



# ***Grocery Market Ombudsman Bill***

**Bill 18 of 2009-10**

**RESEARCH PAPER 10/21** 2 March 2010

This briefing on the *Grocery Market Ombudsman Bill* has been prepared for the Second Reading Debate on the Bill in the House of Commons. The Bill is a Private Member's Bill introduced by Albert Owen MP. It is scheduled to be debated on 5 March 2010.

The Bill would establish an independent ombudsman for the grocery market to oversee the operation of the Groceries Supply Code of Practice. Although the Government accepts the general idea of an ombudsman, they have not commented on the particular proposals in this Bill.

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## Summary

Four large supermarkets have three quarters of the UK grocery market. Many suppliers feel at a competitive disadvantage and have been arguing for years that the competition authorities should act to redress the situation. In 2000, the Competition Commission (CC) reported on the groceries market, concluding that it was broadly competitive. However, they were unhappy at certain practices by the supermarkets, which they considered against the consumer interest. A code of practice was negotiated between interested parties and published in 2001.

Dissatisfaction continued among suppliers, although no complaints were made to the Office of Fair Trading (OFT) that the code of practice had been infringed. A further investigation by the CC produced a report in 2008. Again, the report was broadly favourable to the supermarkets but noted concern about certain uncompetitive practices. It recommended the sector agreeing to a stricter code of practice, to be enforced by an independent ombudsman. In the event, agreement was not reached and the large four supermarkets have remained hostile to the idea of an ombudsman. The CC – which has no powers to create a new body - recommended in August 2009 that the Government establish an ombudsman.

After the *Grocery Market Ombudsman Bill* had its First Reading, but before it was published, the Government agreed in principle to the idea of an ombudsman, and published a consultation about ways in which it might be set up.

The Bill would establish the Ombudsman in a particular way, although much detail would be left to the Secretary of State, who would be given specific powers to make regulations. The Ombudsman would be independent of the OFT. It would have the powers to impose monetary penalties and to award costs. The only right of appeal against its decisions would be on a point of law to the High Court. The OFT would directly fund all the Ombudsman's activities and would raise money from retailers to do so, according to a reimbursement formula.

## **1 Introduction**

The idea of a supermarket ombudsman stems from the competitive position in the groceries market. It is well known that four large supermarkets have three quarters of the market between them, with Tesco alone taking over 30%. Farmers and other suppliers consider themselves at an unfair competitive disadvantage. The competition authorities do not necessarily object to the concentration of suppliers – particularly since it has mainly arisen through supermarket growth rather than through mergers. They do not wish to interfere with the ability of supermarkets to obtain supplies at a low price. They do object, however, to certain specific anti-competitive practices – such as retrospectively imposing charges on suppliers to finance a special offer for consumers. After the Competition Commission (CC) inquiry into supermarkets in 2000, a Code of Practice was established for treatment of suppliers by the five largest supermarkets. However, no complaints have been made to the Office of Fair Trading in relation to it. A further CC report in 2008 proposed a stricter code of practice, applying to more supermarkets, and enforcement by an ombudsman. The Government has accepted this recommendation and is consulting on the detail.

### **1.1 The Competition Commission Report 2000**

In 2000 the CC reported on supermarkets, finding the market competitive, but recommending a statutory code of practice for certain abuses. They received many allegations from suppliers about the behaviour of the main parties:

Most suppliers were unwilling to be named, or to name the main party that was the subject of the allegation. There appeared to us to be a climate of apprehension among many suppliers in their relationship with the main parties.

Many of the main parties were carrying out undesirable practices:

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 unreasonably transferring risks from the main party to the supplier. We believed that, where the request came from a main party with buyer power, it amounted to the same thing as a requirement.

When carried out by the five multiples - each with at least an 8% share of the grocery market – these practices gave rise to a second complex monopoly situation:

These practices, when carried on by any of the major buyers, adversely affect the competitiveness of some of their suppliers with the result that the suppliers are likely to invest less and spend less on new product development and innovation, leading to lower quality and less consumer choice. This is likely to result in fewer new entrants to the supplier market than otherwise. Certain of the practices give the major buyers substantial advantages over other smaller retailers, whose competitiveness is likely to suffer as a result, again leading to a reduction in consumer choice.

The CC recommended a Code of Practice, including provisions for dispute resolution, for those retailers. The Code would require approval from the Director General for Fair Trading.

The CC concluded that:

Taking all the above matters into consideration, we are satisfied that the industry is currently broadly competitive and that, overall, excessive prices are not being charged, nor excessive profits earned. (...) <sup>1</sup>

## 1.2 The Code of Practice 2001

After considerable discussion, a Supermarkets Code of Practice (SCOP) was agreed between interested parties, including the following conditions – greatly amplified in the main text.

