

**Provisional decision on remedies relating to
supply chain practices**

Introduction

1. This paper is one of three papers setting out provisional decisions of the Competition Commission (CC) in relation to remedies to the adverse effects on competition (AECs) identified in the provisional findings of the groceries market investigation. The CC provisionally found AECs in relation to local market concentration and in relation to supply chain issues. This paper discusses remedies that address the AEC we provisionally found in relation to supply chain issues. Two further papers assess the remedy options in relation to local market concentration. A fourth paper sets out the background to our provisional decision, including the framework we have used for the assessment of remedies. This fourth paper also summarizes our package of remedies and provides an overall assessment of effectiveness and proportionality. These four papers together set out our provisional decision on remedies, and it is important that they are read together.

2. This paper is set out as follows:
 - first, we outline the background to the existing SCOP;
 - second, we briefly discuss the nature of buyer power, explaining why, in this inquiry, we provisionally decided to remedy the exercise of buyer power;
 - third, we set out briefly the AEC finding related to supply chain practices, as stated in our provisional findings;
 - fourth, we set out our assessment of the various remedy options we identified in our Notice of Possible Remedies (Remedies Notice); and
 - finally, we assess remedy options suggested by parties in response to our Remedies Notice;

3. In summary, we have provisionally decided to put in place the following remedies to address the AEC in respect of supply chain practices:

- (a) a new code of practice will be created, the terms of which certain grocery retailers will be required to adhere to in their dealings with suppliers of groceries, and which those retailers will be obliged to incorporate into all contracts with suppliers of groceries;
- (b) the coverage of the code of practice will be extended to all UK grocery retailers that are part of corporate groups with a turnover greater than £1 billion in the supply of groceries at a retail level in the UK, and the code of practice will be referred to as the Groceries Supply Code of Practice (GSCOP), to reflect the fact that its coverage is broader than the SCOP;
- (c) the substantive provisions of the GSCOP will essentially mirror those of the SCOP, with certain amendments:
 - (i) to prohibit outright retrospective changes to agreed terms of supply; and
 - (ii) to require retailers to make certain improvements to their internal processes in relation to dealing with suppliers;
- (d) those grocery retailers that are subject to the GSCOP will be obliged to:
 - (iii) appoint an in-house code compliance officer;
 - (iv) improve their arrangements for keeping records of contracts with suppliers;
 - and
 - (v) automatically provide to their suppliers information on contractual terms (including the GSCOP), rights to complain and details of the dispute resolution procedure; and
- (e) our preference is for the establishment of a groceries supply code ombudsman, which, in particular, would:
 - (vi) arbitrate disputes between retailers and suppliers arising under the GSCOP;
 - (vii) publish guidance regarding specific provisions of the GSCOP;
 - (viii) have the power to gather information (for example, by receiving confidential complaints from suppliers and primary producers regarding breaches of the GSCOP) and pro-actively investigate retailers' records in areas subject to

complaint, in order to identify whether breaches of the GSCOP had occurred; and

(ix) report to the public and the Office of Fair Trading (OFT) on retailers' compliance with the GSCOP;

(f) in the absence of such an ombudsman being established:

(i) disputes between retailers and suppliers under the GSCOP will be heard by an independent arbitrator, nominated by an external body with expertise in alternative dispute resolution, such as the Centre for Effective Dispute Resolution (CEDR);

(ii) those grocery retailers that are subject to the GSCOP will be obliged to provide to the OFT details of all disputes arising under the GSCOP (regardless of whether those disputes have involved independent arbitration), and will be required to have their compliance with the GSCOP certified by an independent audit, conducted periodically;

(iii) we will recommend to the OFT that as part of monitoring retailers' compliance with this remedy, it should:

- gather information (for example, by receiving confidential complaints from suppliers and primary producers regarding breaches of the GSCOP) and pro-actively investigate retailers' records in areas subject to complaint, in order to identify whether breaches of the GSCOP have occurred;
- publish guidance on specific provisions of the GSCOP where it considers that differences in interpretation exist; and
- report annually to the public on operation of the GSCOP, using the information provided to it by retailers.

Establishment of the SCOP

4. The background to the SCOP is set out in detail in our provisional findings.¹ In summary, during its monopoly inquiry into supermarkets in 2000 ('the 2000 investigation'), the CC received information from suppliers about a number of practices which they alleged were carried out by grocery retailers. As a result, a list of 52 practices was sent to grocery retailers² and each was asked whether it had carried out any of these practices in the five years to 31 December 1999. The CC found that 42 of these practices had been carried out by various grocery retailers in the previous five years.³

5. One of the outcomes of the 2000 investigation was that the CC recommended⁴ that a code of practice governing relations between grocery retailers and suppliers should be drawn up, to ensure that grocery retailers' buyer power was not exploited. In general terms, the CC said that the code should be designed to ensure that suppliers: (a) had reasonable certainty as to the price they would receive when they accept orders; (b) were not required to vary terms on which they traded with retailers without reasonable notice; and (c) did not face unreasonable or discriminatory trading terms or conditions.

6. The CC also recommended that the code should make provision for dispute resolution, first involving internal dispute resolution procedures at the retailer, and then moving to arbitration by an independent third party.

¹Annex 1, Appendix 8.10.

²Aldi, Asda, Booth, Budgens, Co-op, Iceland, M&S, Morrisons, Netto, Safeway, Sainsbury's, Somerfield, Tesco and Waitrose.

³Three of the ten practices where the CC did not find evidence of it having been carried out in the previous five years related to category management. However, late in the inquiry, it emerged that Asda was engaging in at least one of these practices. Given the late stage of the inquiry, the CC was unable to reach a view on the effect of this practice, although it noted its concerns in its report (see CC, 2000, paragraphs 2.535 and 2.536).

⁴Prior to the coming into force of the Enterprise Act in 2003, the CC was not a determinative body and was only able to make recommendations for remedial action.

7. Following the publication of the CC's report in October 2000, the OFT entered into discussions regarding the content of the proposed code with the five supermarkets identified by the CC as having buyer power. The OFT's discussions with the grocery retailers followed the CC's recommendation that its proposed remedies be implemented by way of undertakings rather than an order. The Secretary of State for Trade and Industry, acting on the advice of the OFT, subsequently accepted undertakings, which encompassed the terms of the SCOP, from four grocery retailers (Asda, Safeway, Sainsbury's and Tesco).⁵ The SCOP came into force on 17 March 2002.⁶ The retailers who gave these undertakings are legally bound to abide by the terms of the SCOP. Failure to do so would constitute a breach of the undertakings. A supplier suffering loss or damage as a result of the breach could bring proceedings against the retailer for breach of statutory duty.⁷

Buyer power—the case for remedial action

8. Buyer power is a form of market power that a firm—in this case a grocery retailer—is able to exercise with respect to its suppliers.⁸ In principle, because it acts as a countervailing force to any market power possessed by suppliers, the exercise of buyer power by grocery retailers may benefit consumers. The beneficial effects of buyer power may be seen in terms of lower prices or better quality products. The exercise of buyer power may also spur innovation in the supply chain. As a result, while the exercise of buyer power may prevent, restrict or distort competition, we do not consider that the presence of buyer power in itself creates detriment to consumers.

⁵Somerfield was excluded from having to provide undertakings to the OFT to comply with the SCOP, as it was subsequently found to have a national sales share of less than the 8 per cent identified by the CC as being the threshold for the possession of buyer power.

