transactions between suppliers and the supermarkets could unduly fetter the ability of the supermarkets in particular to react to competitive pressures in the market. In this regard, an inflexible code could have the effect of deterring collaborative arrangements engaged in freely by a supplier and a Supermarket for mutual benefit. This in turn could lead to adverse competition effects in terms of less innovation and consumer choice and possibly also higher prices if, for example, promotional activity were curtailed. On the basis of the evidence currently available, we have not been able to conclude that any particular clauses of the

code would merit a more rigorous approach more in line with the recommendations in the 2000 CC monopoly report. For example, the CC recommended (paragraph 2.588(e)) that the supermarkets should not request suppliers to contribute to the supermarkets' costs of buyer visits, artwork and packaging design, consumer or market research, the costs of store refurbishment or opening, or to provide hospitality. However, the code (clause 5) permits supermarkets to request such contributions, provided suppliers are not unreasonably required to do so. Subject to the outcome of the audit described at paragraphs 7.23 – 7.27 below, it may be appropriate for certain provisions of the code to be brought more into line with the CC's original recommendations.

- 7.21 Other suggestions were made which, realistically, could never be put into effect, such as standardisation of the definition of reasonableness across all sectors and removal of all ambiguities in the code (not least because what is clear to one party may be seen as ambiguous by another); and fining the supermarkets for non-compliance with the code (for which there is no provision under the Enterprise Act 2002). A review of the definition of groceries in the code would require a new reference to the CC under the Enterprise Act 2002, as would consideration of whether the supermarkets rather than suppliers should absorb duty increases on alcohol (paragraph 5.35 refers). Regulation of internet auctions (see Chapter 5 above) was suggested but these were not considered specifically in the 2000 CC monopoly report and they are not, therefore, covered in the CC's findings of adverse effects. The code deals with post- rather than pre-contract behaviour like setting up internet auctions and consequently, at this stage, it would not seem appropriate (or, arguably, possible without a CC reference) to amend the code in relation to these.

### **Further action the OFT intends to take**

- 7.22 Our consultation of suppliers and their trade associations has shown that the level of dissatisfaction with the code and with the supermarkets' conduct towards them is high and suggests that the adverse effects specified in the 2000 CC monopoly report and which the code was meant to remedy or prevent might remain. While the evidence we have of breaches of the code is anecdotal, the responses to our consultation and the CC's findings in the 2003 CC merger report suggest that further enquiry is necessary to try to get deeper towards the root causes of the level of dissatisfaction shown by suppliers. Without detailed information as to how and where the code may be failing and why, it is difficult even to identify the key problems, far less formulate solutions.
- 7.23 Our willingness to discuss concerns on a confidential basis, the encouragement to trade associations to provide aggregated evidence and this review have not provided us with the necessary evidence needed to determine whether and, if so, what further formal action is required by the competition authorities in relation to the code. Given the limited nature of the information available to us and the similar lack of substantive evidence received by the CC in response to its surveys, we doubt that relying on suppliers and their trade associations or indeed the mediation process provided for in the code will be effective in achieving this.

- 7.24 We consider that the best way of taking this forward would be to carry out a compliance audit of the supermarkets' dealings with their suppliers using our monitoring powers under paragraph 2 of the undertakings. We will be concentrating on those provisions of the code which are of most concern to suppliers in key sectors and by sampling a cross-section of suppliers.
- 7.25 In view of the very large number of suppliers, the scope of the audit must be based on a sample. We intend that each of the four supermarkets that have given undertakings will be audited. In each case, a sample of the supply agreements entered into over a time period yet to be determined will be examined, covering both smaller and larger suppliers. In addition, for each supermarket, it is proposed that the audit will exclude suppliers whose total sales to the four supermarkets are less than £100,000 per annum. It is planned that the audit will differentiate between small and large suppliers: the CC's definitions of these in its 2003 report are likely to be followed closely<sup>13</sup>, namely small suppliers being defined as those whose total sales to the supermarkets are £100,000 to £73 million per annum and large suppliers being defined as those whose total sales to the supermarkets are over £73 million per annum.
- 7.26 Based upon the information received during this review and the 2003 CC merger report, we propose that the audit will focus on those clauses in the code where claims of breaches are more frequent. These are listed below. As Chart 1 and Table 1 in Chapter 5 indicate, these clauses were subject to the highest and most widespread level of complaint by those respondents to our consultation who complained about breaches of particular clauses in the code. The purpose of the audit will be to establish what is occurring in practice in relation to each of these clauses:
- Clause 3 - payment times
  - Clause 4 - retrospective reductions in price during the period of a contract
  - Clause 5 - supplier contributions to marketing costs (whether or not ostensibly of the supplier's own volition)
  - Clause 9 - lump sum payments as a condition of supply
  - Clauses 19 – 21 - payments in respect of consumer complaints and
  - Clause 22 – tying of third party goods/ services.