- Terms of business to be available in writing
- No retrospective reduction in price without Reasonable Notice
- No Promotions without Reasonable Notice
- No change to supply chain procedures without Reasonable Notice or compensation
- No unjustified Payment for consumer complaints
- No tying third party goods and services for Payment
- Obligatory training for buyers
- Compliance and Dispute Resolution <sup>2</sup>

## 1.3 Effectiveness of the Code of Practice

In February 2003, the Office of Fair Trading (OFT) announced a review of the supermarkets code, <sup>3</sup> which was published in February 2004. The OFT found massive resentment against the supermarkets but were unable to find objective evidence of abuse of SCOP. It therefore commissioned further work to establish how supermarkets deal with suppliers under the SCOP. <sup>4</sup>

On 22 March 2005, the OFT Compliance Audit was published, again finding little evidence of bad behaviour by supermarkets. The supermarkets were, by and large, complying with SCOP. Varying the Code would be unlikely to tackle its perceived ineffectiveness. No code could be successful in dealing with allegations of breaches unless there was evidence of those alleged breaches. Making the code more rigid and prescriptive might stop mutually beneficial arrangements between suppliers and supermarkets, in turn damaging competition.

At present, the available evidence does not suggest that the market for the supply of groceries is not working well for consumers, but the OFT invites any evidence that there may be aspects of the grocery market which may have an adverse affect on competition... <sup>5</sup>

On 3 August 2005, the OFT announced that it would take no further action:

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<sup>1</sup> Competition Commission, [Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom](#), 2000

<sup>2</sup> DTI Press Notice 2001/606, *Hewitt Backs Good behaviour Code for Supermarket Suppliers*, 31 October 2001

<sup>3</sup> OFT Press Notice PN 16/03, *OFT to conduct supermarkets code review*, 17 February 2003

<sup>4</sup> Office of Fair Trading Press Notice 28/04, *OFT publishes supermarkets code review*, 20 February 2004

<sup>5</sup> OFT Press Notice 532/05, *OFT publishes supermarkets compliance audit*, 22 March 2005

The OFT has concluded that the Supermarkets Code of Practice should remain unchanged but be used more effectively. Consumers are benefiting from competition in grocery retailing, and evidence has not come forward that the code is being breached...Without clear evidence that the Code is not working, or that competition in the market is being restricted or distorted, the OFT does not have grounds to refer the market to the Competition Commission or to launch a new market study.

The OFT will continue to encourage the use of the Code and work with supermarkets and suppliers to improve its practical usefulness. This initiative will include:

- working with supermarkets to ensure written records of supermarket-supplier dealings are kept, allowing for greater transparency in the terms of business
- regularly monitoring supermarkets' Code compliance procedures
- confirming that trade associations can take group actions on behalf of their members under the Code with sufficient evidence.<sup>6</sup>

However, the Association of Convenience Stores challenged that decision in the Competition Appeal Tribunal. Even before judgment was reached, the OFT announced that it would reconsider its decision.<sup>7</sup>

## **2 The Competition Commission Report 2008**

### **2.1 CC research on suppliers' problems, 2007**

In 2006 the OFT again reported the grocery sector to the CC, which published its final report in 2008. As part of its second inquiry into the grocery market, the CC commissioned research from GFK NOP. The results do not show clear abuse. Suppliers accept that there were some efficiency benefits to small customers resulting from their dealings with large customers. However, small customers can be affected by supply of products, if there is a shortage or a large customer increases demand. In general, suppliers are satisfied with the frequency of price negotiations. A tenth of suppliers felt that they had bargaining power with respect to one of the large supermarkets. Two thirds of suppliers sometimes have to contribute to marketing and promotion of their products. On the whole suppliers considered that payments made to customers were reasonable although there were mixed opinions. Two thirds of suppliers considered that gross margins had declined over the previous five years.

Here are the report's main findings:

#### **Main Findings**

The report has been edited to remove information that might disadvantage particular parties but a fuller report was given to the Competition Commission. Below is a summary of the main findings.