⁶Following its acquisition of Safeway in 2003, Morrisons agreed to abide by the SCOP although it takes the view that it is not statutorily obliged to do so.

⁷The SCOP, being undertakings accepted under the *Fair Trading Act 1973*, is enforceable under section 167(4) EA, pursuant to paragraph 15 of Schedule 24 EA.

⁸A firm with buyer power may also have market power with respect to its customers, although this will not necessarily always be the case.

9. However, in certain circumstances, the effect of grocery retailers exercising buyer power might be detrimental to consumers. In particular, the exercise of buyer power by grocery retailers may raise concerns if its effect on suppliers (eg by forcing reductions in investment, innovation and financial viability) also results in detriment to consumers (eg lower product quality and fewer new product offerings).

10. As with most, if not all, other firms, grocery suppliers must make investments in an uncertain commercial environment. Demand for products may unexpectedly ebb and costs of inputs may rise without warning, so that uncertainty is an inherent part of normal business activity. In common with other firms, suppliers will decide whether to undertake investment projects by calculating likely returns, and assessing the risks involved. Our concern is that retrospective adjustments to the terms on which they sell to retailers will increase uncertainty in this assessment process. This increased uncertainty has the potential to significantly diminish suppliers' incentives to fund investments for the development of new products or improved production processes. It is because suppliers come to expect that these retrospective changes might take place that they may become reluctant to launch new investment projects. The level of uncertainty will increase as suppliers become unable to determine the nature of these unexpected adjustments, or their frequency, or to quantify their impact on future earnings.

11. We have provisionally concluded that retailers with buyer power are able to impose retrospective adjustments to contracts held with their suppliers. A retailer's threat of delisting a supplier or switching part of its orders to other suppliers would inflict a loss that is large enough for the supplier to be forced to acquiesce to the retailer's retrospective adjustments.⁹ Without buyer power, retailers would not be able to

⁹The threat of delisting or shifting business to other suppliers is prospective. However, it is precisely because this threat is credible and would result in a large loss to suppliers in the near to immediate future that retailers can impose these retrospective adjustments.

impose these retrospective adjustments. However, we consider that these practices are a side effect of competition between retailers with buyer power. Competition at the retail level naturally leads retailers to always seek the best terms and conditions from their suppliers. When they negotiate with their suppliers, they will want, among other things, to shift risk and transfer costs to their suppliers. Such an exercise of buyer power can be of benefit to consumers, since part of the reduced costs and the lower supply prices would be expected to be passed on to consumers if the retail market were competitive. However, when, in the hope of gaining a competitive advantage, retailers also make retrospective adjustments to previously agreed terms and conditions with their suppliers, we are concerned that this lessens suppliers' incentives to invest in new products and production processes. If unchecked, it is our view that these practices are detrimental to the interests of consumers.

The provisional findings in relation to supply chain practices

12. We provisionally found that the exercise of buyer power by certain grocery retailers and symbol groups with respect to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers, is a feature of the markets for the supply of groceries by all grocery stores, which prevents, restricts or distorts competition in connection with the acquisition of groceries by those grocery retailers and symbol groups.

13. Having identified this feature, our analysis of appropriate remedies focused on amending the SCOP. We believe that the existing SCOP represents a logical starting point for our consideration of remedies for this AEC, since the SCOP provides an existing framework for addressing supply chain practices and is now familiar to many of the relevant parties. The CC set out in the Remedies Notice the following possible remedies in relation to supply chain practices:

- (a) changing the threshold according to which grocery retailers are included within the SCOP;
 - (b) changing the SCOP such that symbol groups are included within it;
 - (c) changing the SCOP such that only certain suppliers are included within it, and if so which those suppliers should be;
 - (d) changing the nature of the restrictions contained within the SCOP;
 - (e) changing the SCOP so as to improve the visibility of compliance or non-compliance; and
 - (f) changing the institutional arrangements for the monitoring and enforcement of the SCOP.
14. The CC also set out in its Remedies Notice the following possible remedies in relation to best practice by retailers in their supply chain practices:
- (a) Should the CC itself seek to identify best practice? If so, how? Should the CC instead seek to establish a mechanism by which retailers, wholesalers and buying groups should identify best practice? If so, how should this be done?
 - (b) How could such best practice be disseminated among grocery retailers?
 - (c) How could the adoption of such best practice be encouraged?
15. The next section of this paper sets out the various elements of the remedy that we have provisionally decided should be adopted in order to address the AEC in relation to supply chain practices.

Assessment of remedy options

Amendment of the SCOP

16. The SCOP currently applies to dealings between each of the four largest grocery retailers—Asda, Morrisons, Sainsbury’s and Tesco—and their suppliers of groceries. The Remedies Notice drew attention to the possibility of changing the threshold

according to which grocery retailers and wholesalers would be subject to the SCOP. The basis for this proposal was our provisional finding that ‘all grocery retailers and wholesalers are, in certain circumstances, able to exercise buyer power in relation to at least some of their suppliers’.¹⁰ We have also considered whether the SCOP might be extended vertically up the supply chain to apply to the relationships that suppliers to grocery retailers have with their own suppliers, including primary producers.

Horizontal scope

Views of the parties

17. In responding to our Remedies Notice, the retailers currently covered by the SCOP, as well as various trade associations and NGOs, all favoured extending the SCOP to cover other major grocery retailers, wholesalers and buying groups. Many of them were motivated by the view that our provisional findings stated that all grocery retailers and wholesalers may, in some circumstances, have buyer power. Certain retailers currently covered by the SCOP also stated that extending the SCOP to all grocery retailers might reduce the possibility of adverse publicity arising from buying practices engaged in by smaller grocery retail chains being incorrectly attributed to them, and thereby improve the reputation of the grocery retail industry. The OFT recommended that a flexible approach be adopted to assessing which retailers should be bound by the SCOP, as the ability of retailers to engage in the practices identified depends on their relative power in relation to their suppliers.

18. Three retailers who are not currently subject to the SCOP (CGL, M&S and Waitrose) told us that they believed that it was not necessary to extend the SCOP to cover them because they considered that their own internal codes governing relations with suppliers were more extensive than the SCOP, and effective at ensuring that they did not pass excessive risks and unexpected costs on to their suppliers. However, all

¹⁰See paragraph 9.37 of our provisional findings.

three of these retailers indicated a willingness to be subject to the SCOP if the CC were to decide to extend its coverage to include them.

19. Four other main parties (Somerfield, ACS, Iceland and Aldi) strongly objected to the coverage of the SCOP being extended, as they considered that grocery retailers with a national share of grocery retail sales less than 8 per cent (ie the threshold for retailers' inclusion in the current SCOP) did not have sufficient buyer power to adopt supply chain practices that transfer excessive risks and unexpected costs to suppliers. These retailers also considered that imposing any restriction on smaller retailers' negotiating ability, as well as the compliance burden associated with the SCOP for a retailer with a national sales share of less than 8 per cent, would adversely affect competition in grocery retail markets.

20. During a round-table discussion with grocery suppliers concerning supply chain practices, a number of suppliers ([REDACTED]) told us that, in many cases, retailers not covered by the SCOP have sometimes imposed trading conditions that were worse, in terms of transferring excessive risks and unexpected costs, than those imposed by the retailers covered by the SCOP. Certain larger suppliers present at the round-table discussion considered the SCOP irrelevant to their day-to-day negotiations, seeing it as a measure of last resort. However, those suppliers present at the round-table discussion generally agreed that there was value in the SCOP as a means of setting out what supply chain conduct was appropriate. All those suppliers present considered that any recourse to the SCOP would be likely to affect their trading relationship with a retailer.