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<sup>13</sup> See paragraph 6.38 of the 2003 CC merger report. In this CC report the £100,000 criterion applied to the four supermarkets and Morrison but in our audit we intend that it will apply only to sales to the four supermarkets.

- 7.27 We intend to get this compliance audit underway as soon as possible after the publication of this report.
- 7.28 If we do not find relevant evidence of either actual breaches of the code, or at least widespread conduct contrary to the spirit of the code, in these key areas we are unlikely to find it elsewhere. The findings of the audit work will be made public.
- 7.29 We were concerned to learn from the Friends of the Earth Survey (paragraph 5.30 refers) that only 44 per cent of farmers were aware of the existence of the code. Similarly, a number of the responses to our consultation revealed some confusion over the scope of the code and its purpose. We are aware that many farmers do not deal direct with the supermarkets, meaning that the code does not apply to many transactions relating to the sale of their produce. However, awareness of the code among farmers does seem, nevertheless, to be low. We would encourage relevant trade associations and other bodies, as well as the supermarkets themselves, to ensure that the industry as a whole is fully informed of the provisions of the code.
- 7.30 Meanwhile, we are always willing to talk in confidence to any suppliers who are supplying groceries direct to any of the supermarkets and/or their representative trade bodies if they are contemplating making a complaint about non-compliance with the code, are thinking of taking a case to mediation or wish to have a view on what is or is not reasonable in particular circumstances. Following such discussions, it is open to suppliers to decide whether to take matters further, for example through the complaint procedures under the code. In addition, we reiterate our invitation to trade associations to build up dossiers of alleged breaches of the code on behalf of their members. Similarly, we are on hand to give a view to any of the four supermarkets on any matters to which the code might apply. We recognise that in such consultations we may only hear one side of the story and thus we may only be able to give a limited view depending on the information available to us. We are willing to consider anonymous complaints but it must be recognised that, without verifiable evidence, it will be difficult to pursue the matter with the supermarket concerned.

# ANNEXES

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## **A UNDERTAKINGS GIVEN BY ASDA STORES LIMITED, ASDA GROUP LIMITED, SAFEWAY STORES PLC, J SAINSBURY PLC AND TESCO PLC TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY UNDER SECTION 88(2) OF THE FAIR TRADING ACT 1973**

**WHEREAS** on 8 April 1999 the Director referred to the Commission under sections 10, 47, 49 and 50 of the Act the matter of the existence or possible existence of a monopoly situation in relation to the supply in Great Britain of certain groceries from certain supermarkets;

**WHEREAS** on 16 April 1999 the Director varied that reference under section 52(1) of the Act in order to extend its scope to the United Kingdom;

**WHEREAS** the Report of the Commission sets out adverse public interest findings in relation to the exercise of buyer power by certain supermarkets;

**AND WHEREAS** pursuant to a request by the Secretary of State, the Director has consulted with the Company with a view to obtaining from it undertakings to take certain action;

**NOW THEREFORE** the Company gives to the Secretary of State under section 88(2) of the Act the undertakings below to take action requisite for the purpose of remedying or preventing the adverse effects specified in the Report:

### **Compliance with the code**

- 1- (1) Subject to paragraphs (2), (3) and (4) below, the Company shall comply with the code on and after the Starting Date.
- (2) The code need not apply to agreements made before 1 November 2001.
- (3) Where relevant on or after the Starting Date, the code shall be read as if amended by the provisions set out in Schedule 1.
- (4) The Company need not comply with the code during the period between:

(a) the day on which the Secretary of State determines that the Company no longer has a Relevant Market Share; and

(b) the fourteenth day after the day on which the Secretary of State subsequently determines that the Company again has a Relevant Market Share ('the Restarting Date'), and where relevant on or after that Restarting Date, where the words 'Starting Date' appear in Schedule 1, they shall be replaced with 'Restarting Date'.

### **Compliance with these undertakings**

2.- The Company shall furnish promptly to the Director such information as the Director considers necessary from time to time to monitor these undertakings.

3.- The Company shall comply promptly with such written directions as the Director may from time to time give:

(a) to take such steps as may be specified or described in the directions for the purpose of carrying out or securing compliance with these undertakings or the code; or

(b) to do or refrain from doing anything so specified or described which it might be required by these undertakings or the code to do or to refrain from doing.

4.- The Company shall procure that any member of the same Group of Interconnected Bodies Corporate as the Company shall comply with these undertakings as if it had given them.