#### **Sample profile**

- The sample profile was representative of the initial sample frame of suppliers provided by retailers

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<sup>6</sup> OFT Press Notice 146/05, *OFT Concludes Review of Supermarkets Code*, 3 August 2005

<sup>7</sup> The reason for the challenge and how it led to a referral is explained in [Supermarkets: Competition Concerns \(SN/BT/3653\)](#)



- Three-quarters of suppliers surveyed were selling branded goods, two-thirds own label and a quarter non-branded goods
- Suppliers of frozen food and unpreserved food were among the largest companies in terms of turnover, but they also made lower gross margins on their products (those supplying drinks also made lower gross margins)

#### **Advantages/Disadvantages for smaller customers**

- Suppliers generally agreed there were some benefits for small customers resulting from their dealings with larger customers, specifically in efficiency and process innovation
- Suppliers claimed that small customers can be affected by supply of products to some degree, particularly when there is a shortage or a large customer increases demand
- Over four-fifths of suppliers claimed they would not increase prices to smaller customers if a large customer had negotiated a lower price

#### **Negotiations**

- Quarterly price negotiations tended to be more common with other chain stores compared with the four largest supermarkets
- In general, suppliers were satisfied with the frequency of their negotiations
- Suppliers were less satisfied if they were having daily or less than 6 monthly negotiations
- Approximately a third of suppliers claimed to have been asked to enter into an exclusivity agreement with any customer and a fifth had actually entered into a contract
- Only about one in ten suppliers felt they had a high level of bargaining power with any of the four largest supermarkets (score of 7 or more on a scale of 1-10)

#### **Payments and Additional Services**

- The most widespread type of payment made to customers by suppliers was as a contribution to marketing and promotions, mentioned as happening by two-thirds of suppliers
- The largest suppliers were most likely to be making payments of any kind to customers.
- On balance, most [suppliers] felt that payments made to customers were reasonable, although there were mixed opinions amongst suppliers
- About a quarter of suppliers combined shipments of deliveries to customers with another supplier

#### **Competitive Environment**

- Two-thirds of suppliers claimed that gross margins had decreased over the last 5 years

- 84% of suppliers claimed that it would be difficult to replace the customers from whom they receive the lowest gross margins.
- None of the largest companies (£50m+ turnover) felt it would be easy to replace these customers
- Three in ten suppliers had ever tendered for business via auctions
- Four-fifths of suppliers who had tendered for business via auctions claimed the gross margins were lower when business is won in this way

#### **Code of Practice**

- Obligatory contributions to marketing costs was the most common behaviour of the sort regulated by the Code of Practice which had happened to a supplier in the last 5 years (61% of suppliers)
- Suppliers were most likely to claim that customers requesting price reductions for products soon before or after delivery had happened to a greater extent in the last 12 months.<sup>8</sup>

## **2.2 CC report proposes voluntary agreement on an ombudsman**

That research was supplemented by interviews with interested parties. In April 2008, the CC published their final recommendations on the groceries sector. The report found competition broadly working favourably but still had concerns about particular anti-competitive practices. Paragraph 10.1 notes:

We found that, in many important respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers, but not all is well.

Paragraph 10.5 of the final report sums up one concern:

We found that all large grocery retailers, wholesalers and buying groups have buyer power in relation to at least some of their suppliers. This buyer power is of benefit to consumers since part of the lower supplier prices arising from this buyer power will be passed on to consumers in the form of lower retail prices. However, we found that when, in the hope of gaining competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes. If unchecked, we conclude that this will ultimately have a detrimental effect on consumers, by leading to lower-quality goods, less choice of goods, or less product innovation.<sup>9</sup>

The CC recommended relying upon the sector voluntarily agreeing to a code of practice and an ombudsman to enforce compliance with the code. Only if that approach failed should Government become involved:

Establishing a Groceries Supply Code of Practice (GSCOP), based on the existing SCOP, but amended such that:

- All retailers controlled by corporate groups with UK retail groceries turnover in excess of £1 billion a year are included within its scope.
- An overarching fair dealing provision is included.

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<sup>8</sup> GfK NOP, [Research on Suppliers to the UK Grocery Market](#), 15 January 2007

<sup>9</sup> Competition Commission, [The supply of groceries in the UK market investigation](#), 30 April 2008

- Retailers are prohibited from making retrospective adjustments to terms of supply.
- Retailers are prohibited from entering into arrangements that result in suppliers being held liable for losses due to shrinkage.
- Retailers are required to enter into binding arbitration to resolve any dispute with a supplier under the GSCOP.
- Retailers are required to provide notice of and reasons for de-listing suppliers or significantly reducing suppliers' business.
- Retailers are required to establish an in-house compliance officer responsible for compliance with the GSCOP, with a direct reporting line to the audit committee (or non-executive director).
- Retailers are required to keep written records of all agreements with suppliers on terms of supply.
- Retailers are required to provide to the body monitoring and enforcing the GSCOP such information as it may reasonably require in pursuit of its functions.