21. CGL emphasized that the retailers currently covered by the SCOP account for most of the supplier complaints noted in our provisional findings which specified a

retailer,¹¹ and that over 60 per cent of suppliers surveyed by GfK reported that they enjoy a 50/50 or better bargaining position with retailers other than the four largest grocery retailers (see paragraph 8.16 of our provisional findings).

Our assessment

22. We provisionally found that all grocery retailers are capable of exercising buyer power in respect of their suppliers in certain circumstances. We also observed, in our provisional findings, that suppliers reported a greater proportion of adverse practices being carried out by retailers that are not covered by the SCOP (see Table 8.3). In order to achieve a comprehensive remedy to this AEC, we believe that it is necessary to consider extending the coverage of the SCOP (as revised in line with our remedies discussed below and henceforth referred to as the 'GSCOP') to all grocery retailers.

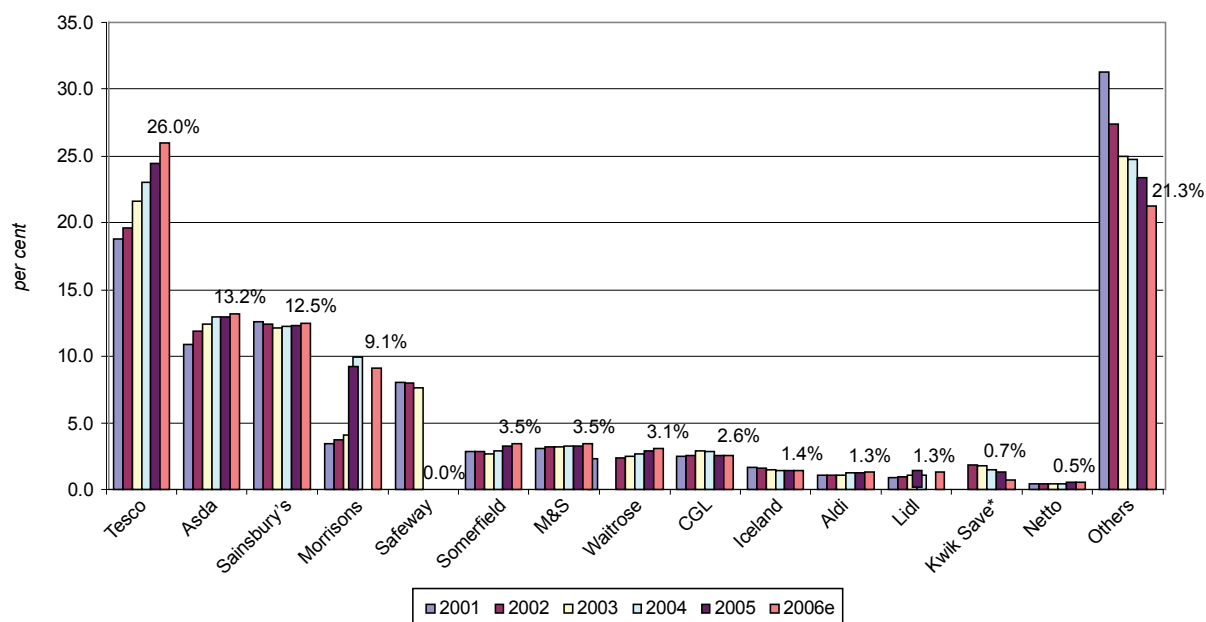
23. However, we recognize that the burden of compliance costs is a relevant factor in the design of our remedy. While recognizing that any such threshold will inevitably be somewhat arbitrary we have considered how best to set an appropriate *de minimis* threshold below which grocery retailers will not be required to abide by the GSCOP. In our provisional findings we acknowledged that the largest grocery retailers, given their size, will have a level of buyer power which allows them to adopt supply chain practices that transfer excessive risks and unexpected costs in relation to a greater proportion of their suppliers than smaller grocery retailers. We therefore consider that the adoption of a *de minimis* threshold, provided it is set an appropriate level, is consistent with our need to achieve as comprehensive a remedy as is reasonable and practicable.

¹¹Retailers were only specified in around 140 of the approximately 380 complaints that were referenced in paragraph 47 of Appendix 8.10.

24. We consider that it is desirable, in the interests of regulatory certainty, for the threshold for inclusion of a grocery retailer within the GSCOP to be based on an easily observable metric, so that it will be clear not only to each grocery retailer but also to others whether an individual retailer is covered by the GSCOP or not. Examples of such metrics include national grocery retail sales, turnover or number of stores.
25. As noted in paragraph 7, in 2000 the CC identified five retailers as having buyer power based on a threshold of 8 per cent share of national grocery retail sales. In our provisional findings, we observed that Somerfield, M&S, Waitrose, CGL, Iceland, Aldi, Lidl and Netto each hold national sales shares of between 0.5 and 3.5 per cent, which sees them currently excluded from the SCOP (see Figure 1).

FIGURE 1

National sales shares by grocery retailer, 2001 to 2006



Source: Verdict, *UK Grocery Retailers 2007*, December 2006.

*Kwik Save was placed in administration on 6 July 2007.

Note: The measurement of national sales shares differs between data sources, with varying definitions of retail sectors and product categories. The Verdict data series in this figure includes sales for both M&S and smaller retailers represented as 'Others'. The Verdict analysis uses turnover figures based on government data and company accounts, while IGD's analysis is based on TNS information (and this explains the slight differences between the data in Figure 1, and those reported in Table 1). Trends in sales shares are, however, comparable between the Verdict and IGD data.

26. Notwithstanding our provisional finding that even grocery retailers with a very small share of national sales could still exercise buyer power, share of national sales could in principle be used as the basis for a *de minimis* threshold. However, a national sales share figure, as well as being difficult to compute and open to debate, reflects the size of a retailer relative to other retailers, rather than its size relative to suppliers. On this basis, we consider that a threshold based on a share of national grocery retail sales would not be appropriate.
27. A threshold based on the number of stores from which a company sells groceries would be comparatively simple to apply. However, the number of stores from which a retailer trades may not be a good proxy for its overall size or its buyer power. For example, in Table 1, it can be seen that Asda has around one-third of the stores of Somerfield and yet has nearly three times Somerfield's annual turnover.
28. It was suggested to us by Morrisons, CGL and NFU Scotland that a threshold test based on turnover or purchases might be appropriate. We consider that a threshold based on groceries turnover is a useful proxy for the size of a grocery retailer and therefore also its likely buyer power. The suggested thresholds ranged from £50 million of turnover (Morrisons) to £1 billion (ie £1,000,000,000) of purchases in aggregate per financial year (CGL). We note that the grocery retail chains listed in Table 1 had groceries turnover in the UK of between £10 million and £29,990 million in the financial year 2005/06.¹²

¹²As reported in Appendix 3.1 of our provisional findings.