### **Interpretation**

5.- The Interpretation Act 1978 shall apply to these undertakings as it does to Acts of Parliament.

6.- For the avoidance of doubt, compliance with these undertakings does not affect the duty on the Company to comply with or restrict the application of the Competition Act 1998.

7.- In these undertakings:

'the Acceptance Date' is the day on which these undertakings are accepted by the Secretary of State;

'the Act' means the Fair Trading Act 1973;

'the code' means the code set out in Schedule 2 or such code as may be amended pursuant to section 88 of the Act;

'the Commission' means the Competition Commission;

'the Company' means [one of the signatories of the undertakings];

'the Director' means the Director General of Fair Trading;

'Groceries' has the meaning given in the code;

'Group of Interconnected Bodies Corporate' has the meaning given in section 137(5) of the Act;

'Reference Stores' means multiple stores in the United Kingdom being supermarkets with 600 square metres or more of grocery sales area, where the space devoted to the retail sale of food and non-alcoholic drinks exceeds 300 square metres and which are controlled by a person who controls ten or more such stores;

'Relevant Market Share' means eight per cent share of the market for the purchase of Groceries for resale from all stores operated in the United Kingdom by persons who operate Reference Stores or, without prejudice to section 88 of the Act, such other market as may be agreed by the Company and the Secretary of State following consultation with the Director;

'the Report' means the report of the Commission on the supply of groceries from multiple stores in the United Kingdom presented to Parliament in October 2000 (Cm 4842);

'the Restarting Date' has the meaning given in subparagraph 1(4)(b) above;

'the Secretary of State' means the Secretary of State for Trade and Industry; and  
'the Starting Date' is the ninetieth day after the Acceptance Date.

**FOR AND ON BEHALF OF [ ]**

..... **Date** .....

**Name...** ..... **(Director)**

.....

**Name...** ..... **(Director/Secretary)**

## SCHEDULE 1

### ADDITIONAL PROVISIONS FOR THE CODE THAT MAY BE APPLICABLE

CLAUSE	PROVISION
3	At the end of the clause, insert 'where that invoice is dated on or after the Starting Date'.
4	In line 2, insert 'where such reduction or increase takes place on or after the Starting Date' between 'product' and ' <b>unless</b> '.
5	At the end of the clause, delete the full stop and insert on a new line flushed left 'where such costs are incurred or the relevant activity described in paragraphs (a) to (e) above takes place wholly or partially on or after the Starting Date.'.
6	In line 3, insert 'where such Payment is made wholly or partially on or after the Starting Date' between 'Supermarket' and ' <b>unless</b> ' and at the end of the clause, delete the full stop and insert 'or unless the basis of any such Payment is agreed before the Starting Date in respect of products delivered before the Starting Date.'.
7	In line 3, insert 'where such wastage is incurred wholly or partially on or after the Starting Date' between 'stores' and ' <b>unless</b> ' and at the end of paragraph (b), delete the full stop and insert '; or' and then insert on a new line flushed left '(c) the basis of any such Payment is agreed before the Starting Date in respect of products delivered before the Starting Date.'.
9	In line 2, insert 'where such lump sum payment is made wholly or partially on or after the Starting Date' between 'products' and ' <b>unless</b> ' and at the end of subparagraph (ii), delete the full stop and insert '; or' and then insert on a new line flushed left '(c) the basis of any such payment is agreed before the Starting Date in respect of products delivered before the Starting Date.'.
10	In line 3, insert 'where such lump sum payment is made wholly or partially on or after the Starting Date' between 'store' and ' <b>unless</b> ' and at the end of the clause, delete the full stop and insert 'or unless the basis of any such payment is agreed before the Starting Date in respect of products delivered before the Starting Date.'.
11	In line 2, insert 'and such Payment is made wholly or partially on or after the Starting Date' between 'products' and the comma and at the end of the clause, delete the full stop and insert 'unless in respect of a Promotion which takes place wholly before the Starting Date.'.

- 12 At the beginning of the clause, delete 'A' and insert 'Where a Promotion begins on or after the Starting Date, a'.
- 14 At the end of the clause, insert 'where such Promotion begins on or after the Starting Date'.
- 15 In line 3, insert 'where such change takes place wholly or partially on or after the Starting Date' between 'procedures' and '*unless*'.
- 16 In line 3, insert 'where such change takes place wholly or partially on or after the Starting Date' between 'order' and '*unless*'.
- 17 In line 2, insert 'to the extent that such cost is incurred wholly on or after the Starting Date as a result of a forecast made in respect of products delivered on or after the Starting Date' between 'Supermarket' and '*unless*'.
- 19 In line 1, insert 'which is made in respect of a product delivered on or after the Starting Date' between 'complaint' and 'can'.
- 20 In line 1, insert 'which is made in respect of a product delivered on or after the Starting Date' between 'complaint' and 'cannot'.
- 22 In line 2, insert 'delivered on or after the Starting Date' between 'property' and 'from'.
- 32 After 'In this code:', insert, each on an indented new line, '"the Acceptance Date" is the day on which the undertakings in which this Schedule appears are accepted by the Secretary of State;' and '"the Starting Date" is the ninetieth day after the Acceptance Date;'.