In addition to the above remedies, the CC (Competition Commission) will seek undertakings from grocery retailers to establish a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP, and whose functions are to include:

- the arbitration of disputes between suppliers and retailers arising under the GSCOP;
- gathering of information (for example, by receiving confidential complaints from suppliers and primary producers) and proactively investigating retailers' records in areas subject to complaint in order to identify whether breaches of the GSCOP have occurred;
- the publication of guidance on specific provisions of the GSCOP where it considers that differences of interpretation exist; and
- the publication of an annual report on the operation of the GSCOP.

In addition, the CC is recommending to BERR that if the CC does not secure satisfactory undertakings from the retailers creating the GSCOP Ombudsman within a reasonable period, BERR should take such steps as are necessary to establish the Ombudsman. The CC further recommends that, if this is the case, BERR take steps to give the Ombudsman the power to levy significant financial penalties on the retailers for non-compliance.

If neither the CC nor BERR are successful in establishing the Ombudsman within a reasonable period of time, the functions of the Ombudsman will be carried out by the OFT, although arbitration of disputes under the GSCOP will be conducted by an independent body with expertise in dispute resolution.

The CC's terms of reference do not permit it to make a finding with respect to relations between primary producers and intermediaries, and it is therefore unable to make any formal recommendations in this regard. However, if it subsequently appears that, despite the operation of the GSCOP (and the Ombudsman) intermediaries continue to transfer excessive risks and unexpected costs further up the supply chain, it suggests that Defra and BERR should consider the introduction of appropriate measures, including the extension of the GSCOP and the role of the Ombudsman or the

introduction of a similar, complementary code and arrangements to cover the intermediaries and primary producers, such as farmers.<sup>10</sup>

### **2.3 Government intervention recommended when no agreement reached**

On 4 August 2009, the CC noted that the retailers had not voluntarily agreed to an ombudsman and formally recommended that the Government should establish one:

Peter Freeman, CC Chairman and Chairman of the Groceries inquiry said:

Our inquiry clearly revealed problems that require action and which, if left unchecked, would damage the consumer. We continue to believe that everyone's interests—and that includes retailers—would be served by tackling a problem that has clouded the industry for many years now. The current economic difficulties if anything reinforce rather than reduce the need for action.

Whilst some retailers have recognized this, regrettably the majority have not. We made every effort to persuade retailers of our case as it would be the quickest way to establish the Ombudsman. We are now left with no alternative but to set out the new Code of Practice and recommend that BIS set up the Ombudsman to oversee its operation.

It is clearly desirable that the Ombudsman be established as soon as is practicable. The new Code of Practice will work much better as a result and suppliers and retailers will have greater confidence that its terms will be observed.

The costs of the Ombudsman, which we think would be about £5 million a year in total including initial set-up costs, are very modest compared with the annual turnover of £70 billion in grocery supplies to retailers. It is obviously for BIS to consider these matters very carefully but we are making our views as clear as we can.

The new Code of Practice will be included in all retailers' contracts with their suppliers and provide a much clearer framework for these agreements. The aim is to ensure that suppliers do not have costs imposed on them unexpectedly or unfairly by retailers. (...)

The Ombudsman would be appointed by the Office of Fair Trading (OFT), which would also set an annual budget for costs and expenses. These costs will be reimbursed from retailers using a formula which will take into account the size of retailers as well as the number of complaints involving them and requiring resolution. The overriding objective of the Ombudsman will be to undertake investigations and arbitrate disputes arising from GSCOP to promote the interests of consumers. Its principal duties will be:

- to act as an arbitrator between retailers and suppliers in relation to disputes arising under the GSCOP;
- to receive complaints in relation to a breach of the GSCOP, and where appropriate to conduct investigations;
- to publish guidance on specific provisions of the GSCOP when necessary;
- to make recommendations to retailers on how to improve compliance with the GSCOP and to monitor progress on the implementation of such recommendations; and

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<sup>10</sup> Competition Commission Press Release, [Groceries Market Investigation – Final Report](#), 30 April 2008

- to advise and report to the OFT on the operation of the GSCOP.<sup>11</sup>

### 3 Different views on having an Ombudsman

#### 3.1 Arguments for having an ombudsman

Medium sized retailers were more sympathetic to the idea of an ombudsman than the large four. Waitrose welcomed the new Code and said it was happy to work with an ombudsman.<sup>12</sup> Marks & Spencer and Aldi also supported an ombudsman.<sup>13</sup>

The National Farmers Union President called on supermarkets to support an ombudsman:

“What I’m saying to the supermarkets is very simple: You’re doing some great work on behalf of British agriculture and the consumer - go the next step and say yes to an independent ombudsman to monitor your compliance with the revised code of practice”, said Mr Kendall. “And remember, this isn't just coming from suppliers - an overwhelming majority of consumers are also saying they’re concerned about retailer treatment of small businesses\*. (...)”