TABLE 1 UK grocery retailers

Retailers	<i>Turnover 05/06</i> £m	<i>No of stores</i>	
Tesco	29,990	1,920	
Sainsbury's	15,731	754	
Asda	14,250	306	
Morrisons	12,115	371	
Somerfield	5,065	1,118	
M&S	3,631*	424	
Waitrose	3,341	188	
CGL	2,983†	1,659	
Aldi	1,497†	320	
Iceland	1,415	667	
Lidl	1,321†	387	
Netto	676†	169	
Farmfoods	401	300‡	
Booths	215	26§	
Proudfoot	10	6§	

Wholesalers	<i>Turnover 05/06</i> £m	<i>Symbol group</i>	<i>Buying group affiliation</i>
Palmer & Harvey McLane Ltd	3,533	Mace, Mace Express, Super Shop	
Booker Ltd	3,228	Premier	
Bestway Cash & Carry Ltd (Batleys)	1,600	Best One	
Makro Self Service Wholesalers Ltd	1,100		Today's
Costco Wholesale UK Ltd	953		
AF Blakemore and Son Ltd	622	Spar (UK)	Spar
James Hall and Company (Holdings) Ltd	314	Spar (UK)	Spar
Dhamecha Foods Ltd	271		Today's
Capper & Co Ltd	253	Spar (UK)	Spar
CJ Lang & Son Ltd	237	Spar (UK)	Spar
Henderson Wholesale Ltd	233	Spar (UK)	Spar
AG Parfett & Sons Ltd	219		Landmark
Woodward Foodservice Ltd	148		
JW Filshill Ltd	147		Key Lekkerland
Appleby Westward Group plc	142	Spar (UK)	Spar

Symbol groups	<i>No of stores</i>
Spar UK	2,724
Budgens/Budgens Local/Londis (Musgrave)	2,087
Premier (Booker)	1,900
Lifestyle/Scandia (Landmark)	1,440
Costcutter	1,400
Nisa Today's	1,040
Best In/Best One (Bestway)	920
P&H Retail (Mace, Mace Express, Supershop and Your Store)	710
Key Store/Shop (Key Lekkerland)	342
VG/Vivo (Northern Ireland)	102
Centra (Musgrave NI)	65

Source: IGD, Verdict, Companies House.

*M&S food division turnover is an IGD estimate.

†CGL, Aldi, Lidl and Netto turnover is obtained from Verdict Research publications. We consider this data broadly comparable with that published by IGD on the other retailers and included in the table above.

‡Farmfoods website.

§Booths and Proudfoot store numbers are obtained from IGD.

Notes:

1. Not all retailers have identical financial year end dates.
2. Turnover figures were estimates at the time IGD and Verdict printed their reports.
3. Store number estimates are those reported in our provisional findings at Table 3.1 and Appendix 3.1 for Iceland, Aldi, Lidl, and Netto (as at 2006).
4. Wholesaler information from IGD and Companies House.

29. If the turnover threshold were set at £1 billion, then the GSCOP would cover Tesco, Sainsbury's, Asda, Morrisons, Somerfield, M&S, Waitrose, CGL, Aldi, Iceland, and Lidl. A threshold of £100 million would cover those retailers, as well as Netto, Farmfoods and Booths. Although retailers with groceries turnover of £100 million might possess buyer power, with the ability to adopt supply chain practices that transfer excessive risks and unexpected costs to suppliers, the evidence before us (for example, the number of supplier complaints received by us in relation to the conduct of individual retailers, as reported in Appendix 8.8 of our provisional findings) suggests that this would occur in far fewer of their trading relationships than those of retailers with significantly higher turnover.
30. We do not expect that the compliance costs faced by retailers as a result of being covered by the GSCOP will be substantial. The principal compliance burden will stem from the requirement to appoint an in-house code compliance officer (see paragraphs 83 to 87 below), although a number of retailers have told us that they would expect that this role could be performed by an existing employee. There will also be additional costs arising from new record-keeping obligations, the need to pay for dispute resolution by an independent body, and, in the case of monitoring, either the cost of the ombudsman proposal or costs arising from periodic audits of the retailer's compliance. It is our judgement that the costs of complying with the GSCOP borne by retailers with groceries retail turnover greater than £1 billion would not be disproportionate to the AEC or adverse effects on final consumers resulting from supply chain practices that may be undertaken by retailers with this level of turnover. Moreover, if the threshold were set at a level higher than £1 billion, we would be concerned that the GSCOP would not apply to retailers that we know from our provisional findings have the ability to exercise buyer power. Given this we are concerned that a setting the threshold for inclusion in the GSCOP higher than

£1 billion would mean that we had not achieved as comprehensive a solution as was reasonable and practicable.

31. We also note that only around 15 per cent of suppliers of groceries to UK grocery retailers have a turnover of more than £50 million a year,¹³ and so, with a threshold set at £1 billion, a large proportion of suppliers will still be significantly smaller than those retailers subject to the GSCOP.
32. On the basis of the analysis above, we have therefore provisionally decided that the GSCOP should apply to all grocery retailers which are controlled by corporate groups with an annual UK retail groceries turnover of £1 billion or above.

Symbol groups, wholesalers and buying groups

33. While national-level grocery retailers purchase directly from food and drink manufacturers and other producers, convenience store operators generally source their supplies through grocery wholesalers.
34. A significant proportion of convenience stores operate as part of symbol groups (ie groups of convenience stores which trade under a common fascia). The central organization of the symbol group undertakes joint marketing and advertising, co-ordinates promotions, arranges for the provision of own-label products using the symbol group brand, and supplies support services (eg staff training, financial management and merchandising), in return for a membership fee paid by the store owner. Symbol group convenience stores are usually independently owned, although some are directly owned by wholesalers (eg AF Blakemore, Henderson Group, both members of the SPAR buying group). Major symbol groups in the UK are shown in Table 1.

¹³GfK, *Research on Suppliers to the UK Grocery Market: A Report for the Competition Commission*, 15 January 2007—see Figure 3.10 in our provisional findings.

35. The structures of symbol groups, and the nature of their links to wholesalers and buying groups, vary considerably. However, typically, the stores within a symbol group acquire most or all of their grocery suppliers through grocery wholesalers that are affiliated with the symbol group. In turn, these wholesalers are often members of 'buying groups', which negotiate collectively with grocery suppliers. The 16 largest wholesalers in the UK, with their symbol and buying group affiliations, are shown in Table 1.
36. Independent non-affiliated independent convenience stores for the most part purchase their products from cash and carry wholesalers, but may also purchase from elsewhere, including wholesalers affiliated with symbol groups, limited assortment discounters and supermarkets.
37. In our provisional findings, we set out our view in relation to supply chain practices that 'all grocery retailers and wholesalers are, in certain circumstances, able to exercise buyer power in relation to at least some of their suppliers'. Given the breadth of the provisional finding in relation to buyer power, the Remedies Notice advised that we were considering whether to extend the coverage of the SCOP to 'symbol groups' (such as Spar and Londis).
38. In practice, however, the convenience stores—ie the grocery retailers—within symbol groups do not themselves acquire groceries from suppliers. If the GSCOP were to apply to that portion of grocery sales made through symbol group convenience stores, then the entities covered by the GSCOP would need to be buying groups (or, more correctly, the wholesalers that comprise those buying groups).
39. Under the market investigation regime, the CC has power to take action to remedy 'features'. The definition of 'feature' in section 131(2) of the Enterprise Act ('EA')

includes conduct (whether or not in the reference market) 'of one or more than one person who supplies or acquires goods or services' in the reference market (and the reference market is the market/s referred to us for investigation by the OFT, being the supply of groceries *by retailers* in the UK). The CC's power to make orders under section 161 EA would allow us to take remedial action against supply chain practices carried out by a wholesaler that also owns stores, on the basis that the corporate group to which the wholesaler belongs is a 'person' who supplies groceries at a retail level in the UK.