## **SCHEDULE 2**

### **CODE OF PRACTICE ON SUPERMARKETS' DEALINGS WITH SUPPLIERS**

**HAVING REGARD TO** the Fair Trading Act 1973;

**HAVING REGARD TO** the Supermarkets Report of the Competition Commission;

**RECOGNISING** that:

(a) a competitive market is the most effective way of protecting the interests of UK consumers;

(b) in a free and fair market place, the supermarkets compete with each other in the level of service, quality of product and value for money that they offer to UK consumers; and

(c) it is in the interests of UK consumers that supermarkets should constantly seek to improve their operating efficiency.

**WHEREAS:**

(a) The Competition Commission has recommended that a code of practice should be introduced to put relations between supermarkets and their Suppliers on a clearer and more predictable basis.

(b) The Competition Commission found that the undue exercise of buyer power by supermarkets in the circumstances identified in the supermarkets Report has effects which are against the public interest.

(c) The Director, following consultation with the supermarkets, has devised this code of practice to meet the concerns of the Competition Commission without wishing to inhibit mutually beneficial arrangements genuinely entered into by supermarkets and their Suppliers.

(d) The effective operation of this code depends upon both the supermarkets and their Suppliers being reasonable in their dealings with each other.

(e) The Director expects that the dispute resolution procedure provided for in this code will be effective and that mediation is the most appropriate way of resolving disputes arising under the code.

(f) The supermarkets are fully committed to the objectives of this code and undertake to operate under this code in good faith.

**NOW THEREFORE** this code has effect:

## **PART 1 - STANDARD TERMS OF BUSINESS**

### **Terms of business to be available in writing**

- 1 The terms of business offered by a Supermarket for its dealings with a Supplier shall be available in writing at the request of that Supplier such that:
  - (a) the standard terms of business offered to all Suppliers, or to all Suppliers in a particular category, shall be available at the request of any Supplier in that category; and
  - (b) the particular terms of business offered to any one Supplier shall be available at the request of that Supplier.
- 2 Reasonable Notice of variation of a Supermarket's terms of business shall be given to the affected Supplier(s).

### **No undue delay in Payments**

- 3 A Supermarket shall pay a Supplier for products delivered to that Supermarket's specification within a reasonable time after the date of that Supplier's invoice.

## **PART 2 – PRICES & PAYMENTS**

### **No retrospective reduction in price without Reasonable Notice**

- 4 A Supermarket shall not directly or indirectly require a Supplier to reduce the agreed price of or increase the agreed discount for any product *unless* Reasonable Notice of such requirement is given to that Supplier in writing before the relevant supplies of that product are made.

### **No obligation to contribute to marketing costs**

- 5 A Supermarket shall not, directly or indirectly, Unreasonably Require a Supplier to make any Payment towards that Supermarket's costs of:
  - (a) buyer visits to new or prospective Suppliers;
  - (b) artwork or packaging design;
  - (c) consumer or market research;
  - (d) the opening or refurbishing of a store; or
  - (e) hospitality for that Supermarket's staff.

### **No Payments for lower profits *unless* the basis of Payment is agreed in advance**

- 6 A Supermarket shall not directly or indirectly require a Supplier to make any Payment to compensate that Supermarket when profits from the sale of that Supplier's products are lower than expected by that Supermarket *unless* the basis of any such Payment is agreed in writing between that Supermarket and that Supplier before the relevant supplies of that product are made.

### **No Payments for wastage without prior agreement, negligence or default**

- 7 A Supermarket shall not directly or indirectly require a Supplier to make any Payment to cover any wastage of that Supplier's products incurred at that Supermarket's stores *unless*
- (a) such wastage is due to the negligence or default of that Supplier; or
  - (b) the basis of such Payment is agreed in writing between that Supermarket and that Supplier before the relevant supplies of that product are made.
- 8 A Supermarket shall use its best endeavours to agree in writing with a Supplier what principal factors in their dealings would be likely to amount to negligence or default on the part of that Supplier.