“Let’s be clear. Voluntary codes and charters are all well and good but when it comes to how big retailers deal with their small suppliers they simply haven’t done the job. And we’ve only got to look at what’s happened in the financial sector to see how leaving big players unregulated can backfire to all our costs. We can’t risk that with our food supplies,” said Mr Kendall.<sup>14</sup>

Professor Roger Clarke of Cardiff Business School wrote a paper strongly in favour of an ombudsman:

#### 3. Commentary

It is possible to identify several advantages of introducing a Grocery Ombudsman. Since the Ombudsman will be independent of the supermarket chains on the one hand and Government on the other, it will be able to treat cases impartially focusing on the general concept of fairness introduced explicitly in the GSCOP. This would replace the current policy operated by the OFT which is both internal and not transparent. Transparency, as envisaged in the report, will foster a clearer understanding of what is acceptable (and what is not) in retailer/ supplier relations and will encourage positive policies by retailers to ensure compliance. This, in turn, will mean that consumers will benefit from increased investment and innovation by suppliers, in the long run feeding through into better quality products, more variety and lower product prices.

While the creation of an Ombudsman will involve some cost (estimated at about £5-6 million per year) this is likely to be small relative to consumer benefits as a whole. As noted by the CC, the actual size of the food retail sector in the UK is £110.4 billion and a 0.1% price fall for the largest 4 retailers is equivalent to a reduction in consumer expenditure of £80 million a year (CC report, para. 6.72). While the operating costs of the Ombudsman will fall on the retailers themselves, being paid out on the basis of market share, and some other costs are likely to be involved in the firms themselves, the costs are likely to be minor compared to the benefits for consumers that arise. These benefits are not quantified in the report. However, the remedies, if effectively

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<sup>11</sup> Competition Commission News Release, *CC publishes Code of Practice and Ombudsman Recommendation*, 4 August 2009

<sup>12</sup> Waitrose Press Release, *Waitrose Welcomes New Code of Practice*, 4 August 2009

<sup>13</sup> “The supermarkets must be brought to heel The cost-cutting zeal of the big chains is threatening our farmers’ livelihoods, says Charlie Brooks”, *Daily Telegraph*, 8 January 2010

<sup>14</sup> NFU Press Release, *NFU calls on supermarkets to act now on ombudsman*, 7 July 2009

enforced, are likely to lead to more choice, better quality products and lower prices in some cases. Even very small price reductions and other benefits are likely to result in consumer benefits far outweighing the modest cost of the Ombudsman.

One way to examine the effectiveness of the proposal is to consider the counterfactual i.e. what would happen if an Ombudsman is not introduced. The fallback in this case would be to continue with the OFT, with responsibility for arbitration conducted by an outside body such as the Centre for Effective Dispute Resolution (CEDR). This possibility is unlikely to be as successful as introducing an Ombudsman and hence in the long run is not likely to be in the consumers' best interest. Several reasons for this exist:

1. failure in introducing an Ombudsman is likely to lead to less transparency with the implication that the policy is likely to be less successful in enforcing 'fairness' in the retailer/supplier relation;
2. the focus of the OFT on competition in the whole economy will make it less likely that attention is focused on the GSCOP in grocery retailing thereby hindering the effective working of the policy;
3. partly as a result of (1) and (2) complaints are likely to continue to arise from suppliers thereby requiring further action in the future;
4. the cost of introducing a Grocery Ombudsman is likely to be very small compared to the benefits that are likely to follow.

In this scenario, not only are the consumer benefits discussed above less likely to arise but consumer detriment could well continue or even increase.

There is also a case for action now given the imminent recession and its likely immediate impact on SMEs, including retailers and small suppliers. By introducing an Ombudsman, the Government is likely to strengthen retailer compliance with the GSCOP, and this will provide added support for small suppliers and, by extension, smaller retailers. This is particularly needed at the present time as large retailers use their buyer power to put further pressure on suppliers.