40. However, it is less clear that the order-making powers of the CC would extend to imposing obligations on wholesalers or buying groups where the link between the wholesaler and the reference market is less direct than ownership of stores (eg where the wholesaler merely holds shares in a corporate group in which independent convenience store owners also hold shares, or the wholesaler merely supplies franchising services to independent convenience store owners).

41. Wholesalers that own and operate stores account for only a small portion of overall sales of groceries through symbol groups. We are concerned that remedial action by the CC which targeted certain wholesalers and not others, based solely on the business structure that a particular wholesaler had adopted, would be open to evasion, which might itself distort wholesalers' commercial decisions. If coverage under the GSCOP was based on a wholesaler owning and operating grocery stores, then it would be possible for a wholesaler to bring itself outside the ambit of the GSCOP very easily, by selling its interest in those stores, and our remedy could provide it with an incentive to structure itself in this way. Moreover, the ability of a wholesaler to exercise buyer power with respect to suppliers (relative to the buyer power of a vertically-integrated retailer) may be diminished where the convenience

stores to which the wholesaler supplies are able to purchase groceries from other sources.

42. Given these concerns, we have provisionally decided not to extend the coverage of the GSCOP to wholesalers and buying groups.

Vertical scope

43. As noted in paragraph 16, we have considered whether the GSCOP (or some similar code of practice) should apply to commercial relationships that suppliers of groceries have with their own suppliers, including primary producers.
44. As an initial comment, we note that the ability of an intermediary to exercise buyer power with respect to their own suppliers, through the adoption of supply chain practices that transfer excessive risks and unexpected costs, requires that the intermediary itself possesses buyer power with respect to its own suppliers. To some extent, the effect of buyer power from grocery retailers may also be transmitted through intermediaries, by means other than supply chain practices, although in any event, the intermediary would need to have a degree of buyer power in its own right for this to become an exercise of buyer power in relation to its own suppliers.
45. The focus of this market investigation has been on the supply of groceries by retailers, in accordance with the terms of reference from the OFT. However, during the course of the inquiry, we have received a number of complaints from primary producers that the intermediaries with whom they deal have transferred excessive risk and unexpected costs to them. In addition, in our provisional findings, we stated that increasing concentration in the groceries supply chain, in the past and in the future, may have an adverse effect on the incomes and profitability of UK primary

producers.¹⁴ We expect that increasing and ongoing consolidation by intermediaries in many sectors is likely to confer buyer power on those suppliers in relation to primary producers.

Views of the parties

46. We have received a number of submissions on the issue of applying the SCOP to commercial relationships at levels further up the groceries supply chain. In their submissions, Waitrose, Tesco, Morrisons and Somerfield supported an extension of the SCOP to cover suppliers to intermediaries and processors, as they considered it may reduce the perception that they deal inappropriately or cause others (such as intermediaries) to deal inappropriately with primary producers, and believed that extending the rules would bring greater transparency to supply chain practices. Tesco submitted that it should not be held accountable for the practices of intermediaries, for whom, Tesco said, it was easy to blame the retailer for their own behaviour. However, CGL, Sainsbury's, ACS and M&S all noted that our investigation should not be focused on the buying practices of parties other than grocery retailers. M&S also told us that the SCOP has been designed to govern the relationship between retailers and their direct suppliers, not those between intermediaries and primary producers. For this reason, many of the provisions of the existing SCOP would not be relevant to relationships between primary producers and intermediaries, while other practices that are relevant to these relationships would not be addressed by the current terms of the SCOP (although we note that it would be possible to adapt the terms of the SCOP to make it more applicable to supply chain practices affecting these relationships).
47. In round-table discussions that we held with suppliers, intermediaries and primary producers, we received mixed views on applying the SCOP to these levels of the

¹⁴Paragraph 8.74 of our provisional findings.

supply chain. Generally, smaller suppliers considered the SCOP more important than larger suppliers, and some smaller intermediaries supported the SCOP applying directly to their own trading agreements with primary producers. However, larger suppliers and intermediaries generally wanted less regulation and considered the SCOP had a very limited role in their day-to-day transactions with retailers (even though it applies to their own agreements with the four largest grocery retailers).

48. We also received submissions from ActionAid, BIFGA,¹⁵ Tesco, Friends of the Earth, NFU Scotland, and a number of consumers, arguing that the SCOP should apply to all parts of the supply chain.

Our assessment

49. The evidence that we have received in relation to this issue, even if limited in scope, suggests that it is possible that many intermediaries hold buying power in relation to primary producers, and we observe that we have received a number of complaints from primary producers that intermediaries engage in trading practices that transfer excessive risk and unexpected costs to them. As such, we consider that it is possible that extending coverage of the SCOP (or an equivalent code of practice) to intermediaries would benefit primary producers.
50. However, any remedial action taken by the CC in this market investigation must be for the purpose of remedying, mitigating or preventing an AEC (or detrimental effect on customers resulting from the AEC). In turn, an AEC must be based on a 'feature' of the market/s referred to the CC by the OFT, in this case the supply of groceries *by retailers* in the UK. We are not satisfied that supply chain practices adopted by intermediaries in their dealings with primary producers could be described as 'features' of the reference market. As such, it would not be legitimate for the CC to

¹⁵British Independent Fruit Growers Association.

take remedial action as part of the current market investigation to address these practices.

51. However, the evidence that has been presented to us during this inquiry by suppliers to intermediaries and processors, especially primary producers, strongly suggests that supply chain practices transferring excessive risks and uncertain costs up the supply chain are sufficiently prevalent in many sectors to justify greater scrutiny of the nature of these commercial relationships. In our judgement, it would be appropriate for consideration to be given to the establishment of codes of practice governing the commercial relationships between primary producers and their customers. We anticipate that a body such as the Department for Environment, Food and Rural Affairs may be well-placed to conduct such an exercise and we are currently minded to recommend that it do so.

52. In making this recommendation, we would suggest that DEFRA consider several examples of codes of practice that might provide useful material for a primary producer code in the UK. We would observe that a code of practice covering commercial relationships at this level of the groceries supply chain could draw on the provisions of the GSCOP, although it should be noted that fresh produce is significantly different from manufactured goods in that it quickly deteriorates and becomes un-saleable, which needs to be taken into account for any code of practice.

53. We would also note that the Australian Horticulture Code of Conduct¹⁶ attempts to deal with this by stipulating that if a purchaser decides to reject a grower's produce, he or she is required to contact the grower immediately and provide written notification of the rejection and the consequences of the rejection. The Code of Conduct also provides that a purchaser can only reject produce for reasons outlined

¹⁶<http://www.daff.gov.au/agriculture-food/hort-crops-wine/hort-policy/code-of-conduct>.

in a written agreement, and creates a system of independent assessors, who can investigate and report on whether produce was rejected in accord with the agreement and the Code of Conduct, and whether payments by the purchaser were calculated in accordance with the Code of Conduct.