### **Limited circumstances for lump sum payments as a condition of being a Supplier**

- 9 A Supermarket shall not directly or indirectly require a Supplier to make any lump sum payment as a condition of stocking or listing that Supplier's products *unless* either:
- (a) such payment is made in relation to a Promotion; or
  - (b) such payment:
    - (i) is made in respect of new products which have not been stocked, displayed or listed by that Supermarket during the preceding 365 days in 25 per cent or more of its stores; and
    - (ii) reflects a reasonable estimate by that Supermarket of the risk run by that Supermarket in stocking, displaying or listing such new products.

### **No lump sum payments for better positioning of goods *unless* in relation to Promotions**

- 10 A Supermarket shall not directly or indirectly require a Supplier to make any lump sum payment in order to secure better positioning or an increase in the allocation of shelf space for any products of that Supplier within a store *unless* such payment is made in relation to a Promotion.

## **PART 3 – PROMOTIONS**

### **No Promotions without Reasonable Notice**

- 11 Where a Supermarket directly or indirectly requires any Payment from a Supplier in support of a Promotion of one of that Supplier's products, a Supermarket shall only hold that Promotion after Reasonable Notice has been given to that Supplier in writing.

### **Due care to be taken when ordering for Promotions**

- 12 A Supermarket shall take due care when ordering products from a Supplier at a promotional wholesale price not to over-order, and, if that Supermarket fails to take such care, it shall compensate that Supplier for any product over-ordered and which it subsequently sells at a higher non-promotional retail price.
- 13 A Supermarket shall ensure that the basis on which any order for a Promotion is calculated is transparent.

### **Suppliers not predominantly to fund Promotions**

- 14 A Supermarket shall not, directly or indirectly, Unreasonably Require a Supplier predominantly to fund the costs of a Promotion.

## **PART 4 - COMPENSATION**

### **No change to supply chain procedures without Reasonable Notice or compensation**

- 15 A Supermarket shall not directly or indirectly require a Supplier to change significantly any aspect of the normal supply chain procedures *unless* that Supermarket either:
- (a) gives Reasonable Notice of such change to that Supplier in writing; or
  - (b) fully compensates that Supplier for any net resulting costs incurred as a direct result of the failure to give Reasonable Notice.

### **No change to specifications without Reasonable Notice or compensation**

- 16 A Supermarket shall not directly or indirectly require a Supplier to change the specification (including the quantity of products required) of any agreed order **unless** that Supermarket either:
- (a) gives Reasonable Notice of such change to that Supplier in writing; or
  - (b) fully compensates that Supplier for any net resulting costs incurred as a direct result of the failure to give Reasonable Notice.

### **Limited circumstances for compensation for erroneous forecasts**

- 17 Notwithstanding clauses 15 and 16 above, a Supermarket shall fully compensate a Supplier for any cost incurred by that Supplier as a result of any forecasting error attributable to that Supermarket **unless**:
- (a) that Supermarket has prepared those forecasts in good faith and with due care; or
  - (b) there is an agreement in writing between that Supermarket and that Supplier before the relevant supplies of the product are made that such compensation is not appropriate.
- 18 A Supermarket shall ensure that the basis on which it prepares any forecast is transparent.

## **PART 5 – CONSUMER COMPLAINTS**

### **No unjustified payment for consumer complaints**

- 19 Subject to clause 21 below, where any consumer complaint can be resolved in store by a Supermarket refunding the retail price or replacing the relevant product, that Supermarket shall not directly or indirectly require a Supplier to make any Payment for resolving such a complaint **unless**:
- (a) the Payment does not exceed the retail price of the product charged by that Supermarket;
  - (b) that Supermarket is satisfied on reasonable grounds that the consumer complaint is justifiable and attributable to a failing on the part of that Supplier; and
  - (c) that Supermarket gives notice to that Supplier of such complaint.

- 20 Subject to clause 21 below, where any consumer complaint cannot be resolved in store by a Supermarket refunding the retail price or replacing the relevant product, that Supermarket shall not directly or indirectly require a Supplier to make any Payment for resolving such a complaint **unless**:
- (a) the Payment is reasonably related to that Supermarket's costs arising from that complaint;
  - (b) that Supermarket has verified that the consumer complaint is justifiable and attributable to a failing on the part of that supplier; and
  - (c) a full report about the complaint (including the basis of the attribution) has been made by that Supermarket to that Supplier.
- 21 A Supermarket may agree with a Supplier an average figure for Payments for resolving such complaints as an alternative to accounting for complaints individually.