#### 4. Conclusions

This paper has considered the grounds for introducing a Grocery Ombudsman to oversee the GSCOP from a consumers' best interest point of view. Such a policy will reduce the problem in supplier/retailer relations whereby the abuse of buyer power in the short run has negative effects in the longer run tending to raise prices to consumers. Also the regulation of anti-competitive buyer practices such as the transfer of excessive risk and unexpected cost up the supply chain will reduce risks to suppliers enabling them to invest for the longer term and provide benefits from new innovation such as better quality products and more product variety. The costs of this policy as envisaged by the CC are likely to be very small while failure to introduce an Ombudsman is likely to lead to a significant weakening of the policy. In turn, this is likely to mean further investigations will be needed in the future. The introduction of an Ombudsman is likely to provide significant consumer benefits and be, arguably, in the interests of the supermarkets themselves.<sup>15</sup>

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<sup>15</sup> Professor Roger Clarke, [The Impact of a Groceries Ombudsman on Consumers' Best Interests](#), 2010

### 3.2 Arguments against having an ombudsman

The big four retailers rejected the idea of an ombudsman. Sainsbury's opposition was based on several key concerns:

- the ombudsman would duplicate powers already available to the Office of Fair Trading (OFT);
- the proposal to allow complainants to remain anonymous would not allow the retailer a proper right of defence and would be contrary to the principles of natural justice;
- retailers would be asked to agree an unlimited budget for the Ombudsman, to be set at the discretion of the OFT;
- many suppliers are large multinational businesses, frequently larger than Sainsbury's, that do not need protection.<sup>16</sup>

The British Retail Consortium was also critical:

Customers would be the ultimate losers from an expensive and unnecessary supermarket ombudsman, said the British Retail Consortium (BRC). Reacting to Conservative plans, announced today (Tuesday), to establish an ombudsman to oversee relationships between supermarkets and their suppliers, the BRC said the proposal revealed ignorance of how the market really works.

British Retail Consortium Director General Stephen Robertson, said: "This will harm customers. The last thing they need is a new multi-million pound bureaucracy - unnecessarily piling on costs and pushing up shop prices.

"The proposal reveals disappointing ignorance of how the market actually works. Very few farmers deal directly with retailers. Most supermarket suppliers are multi-national food businesses perfectly able to stand up for themselves. Retailers are right to defend customers' interests by negotiating robustly with them. In sectors such as dairy, where supermarkets have set up direct relationships with suppliers, they are the best paying contracts in the market.

"Where's the evidence to support claims that retailers are unfairly putting the squeeze on their suppliers? There is already a supplier code, overseen by the Office of Fair Trading (OFT), which has long been compulsory for the 'big four' supermarkets and is about to be extended to more retailers.

"OFT Chief Executive John Fingleton has said supermarkets are pro-consumer, bringing lower prices, innovation and new services and an ombudsman is not necessary. Any Government attempt to interfere in the running of the OFT by imposing on it an ombudsman funded by retailers would dramatically undermine its independence, as established in the Enterprise Act."<sup>17</sup>

The supermarket chain Iceland was unenthusiastic about complying with a code of practice:

A new code of conduct to protect farmers and small suppliers from bullying tactics by supermarkets has been branded "a complete waste of time" by the boss of one of the UK's largest grocery chains. Malcolm Walker, the chief executive of the Iceland frozen

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<sup>16</sup> Sainsbury's, *Competition Commission Groceries Market investigation – Sainsbury's Views*, 28 August 2009

<sup>17</sup> British Retail Consortium News Release, *Ombudsman – bad for customers*, 5 January, 2010

food chain, said that the new code - which comes into force today - will not change anything. He described the introduction of the so-called Grocery Supplier Code of Practice (GSCOP) and a proposed supermarket ombudsman as "madness". (...)

He argued that GSCOP will do little to alter the occasionally fractious commercial relationships that exist between stores and their product suppliers.

"Nothing is going to change. It is the nature of life. Big suppliers bully small retailers and big retailers bully small suppliers. It is a fact of life," he said. Mr Walker said that supermarkets and suppliers know that they must adopt a spirit of co-operation in their dealings.

"To have a successful business you have to co-operate with suppliers. When you are dealing with Procter & Gamble it's one thing, but the successful supermarket buyer has to understand that the small supplier has to make a profit. That's how you get the best out of the products. If you do screw a supplier down, he takes quality out of the products," he said.<sup>18</sup>

Tesco is also reported not to want an ombudsman:

A supermarket watchdog would work in the interests of suppliers, rather than helping competition for consumers, the chief of Britain's biggest supermarket claimed yesterday. Tesco boss Sir Terry Leahy hit out at proposals for an ombudsman who is intended to ensure "the grocery supply market continues to work in the long-term best interest of consumers".

"I'm not in favour of an ombudsman - everyone knows supermarkets are one of the most competitive industries around," he said. "That competition puts power in the hands of the consumer."