54. In addition, we would note that [X], a fresh produce supplier, provided us with a voluntary 'code of integrity' that it suggested should apply to the customers of fresh produce suppliers. That code included such terms as:

- prices for 'short season crops' should not be distorted by below cost selling (unless to clear old stock);
- a purchaser should not demand additional quantity at the expense of other customers of the grower;
- loss of profit claims by a purchaser should be balanced against a grower's loss of profit arising from a contract cancellation; and
- where a purchaser imposes a category management structure, payment for produce should be guaranteed in the event of the category management company going into liquidation.

55. Increased transparency would be of significant assistance in revealing supply chain practices and the exercise of buyer power, which might in turn benefit those points of the groceries supply chain with little or no market power. As discussed in paragraph 120 below, we intend to encourage transparency in the supply chain by providing primary producers and other suppliers to intermediaries and processors with the right to initiate complaints about the conduct of grocery retailers with respect to their suppliers.

Changing the obligations within the SCOP

56. Our Remedies Notice raised the possibility that, in creating a new code of practice, some clauses might be removed from the SCOP (reduce the scope), additional clauses added (extend the scope) and that some absolute prohibitions might be incorporated to replace existing reasonableness tests (particularly in relation to retrospective dealings).
57. We have set out in the paragraphs below a discussion of three categories of changes to the SCOP that we intend to incorporate within the new GSCOP:
- (a) changes to prohibit outright retrospective changes to agreed terms of supply (including consequential amendments to the existing provisions);
 - (b) the imposition of a general standard of 'fair dealing'; and
 - (c) the addition of new obligations to require retailers to make certain improvements to their internal processes in relation to dealing with suppliers.

A fourth category of changes—to external dispute resolution procedures—are discussed in the next section, in the context of institutional arrangements for monitoring and enforcement of the GSCOP.

Changes to the existing text, and prohibition of retrospective changes

Views of the parties

58. Several of the retailers currently covered by the SCOP submitted that no change to the terms of the SCOP is necessary, as the SCOP is operating adequately, no case had been made for adding to, or tightening, its restrictions, and its terms were the result of carefully reasoned debate at the time of its implementation. Tesco considered that a more prescriptive SCOP was likely to result in higher prices and fewer new products for customers. It was also noted by Asda and Tesco that the OFT's

review of the SCOP¹⁷ in 2005 did not suggest that the terms of the SCOP required revision. However, M&S and Waitrose suggested a greater focus on prohibiting retrospective amendment of agreements, consistent with our provisional findings and their own commercial practices when dealing with their suppliers.

59. Submissions that we received varied in their emphasis on the text of the SCOP. A number of submissions focused on the use of the term ‘reasonable’ in some clauses. In particular, the retailers currently covered by the SCOP, and some suppliers that we discussed this issue with at our suppliers’ round-table were strongly against any proposal to remove the flexibility afforded by that term. The OFT recommended that the revised SCOP not be overly prescriptive as this could have the effect of deterring collaborative arrangements engaged in by suppliers and retailers for perceived mutual benefit, which could in turn lead to adverse effects on the interests of consumers. Other submissions from the ACS, and many third parties, including BBG, ActionAid, BIFGA, Tescopoly, Friends of the Earth, NFU, NFU Scotland and Bananalink, suggested that the introduction of reasonableness and exceptions such as ‘unless’ into the current SCOP had led to inherent uncertainty and prevented suppliers from relying on the SCOP (and obtaining adequate enforcement).¹⁸ Moreover, one representative of a major grocery retailer, who had been involved in negotiating the terms of the SCOP, suggested that the inclusion of ‘grey areas’ in the SCOP, while done ‘for the right reasons’, had been regrettable, and that the CC, when now conducting a fresh look at the SCOP, should look to whether some of those grey areas could be eliminated.
60. We have also received a number of submissions from retailers on the issue of the difference between a ‘request’ and a ‘requirement’ in the context of a retrospective

¹⁷*Supermarkets: The code of practice and other competition issues*—March 2005.

¹⁸For a complete list of all the submissions that we received see our website <http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm>.

change to the terms of a supply agreement (Asda, Morrisons, Tesco, CGL, Somerfield). For example, retailers have submitted that it is vital in the interests of commercial flexibility that retailers continue to be allowed to request that a supplier pay for the cost of reducing the retail price in order to compete with another retailer after goods have been supplied. Asda contended that the OFT had concluded in 2005 that the 'request/require' distinction avoids undue regulatory prescriptiveness and could introduce rigidities in the relationships between grocery retailers and their suppliers. We note that we received a number of submissions from suppliers during the course of the inquiry that they do not generally consider 'requests' from retailers to be a negotiable position ([§]). However, during the supplier round-table discussions some larger suppliers indicated that they were comfortable entering into these discussions with retailers ([§]).

61. Friends of the Earth and Tescopoly proposed significantly revised codes of practice in their submissions. These codes were more prescriptive than the existing SCOP, and removed the flexibility afforded by the 'reasonableness' criterion used in many clauses of the existing SCOP. It was also suggested by a number of NGOs, including Bananalink and Traidcraft Exchange, that foreign suppliers should specifically have access to the SCOP, although the SCOP currently applies to dealings between the four largest grocery retailers and any suppliers of groceries, so foreign suppliers are not excluded from relying on its provisions (see, in particular, the definition of 'supplier' in clause 32 of the SCOP). It was suggested by Friends of the Earth and Tescopoly that the SCOP should be amended to provide that:

- supermarkets must not make retrospective and unilateral reductions to prices or quantities ordered. Invoice prices and changes to pricing, the retail price charged for the product, the original product specifications and subsequent changes must all be recorded in writing;
- all invoices must be paid within 30 days;

- suppliers are not required to contribute to marketing costs (including promotions such as '2 for 1'), store costs, consumer research, packaging, positioning or shelf space, wastage due to supermarket damage or forecasting error or lower-than-expected sales subsequent to delivery;
- charges for consumer complaints are restricted to proven problems resulting from quality of the product and compensation to customers is restricted to damage arising prior to delivery;
- packaging and transport specifications must be agreed and put in writing. Changes at the request of the supermarket must be paid for by the supermarket. Suppliers should be entitled to use any supplier of goods and services that meet the retailer's specifications and the retailer must not receive any payment through specifying a third party retailer; and
- supermarkets must not require payments or better terms as a condition of stocking or listing a supplier's products or require payments for better positioning of a supplier's products within a store.

62. [X] made a suggestion in its submission to include an overarching principle of 'fair dealing' in the SCOP with a list of sample banned practices, so as to avoid retailers applying a technical interpretation to the clauses of the SCOP. The principle of fair dealing, included in [X] redraft of the SCOP, was based on the Unfair Commercial Practices Directive, the Committee of Advertising Practice Code, and the Department of Business, Enterprise and Regulatory Reform's draft Business Protection from Misleading Marketing Regulations (BPRs). The principle of 'fair and lawful dealing' was proposed in the following terms:

A Supermarket will at all times deal with its Suppliers fairly and lawfully. Fair and lawful dealing shall be understood as requiring Supermarkets to conduct their trading relationships with Suppliers, without distinction between ongoing or once-off dealings or between formal or informal

arrangements, in good faith, without duress and in recognition of the Suppliers' need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues.