## **PART 6 – THIRD PARTY DEALINGS**

### **No tying third party goods and services for payment**

- 22 A Supermarket shall not directly or indirectly require a Supplier to obtain any goods, services or property from any third party where that Supermarket obtains any Payment for this arrangement from any third party, **unless** the Supplier's alternative source for those goods, services or property:
- (a) fails to meet the objective quality standards laid down for that Supplier by that Supermarket for the supply of such goods, services or property; or
  - (b) charges more than any other third party recommended by that Supermarket for the supply of such goods, services or property.

## **PART 7 – STAFF TRAINING**

### **Obligatory training for buyers**

- 23 A Supermarket shall supply a copy of this code to all Grocery buying staff.
- 24 A Supermarket shall provide training on the requirements of this code to all Grocery buying staff.
- 25 A Supermarket shall furnish to the Director an annual return detailing staff training and guidance issued in relation to this code in such form and on such days as the Director may specify from time to time.

## **PART 8 - GENERAL**

### **Compliance and dispute resolution**

- 26 A Supermarket shall negotiate in good faith with a Supplier to resolve any dispute arising under the terms of this code.
- 27 If bi-lateral negotiations under clause 26 above cannot resolve a dispute within 90 days of that dispute arising, a Supermarket shall at its own expense offer the services of the Mediator to assist.
- 28 If the Mediator under clause 27 above has failed to resolve a dispute, the Supermarket shall give notice to the Director.
- 29 A Supermarket shall notify the contact details of any Mediator to the Director.
- 30 A Supermarket shall procure the Mediator to supply to the Director:
- (a) an annual return of its work under this code in such form and on such days as the Director may specify from time to time; and
  - (b) such other information as the Director may specify from time to time in relation to individual cases on which the Director is considering taking action.

### **Interpretation**

- 31 For the avoidance of doubt, compliance with this code does not affect the duty on any person to comply with or restrict the application of the Competition Act 1998.
- 32 In this code:
- 'the Director' means the Director General of Fair Trading;
  - 'Groceries' are products sold from any retail store in the United Kingdom and include food, pet food, alcoholic and non alcoholic drinks, cleaning products, toiletries (dental care products, soap, hair care, sanitary protection, nappies and similar products) and household goods (tissues, kitchen rolls, food wraps, bin liners, light bulbs and similar products) but exclude food and alcoholic and non alcoholic drinks sold for consumption in the store where it is purchased, petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers, magazines, greetings cards, compact discs, video and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products and Grocery means any one of them;

'Group of Interconnected Bodies Corporate' has the meaning given in section 137(5) of the Fair Trading Act 1973;

'the Mediator' means such independent person or persons as shall be appointed by a Supermarket under clause 27 above from time to time to provide mediation services;

'Payment' or 'Payments' includes an inducement in any form (monetary or otherwise) and includes better contractual terms;

'Person' includes a body of persons corporate or unincorporate;

'Promotion' means any offer for sale at an introductory or a reduced retail price, or with some additional benefit to consumers that is intended to be only for a specified period;

the meaning of 'Reasonable Notice' in clauses 2, 4, 11, 15 or 16 depends on the circumstances of each case including, for example:

(a) whether the notice period given is objectively justifiable and this depends on the circumstances of each case including, for example:

(i) the duration of any relevant contract or the frequency with which orders are placed by the Supermarket for relevant Groceries;

(ii) the characteristics of the relevant Groceries and their production including durability and dependency on external factors such as the weather;

(iii) the value of any relevant order relative to the turnover of the Supplier in question; and

(iv) the overall impact on the business of the Supplier of the information given in the notice;

(b) whether the reasons for the notice period given are transparent; and

(c) whether similar cases are treated alike;

'Reference Stores' means multiple stores in the United Kingdom being supermarkets with 600 square metres or more of grocery sales area, where the space devoted to the retail sale of food and non-alcoholic drinks exceeds 300 square metres and which are controlled by a person who controls ten or more such stores;

'the supermarkets Report' means the report of the Competition Commission on the supply of Groceries from multiple stores in the United Kingdom presented to Parliament in October 2000 (Cm 4842);

'supermarkets' means all retailers of Groceries which operate Reference Stores with 8% or more of the market for the purchase of Groceries for resale from their stores in the United Kingdom and 'Supermarket' means any one of them;

'Supplier' means any Person actually or potentially carrying on a business in the supply of Groceries to any Supermarket, such Person being established anywhere in the world but, in relation to any Supermarket, excludes any Person which is a member of the same Group of Interconnected Bodies Corporate as that Supermarket;

'Unreasonably Require' in clauses 5 and 14 excludes a case where a Supplier genuinely volunteers to make a Payment in response to ordinary commercial pressures, provided that, where those pressures are partly or wholly attributable to a Supermarket, they shall only be deemed to be ordinary commercial pressures where they are objectively justifiable, transparent and result in similar cases being treated alike; and

'in writing' includes by e-mail.