He told the Financial Times: "In a free society, why would you want an ombudsman if there are no problems now as far as consumers are concerned? "An ombudsman would be there to protect suppliers but should be there to protect consumers."<sup>19</sup>

## **4 Government policy**

### **4.1 Government accepts principle of ombudsman, 2010**

In January 2010, the Government response to the CC accepted the need for a body to enforce the code of practice:

Consumer minister Kevin Brennan has today announced that he has accepted the Competition Commission's recommendation for a body to enforce the Groceries Supply Code of Practice (GSCOP).

The Code of Practice comes into force on 4 February 2010 and this will be quickly followed by a consultation, beginning in February, on how best to enforce the GSCOP, including who that body might be and the powers it could have.<sup>20</sup>

Jim Fitzpatrick explained the position in a debate in January 2010:

GSCOP will come into force on 4 February, and we will quickly follow that up with a consultation on how best to enforce it, including on the structure of the ombudsman and what powers it could have. We do not anticipate that a significant impact on

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<sup>18</sup> "Supermarket boss attacks new code of conduct as 'madness'", *Daily Telegraph*, 4 February 2010

<sup>19</sup> "Watchdog will make food more expensive, say Tesco", *Western Mail*, 13 February 2010

<sup>20</sup> BIS Press Release, *Government Announces Go-Ahead For Supermarket Enforcer*, 13 January 2010



consumer prices or staffing levels in retail will result from the creation of an enforcement body. We will consult not on whether a body is needed—we have decided that—but on exactly how that body will operate. We will consult on its nature and role, to ensure that all interested parties can make their views heard and that informed decisions are made.

The new, tougher code and proper enforcement will mean that the grocery supply market works in the long-term best interests of consumers. The new ombudsman will help strike the right balance between farmers and food producers getting a fair deal and the interests of supermarkets. That will enable consumers to get the high-quality British food that they want at an affordable price. Helping our farmers produce as much as they can, while using fewer resources, is at the heart of the Government's food strategy, "Food 2030."

I have previously commented in the House on the relationship between retailers and farmers. GSCOP will be for companies that supply produce direct to retailers. Most fresh produce is supplied to retailers through intermediaries such as packers, processors and fresh food wholesalers rather than by farmers. Although most farmers will therefore be outside the direct scope of GSCOP, the limited value of direct purchases by grocery retailers from farmers understates the closeness of the trading relationship between primary producers and grocery retailers. As farmers may be members of, or shareholders in, intermediary businesses that market their produce to grocery retailers, in that respect GSCOP will provide them with some certainty.<sup>21</sup>

Jim Paice explained the Conservative position:

We have said that we will appoint an independent ombudsman, not in a separate office with all the paraphernalia—a reception and a new set of office rates and so on—but within the OFT. We want an independent, discrete unit within the OFT in order to keep the costs of providing an ombudsman down, but he would none the less be independent.<sup>22</sup>

The Liberal Democrat Party wants an ombudsman with full powers, as explained in January 2010:

"Farmers will only get a fair deal if a new regulator is given the teeth to enforce a strict, legally binding code governing the relationship between supermarkets, suppliers, and pricing," said the Liberal Democrat Shadow Environment, Food and Rural Affairs Secretary. Commenting on Conservative proposals to introduce a supermarket ombudsman, Tim Farron said:

"For too long, Britain's food market has been dominated by a 'trolleygarchy' that has seen profits monopolised by the big supermarkets. While the Tories want to sound tough, today's announcement is like fighting a gun battle with a water pistol. Farmers will only get a fair deal if a new regulator is given the teeth to enforce a strict, legally binding code governing the relationship between supermarkets, suppliers, and pricing. It is to its shame that the Government has colluded in the dominance of the supermarkets by failing to follow through on explicit recommendations from its own Competition Commission to establish a genuinely independent regulator."<sup>23</sup>

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<sup>21</sup> HC Deb 21 January 2010 cc465-6

<sup>22</sup> HC Deb 21 January 2010 c468

<sup>23</sup> Liberal Democrat Party Press Release, *Tories want to fight supermarket gun battle with a water pistol says Farron*, 5 January 2010

## 4.2 Government consultation paper, 2010

On 5 February 2010, the day after the new code of practice came into effect, the Government published a consultation on the new body.<sup>24</sup> The following passage explains the main issue:

10. Government accepts that GSCOP compliance needs independent monitoring and enforcement and a mechanism to hear anonymous complaints. This last point is very important. However, there are differing views on whether Government creates a new body or whether this can sit within an existing structure. At the same time we need to consider the regulatory burden that this might impose in developing any policy proposals. This consultation is therefore seeking views on:

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

11. Therefore, we are consulting with all those who have an interest in the grocery supply chain. This includes the largest grocery retailers who are directly covered by the GSCOP, alongside medium sized and smaller grocery retailers for which independent monitoring and enforcement might have an impact. We also want to hear the views of those who supply large grocery retailers either directly or through other routes. The GSCOP itself applies only to direct suppliers to retailers but the CC has proposed that the body should be able to investigate complaints from any other person.