63. [X] also annexed a list of practices to the SCOP and these were divided into those which are always to be considered unfair (not supplying terms of business, payment terms of greater than 30 days, [X], and retrospective adjustments), and those terms which are unfair unless expressly and unambiguously agreed in advance (changes having the effect of retrospective adjustments, unexpectedly reducing returns for suppliers, transferring sales volume risk, creating uncertainty through making a request retrospectively for buyer visits etc, influencing product availability at competing outlets, lump sum payments, some category management practices, practices that may lead to coordination, [X]).
64. [X] redrafted SCOP would be a significant change from the current code, and includes clauses that relate to issues we have not found to be a feature of the reference market. However, we note that the technique of listing practices that are always considered in violation of the SCOP may be useful when revising the SCOP to address retrospective practices listed at paragraph 73.

Changes to the existing SCOP: our assessment

65. The focus of our discussion of supply chain practices in our provisional findings, and the 'feature' that we have identified in our provisional AEC finding, concerns retailers' conduct which transfers excessive risks and unexpected costs to suppliers, including the use of retrospective payments and other adjustments to supply agreements. We do not intend that our remedial action should extend beyond that which is generally necessary to address the feature that we have identified. We note that many of the supply chain practices that Friends of the Earth and Tesco have identified,

summarized in paragraph 61, are retrospective in nature and likely to be caught by the terms of the GSCOP that we have proposed below.

66. In our provisional findings, we found that while the SCOP is effective at regulating some retailer supply practices, the transfer of excessive risks and unexpected costs continued, partly because of uncertainty regarding the ‘reasonableness’ standard employed in many clauses of the SCOP. However, the SCOP is clearly having some effect on the conduct of the four retailers that are subject to it—at paragraph 21 above, we note that suppliers report a greater proportion of adverse supply chain practices being carried out by retailers that are not currently covered by the SCOP.
67. On this basis, we have provisionally decided to retain a number of the provisions of the SCOP as they are currently drafted, with certain consequential amendments (discussed below) which result from the inclusion of an outright prohibition on retrospective changes to agreements. We note that during our round-table discussion with suppliers, and in a number of other submissions that we received, some suppliers preferred that regulation affecting their ability to negotiate agreements with retailers was reduced. This supports a position that it might be reasonable in some circumstances for a retailer to make a ‘request’ of a supplier to enable a negotiation to occur between the parties.

Prohibition on retrospective changes to terms of supply: our assessment

68. Submissions and hearings with various parties have emphasized to us that there is a spectrum of views as to what a retrospective amendment to terms of supply might entail. There are two areas in which interpretations seem to differ:
- (a) the point in time beyond which changes become ‘retrospective’; and
 - (b) the extent to which adjustments that are agreed up-front and have retroactive effect can be described as ‘retrospective’.

69. In our view, where a retailer and a supplier have concluded an agreement for the supply of goods, then any subsequent renegotiation of the contractual terms governing the provision of those particular goods is generally not appropriate. This is even the case where the renegotiation occurs prior to delivery of the goods and acceptance of them by the retailer, since it is reasonable to expect that a supplier will have taken irrevocable steps in reliance upon the contract.
70. However, where a contract sets out expressly and unambiguously in advance the basis on which retroactive adjustments to the terms of supply can occur, then a resulting adjustment would not be considered retrospective because, in that instance, risk has been agreed and apportioned between the parties prior to the transaction. For example, if an erroneous sales forecast by the retailer results in a significant overstock of a product, it would not be appropriate for the retailer to then request or require that the supplier share the costs of a promotion to increase demand. However, if the contract had specified that in the event of a forecasting error, the supplier would bear a pre-specified price reduction, then the contract would have allocated the risk prior to the transaction taking place. An example of an existing clause in the SCOP which stipulates prior agreement as to allocation of risk is clause 7, which regulates payments for wastage.
71. A term of an agreement between a retailer and a supplier which permitted the retailer to request or require an unspecified retroactive allocation of risks and costs in a wide range of circumstances would still be regarded as retrospective, and therefore invalid. In order to be valid, such a clause would need to be sufficiently specific as to the circumstances in which it would be triggered and the allocation of risks and costs that would apply, so that it is clear that both the retailer and the supplier have had the opportunity to consider the apportionment of risk and cost before entering into the contract.

72. We consider that it ought to be feasible for retailers and suppliers to reach agreement up-front in relation to the allocation of risk, and that an outright prohibition of retrospective adjustments to trading terms will not unduly limit parties' freedom to introduce flexibility into their contracts. Our only stipulation is that the bounds of that flexibility are set at the time that the contract is entered into.

Consequential amendments to other clauses of the SCOP: our assessment

73. Those supply chain practices that have the potential to create increased uncertainty for suppliers through the transfer of risks or unexpected costs from grocery retailers to suppliers were discussed at length in Appendix 8.10 of our provisional findings.

The 26 practices that were identified were categorized as follows:

- retrospective price or other adjustments to previously agreed terms (ID 11, 13, 27, 44, 46, 48 and 49);
- practices with an implied retrospective element to previously agreed terms (ID 14, 24, 25, 47, 50, and 51);
- practices that can unexpectedly reduce returns to suppliers (ID 12, 16, 20, 22 and 43);
- retrospective practices that transfer sales volume risk to suppliers (ID 17, 21, 38);
and
- practices that are only of concern if applied retrospectively to previously agreed arrangements (ID 10, 19, 23, 45 and 52).

74. We have provisionally decided to revise those clauses of the SCOP that relate to the practices identified above in order to prohibit those aspects of the practices that are retrospective (or, in some instances, the practice itself). We have concluded that by revising the clauses that relate to retrospective practices, we will address the feature of the markets that we identified in our provisional findings as giving rise to an AEC.

75. This provisional remedies decision does not include text for the GSCOP, since we consider that the actual text of the order or undertakings is a matter to be settled in discussion with parties after publication of our final report. However, the list below provides an indication as to the amendments that we consider are necessary or desirable as a result of our inclusion of an outright prohibition of retrospective amendments to supply agreements in the GSCOP, and the AEC finding:
- (a) Clause 1 will be replaced by the automatic provision of trading terms (including a copy of the GSCOP), as outlined in paragraph 92 below;
 - (b) Clause 2 will remain unchanged, apart from a clarification that changes to terms of business cannot apply retrospectively;
 - (c) Clause 3 will include a clarification that payment by the retailer must be made in accordance with a pre-agreed term;
 - (d) Clause 4 will be superseded by an outright prohibition on retrospective changes to contracts;
 - (e) Clause 5 will include a clarification that any contributions to marketing costs must be agreed up-front;
 - (f) Clause 6 will be superseded by an outright prohibition on retrospective changes to contracts;
 - (g) Clauses 7 and 8 clarification in clause 8 that the factors (if any) which would be likely to amount to negligence or default by the supplier must be set out in the terms of the supply agreement. An additional clause will provide an outright prohibition on suppliers being held liable for shrinkage;
 - (h) Clauses 9 and 10 will remain unchanged;
 - (i) Clauses 11 and 14 will be merged, and will include a clarification that retailers cannot require or request suppliers to participate in promotions retrospectively;
 - (j) Clauses 12 and 13 will remain unchanged, although clauses 17 and 18 will be expressly applied to orders for promotions;
 - (k) Clause 15 will remain unchanged;

- (l) Clause 16 will be superseded by an outright prohibition on retrospective changes to contracts;
- (m) Clauses 17 and 18 will remain unchanged;
- (n) Clause 19 will include a stipulation that the retailer must provide the supplier with adequate evidence of the fact that the consumer complaint is justifiable and attributable to a failing on the part of the supplier;
- (o) Clause 20 will remain unchanged;
- (p) Clause 21 will include a stipulation that the average figure for complaint payments cannot be greater than the expected marginal costs to the retailer of dealing with those complaints;
- (q) Clauses 22 and 23 will remain unchanged;
- (r) Clause 24 will mandate the frequency of GSCOP training; and
- (s) Clauses 26 to 30 will be superseded by new dispute resolution processes involving an independent dispute resolution body.