**FOR AND ON BEHALF OF [ ], A SUPERMARKET**

..... Date .....

**Name**..... (Director)

.....

**Name**..... (Director/Secretary)

## **B LIST OF ORGANISATIONS THE OFT WROTE TO ON 17 FEBRUARY 2003 TO SEEK VIEWS ON THE CODE**

### **Supermarkets**

Asda  
Safeway  
Sainsbury  
Tesco

### **Representatives of those concerned with supplying groceries to the supermarkets**

Association of Bakery Ingredient Manufacturers  
Association of Independent Meat Suppliers  
Biscuit Cake Chocolate & Confectionery Alliance  
British Beer and Pubs Association  
British Brands Group  
British Egg Industry Council  
British Free Range Egg Producers Association  
British Frozen Food Federation  
British Independent Fruit Growers Association  
British Meat Federation  
British Meat Manufacturers Association  
British Oat and Barley Millers' Association  
British Potato Council  
British Poultry Council  
British Soft Drinks Association  
British Tomato Growers Association  
British Trout Association  
Chilled Food Association  
Cosmetic Trade Products Association  
Dairy Industry Association  
English Apples and Pears Limited  
Farmers' Union of Wales  
Federation of Bakers  
Federation of Milk Groups  
Federation of Wholesale Distributors  
Food and Drink Federation  
Forum of Private Business  
Fresh Produce Consortium  
Gin & Vodka Association  
International Brands Group  
International Meat Trade Association  
Mushroom Growers Association  
National Association of British and Irish Millers  
National Beef Association  
National Farmers Union

National Farmers Union of Scotland  
National Pig Association  
National Sheep Association  
Northern Ireland Bakery Council  
Pet Food Manufacturers Association  
Provision Trade Federation  
Scotch Whisky Association  
Scottish Agricultural Organisation Society  
Scottish Association of Master Bakers  
Scottish Association of Meat Wholesalers  
Scottish Dairy Association  
Scottish Food and Drink Federation  
Seafood Scotland  
Shellfish Association of Great Britain  
Society of Independent Brewers  
Soil Association  
Tenants Farmers Association  
UK Agriculture Supply Trade Association  
UK Association of Frozen Food Producers  
UK Cleaning Product Industries Association  
Wine and Spirits Association

**Other interested parties**

British Printing Industry Federation  
British Retail Consortium  
Cold Storage and Distribution Federation  
Graphical Paper and Media Union  
Scottish Executive

## C TEXT OF LETTER SENT TO THE LARGE SUPERMARKETS - TESCO, SAINSBURY, ASDA AND SAFEWAY

### Supermarkets Code of Practice

As you know, your company and the other big three supermarkets<sup>1</sup> gave statutory undertakings to the Secretary of State for Trade and Industry pursuant to section 88(2) the Fair Trading Act 1973 ('the FTA') to comply (on the terms set out in the undertakings) with a code of practice on supermarkets' dealings with suppliers ('the code') with effect from 17 March 2002. The undertakings given by the supermarkets were entered into to remedy adverse public interest findings in relation to the exercise of buyer power identified by the Competition Commission in its Report<sup>2</sup>. This was the culmination of an enquiry by the Competition Commission into the supply of groceries from multiple stores in the United Kingdom. For your convenience, I attach a copy of the undertakings and the code.

We are committed to publishing an annual report on how the code has been working, particularly in relation to dispute resolution<sup>3</sup>. We have also proposed that relevant trade bodies advise us at regular intervals (say every six months) on the operation of the code. Amongst other things, the code requires mediators to report disputes to the OFT to assist in monitoring the effectiveness of dispute resolution. We will consider amending the procedures if there is evidence that they are not working properly. However, we note that, so far as we are aware, no cases have gone to mediation to date.

My purpose in writing is to seek your views on the code and information in relation to its operation. In particular, I should be grateful for responses to the following (and any views) by **31 March**.

- (a) Please provide details of the training given to your buying staff in the application of the code in compliance with paragraphs 23, 24 and 25 of the code.
- (b) How does this training fit in with the other training given to buying staff?
- (c) How is the existence of the code made known to buying and other staff (including those who have to deal with consumer complaints)?
- (d) Please describe any difficulties you have had in applying the code to contracts and transactions with suppliers.
- (e) Please describe any cases where suppliers have made a written complaint alleging a breach of the code and describe how this was resolved.
- (f) Please supply a copy of your current standard terms and conditions of contract with suppliers (if such exist) and describe the circumstances in which these can be varied.

We have today issued a press release which announces that we have started a review of the code.