12. Competition is a reserved matter in the UK and therefore any GSCOP enforcement system that is set up will cover Scotland, Wales and Northern Ireland.

## 5 The Bill

### 5.1 Main features of the Bill

The Bill consists of 16 clauses. It would provide for the OFT, within three months, to establish the Office of the Grocery Market Ombudsman and a person as the Grocery Market Ombudsman (“the Ombudsman”). The Ombudsman would be independent of the OFT (Clause 1). Within six months of being appointed, the Ombudsman would have to establish procedures for his activities (Clause 2). He would investigate complaints or disputes referred by the OFT, a retailer or a supplier (Clause 3). He would have to provide written reasons for decisions (Clause 4).

The Ombudsman would have the power to impose monetary penalties and/or costs (Clauses 6 and 7). The Secretary of State would establish by regulation an appropriate range for those penalties, and would provide for enforcement (Clause 8).

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<sup>24</sup> BIS, [Taking forward the establishment of a body to monitor and enforce compliance with the groceries supply code of practice \(GSCOP\) - A Consultation](#), 5 February 2010

The Ombudsman's determination would be final and binding on all parties, with the only possible appeal being to the High Court on a point of law (Clause 9).

The OFT would directly fund all the Ombudsman's activities and would raise money from retailers to do so, according to a reimbursement formula (Clauses 11 and 12).

The Act would extend to England, Wales, Scotland and Northern Ireland (Clause 16).

## 5.2 How the Bill relates to the Government consultation

In a sense the Bill offers a range of answers to the questions posed by the Government Consultation, listed in section 4.2:

Although the Bill would leave many issues to be decided by the Secretary of State making regulations, it makes clear:

- who would have access to the Ombudsman;
- that there should be a sanctions regime;
- that the appeals mechanism should be limited to points of law; and
- that the OFT should raise money from retailers to fund the Ombudsman.

## 5.3 How the Ombudsman would compare to the Office of Fair Trading

One key difference is the limited scope of the appeal process from the Ombudsman. There is a right of appeal from most similar bodies to the Competition Appeal Tribunal. This is an independent judicial body established to hear appeals against certain decisions of the UK competition and sectoral regulatory authorities made under the *Competition Act 1998*, the *Enterprise Act 2002* and the *Communications Act 2003*. The authorities whose decisions may be appealed to the Tribunal include the Office of Fair Trading and the Competition Commission.

It is possible that in some cases the Ombudsman's rulings might contradict those of the OFT. An example of possible conflict between competition law and being helpful to suppliers came in 2002 and 2003, when an attempt by supermarkets to keep up milk prices ended in disaster. The supermarkets appear to have been partly influenced by appeals from the National Farmers Union to help dairy farmers after the Foot and Mouth epidemic. However, their collusion resulted in increased profits for themselves. The episode ended with the OFT fining several supermarkets for uncompetitive behaviour.<sup>25</sup> In September 2007 the British Retail Consortium rejected the criticisms made by the OFT.<sup>26</sup> The OFT site contains an update on this continuing investigation.<sup>27</sup>

ASDA's response to the Competition Commission on the revised Code of Practice – not specifically on whether an Ombudsman should police it – raised this issue, after noting that ASDA had supported the existing Code of Practice SCOP, but not its proposed successor GSCOP:

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<sup>25</sup> OFT Press Release, [OFT welcomes early resolution agreements and agrees over £116m penalties Investigations continue against other supermarkets and a dairy processor](#), 7 December 2007

<sup>26</sup> BRC Press Release, [BRC denies price fixing claims](#), 20 September 2007

<sup>27</sup> OFT webpage, [Investigation into certain large supermarkets and dairy processors regarding retail pricing practices for certain dairy products](#) [on 2 March 2010]

The Commission has also underestimated the potential for GSCOP to lead to increased consumer prices. The CC states that “we accept that it is possible that [the supply chain practices it seeks to address through GSCOP] have resulted in lower prices for consumers.” But the CC has not properly considered the risk that GSCOP will in fact lead to higher prices. In particular, the CC has not properly considered how the proposed changes to SCOP would have the effect of softening the horizontal competition between Suppliers, leading to higher prices.<sup>28</sup>

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<sup>28</sup> [Asda Response to CC's Second Formal Consultation on GSCOP](#), 30 June 2009