We have also contacted all major suppliers' organisations to seek their views on the operation of the code. We might need to seek your further views on any comments they make, especially if any changes to the code are contemplated.

## **Use of information**

If appropriate to do so, we may wish to put information provided by you to a third party such as other contributors or another Government department. It is our intention that, in due course, information provided to us will be published in full or in summary form in a report. In publishing this report or otherwise disclosing information, we shall have regard to the need to exclude, so far as is practicable:

- (a) any matter which refers to the private affairs of an individual, where disclosure of that matter would or might, in our opinion, significantly affect the interests of that individual, and
- (b) any matter which relates specifically to the affairs of a particular body or persons (such as a company or a trade association), where disclosure of that matter would or might, in our opinion, significantly affect the interests of that body.

If you believe that any information you supply is confidential and/or that its disclosure may significantly harm your legitimate business or private affairs, please clearly identify such information by marking it 'confidential information' and provide an explanation as to why you believe this to be the case.

Please note that, if appropriate to do so, we reserve the right to disclose **any** information provided by you, including information highlighted by you as being confidential or which you believe would or might significantly affect your interests and/or to use that information in connection with other investigations or enquiries. However, where information has been highlighted by you we will, if it is reasonably practicable to do so, give the person who provided the information (1) written notice of the proposed action and (2) a reasonable opportunity to make representations to us.

I look forward to hearing from you soon.

## D TEXT OF LETTER SENT TO SUPPLIERS' ORGANISATIONS

### Supermarkets Code of Practice

As you know, with effect from 17 March 2002, certain supermarkets, namely Sainsbury, Tesco, Asda and Safeway, gave statutory undertakings to the Secretary of State pursuant to section 88(2) of the Fair Trading Act 1973 ('the FTA') to comply (on the terms set out in those undertakings) with a code of practice on supermarkets' dealings with suppliers ('the code'). The undertakings given by the supermarkets were entered into to remedy adverse public interest findings in relation to the exercise of buyer power identified by the Competition Commission in its Report<sup>1</sup>. This was the culmination of an enquiry by the Competition Commission into the supply of groceries from multiple stores in the United Kingdom. For your convenience, I attach a copy of the undertakings and the code.

The code applies to those goods defined in the code as 'Groceries' and to those supermarkets that (i) qualify as 'Reference Stores' (as defined in the code) and (ii) have 8% or more of the UK market for the purchase of Groceries for resale from their stores in the UK. The scope of the undertakings and the code are necessarily limited as, under the FTA, there is no power to take formal action on matters which are not the subject of an adverse finding by the Competition Commission.

We are committed to publishing an annual report on how the code has been working, particularly in relation to dispute resolution<sup>2</sup>. We have also proposed that relevant trade bodies advise us at regular intervals (say every six months) on the operation of the code. Amongst other things, the code requires mediators to report disputes to the OFT to assist in monitoring the effectiveness of dispute resolution. We will consider amending the procedures if there is evidence that they are not working properly. However, we note that, so far as we are aware, no cases have gone to mediation to date.

My purpose in writing is to seek your views on the code and how it has been working in practice, for example in relation to your members' dealings with any of the supermarkets that have given undertakings comply with the code. If you wish to copy this letter to any of your members, please do so: we are happy for them to supply views to us individually if they wish. I should be grateful if you would arrange for any views to reach me by **31 March**.

We have today issued a press release which announces that we have started a review of the code. I have also written today to Asda, Sainsbury, Safeway and Tesco to seek their views on the code.

### Use of information

If appropriate to do so, we may wish to put information provided by you to a third party such as other contributors or another Government Department. We intend that, in due course, information provided to us will be published in full or in summary form in a

report. In publishing this report or otherwise disclosing information, we shall have regard to the need to exclude, so far as is practicable:

- (c) any matter which refers to the private affairs of an individual, where disclosure of that matter would or might, in our opinion, significantly affect the interests of that individual, and
- (d) any matter which relates specifically to the affairs of a particular body or persons (such as a company or a trade association), where disclosure of that matter would or might, in our opinion, significantly affect the interests of that body.

If you believe that any information you supply is confidential and/or that its disclosure may significantly harm your legitimate business or private affairs, please clearly identify such information by marking it 'confidential information' and provide an explanation as to why you believe this to be the case.

Please note that, if appropriate to do so, we reserve the right to disclose **any** information provided by you, including information highlighted by you as being confidential or which you believe would or might significantly affect your interests and/or to use that information in connection with other investigations or enquiries. However, where information has been highlighted by you we will, if it is reasonably practicable to do so, give the person who provided the information (1) written notice of the proposed action and (2) a reasonable opportunity to make representations to us.

We look forward to hearing from you soon.