76. Given the benefits in terms of commercial flexibility that stem from the retailers' ability to 'request' certain things from suppliers, we have provisionally decided to retain in the GSCOP the existing the references to 'require'. However, the existing definition in clause 32 of the SCOP of 'Unreasonably Require' will be applied to all instances of 'require', and the burden of proof will be placed on the retailer concerned to demonstrate that the ordinary commercial pressures are 'objectively justifiable, transparent and result in similar cases being treated alike'.

Fair dealing: our assessment

77. In the SCOP undertakings accepted by the Secretary of State for Trade and Industry and applicable to Tesco, Sainsbury's, Asda and Morrisons, the retailers have undertaken to 'operate under this code in good faith' (Recital (f)). We have provisionally decided that the 'overarching principle' proposed by the BBG at

paragraph 62 should be incorporated into the GSCOP. This would add to the effectiveness of the dispute resolution function, by giving the arbitrator a general standard by which to judge retailers' conduct.

Penalties and compensation

78. Under the existing SCOP, the main sanction for breach arises through section 167(4) EA, under which a supplier suffering loss or damage as a result of a breach of the SCOP can bring proceedings against the retailer for breach of statutory duty (note that the SCOP, being undertakings accepted under the *Fair Trading Act 1973*, are enforceable under section 167(4) pursuant to paragraph 15 of Schedule 24 EA). However, it should be noted that, in addition, the present SCOP does create limited provision for retailers to pay compensation to suppliers (eg for changes to supply chain procedures or specifications without reasonable notice, or erroneous forecasts—see SCOP clauses 15 to 17).
79. We consider that a power to impose monetary penalties on retailers in respect of breaches of the SCOP would be of significant assistance in securing their compliance, and we would implement such a scheme if this option were available to us. However, under the present structure of the EA, the CC is unable either to impose penalties for breaches of orders or undertakings or to confer such a power on another body. Therefore, our intention is to incorporate in the GSCOP the existing provisions in the SCOP for the payment of compensation by retailers, possibly supplemented by a formula for calculating the amount of compensation (if a suitable formula can be devised) or a stipulation as to liquidated damages.

New internal processes

80. In addition to the substantive changes to the SCOP outlined above, there are some positive practices that are currently undertaken by certain retailers that we consider

could, if adopted by all grocery retailers subject to the GSCOP, assist in addressing the uncertainty which suppliers have cited as a reason for their lack of confidence in relying on the SCOP.

81. Tesco suggested that, if we identified a concern, requirements could be imposed on retailers to inform suppliers of their rights and to appoint an in-house code compliance officer, independent of the commercial teams, together with implementation of a faster dispute resolution process.
82. With a view to extending the procedural best practice of which we have become aware during the course of our inquiry, we have provisionally decided that the SCOP should be amended to create obligations on retailers for:
- Appointment of an in-house code compliance officer.
 - Improved record keeping with respect to supply agreements.
 - Automatic provision to suppliers of contractual terms, rights to complain and details of the dispute resolution procedure.

We discuss each of these aspects in turn below.

In-house code compliance officer

83. We are aware that some retailers have an existing internal dispute resolution process, and an escalation process, whereby suppliers' complaints progress to higher levels of management within the commercial buying team and, ultimately, to a board director. Tesco has created a position of SCOP compliance officer, to provide an alternative avenue within the organization for suppliers to raise concerns on a 'confidential' basis and ensure adherence to the SCOP by the retailer. Other organizations such as Waitrose operate an 'open door' policy to their chief executive as an additional and secondary avenue of dispute resolution.

84. The grocery retailers that we propose should be covered by the GSCOP all have buying teams comprising a large number of individuals (in the case of the largest retailers, several hundred). Even in retailers with exemplary compliance histories, and extensive internal training on the GSCOP, there will remain the possibility that a small number of buyers engage in behaviour from time to time that constitutes a breach of the GSCOP. We see the appointment of an in-house GSCOP compliance officer as a means by which retailers may be able to detect such breaches internally.
85. The role of the in-house compliance officer should include acting as a point of contact for any authority making inquiries on GSCOP-related matters. Some organizations may also utilize the independence of the role to obtain regular feedback from suppliers and make recommendations to the executive board on managing supplier relationships. We anticipate that some retailers (in addition to Tesco) will already have an employee performing a similar role.
86. In order to enhance the effectiveness of the in-house code compliance officer, we have also provisionally decided that this officer must have a direct 'reporting line' to the chair of the audit committee of the retailer's board of directors (or, for any retailer covered by the GSCOP which does not have an audit committee, a non-executive director holding a similar position). In addition, the GSCOP will require that the officer must not fall within the commercial buying team, and must not have a reporting line to the management of the commercial buying team or anyone within that team.
87. We anticipate that a report by the in-house code compliance officer would be included in the retailer's annual report. This is consistent with a general trend, on the part of larger companies in particular, to include statements in annual reports on corporate responsibility, including supply chain relationships. We note that some UK grocery retailers already include such an item in their annual reports.

Record keeping

88. We recognize that, currently, not all agreements with suppliers are recorded in writing, and that in many instances, especially in the category of fresh produce, key terms of agreements are agreed verbally. There is a need for retailers to keep sufficient written records to enable proof of compliance with the provisions of the GSCOP, and to facilitate independent arbitration of disputes. The GSCOP will include a requirement that the terms of supply between retailers and suppliers are recorded in writing. Where key supply terms are agreed verbally, it will be acceptable for a retailer to confirm oral agreements on price and quantity in an email, fax or letter to the supplier, or to list the details of those agreements on a restricted access web page available to the supplier.

Automatic provision of documentation

89. We note that clause one of the existing SCOP requires that the general and particular terms of business offered by a retailer be available in writing at the request of a supplier.
90. Tesco suggested to us that the standard terms and conditions of the retailer should be provided in writing to every supplier and not just made available on request. In addition, Tesco suggested that within the standard terms and conditions, or in a separate document, the supplier should be:
- informed of their ability to escalate any buyer's decision to a more senior person in the commercial team for further consideration;
 - informed of the in-house code compliance officer and the confidential complaint mechanism;
 - encouraged to provide the in-house code compliance officer with feedback on the relationship with the commercial teams at the retailer;
 - informed of the procedure and timeframes for delisting;

- informed that suppliers cannot be delisted for complaining, can refuse a request, and of their right to have an interview with the in-house code compliance officer about a delisting decision.
91. Tesco also noted that suppliers had cited to the CC a fear of being delisted for complaining. Tesco did not believe that this fear was justified. However, to help address this perception, Tesco proposed that retailers should be required to inform suppliers that they will not be delisted without receiving:¹⁹
- reasonable notice in writing;
 - a letter at the same time as the notice in writing is received, setting out the reasons for the why the retailer intends to delist the supplier;
 - an opportunity for an interview with the in-house code compliance officer; and
 - notice of their right to escalate a decision for delisting to a more senior person in the commercial team for further consideration.
92. It is our view that an obligation on retailers to provide the information set out in paragraphs 90 and 91, and the extra protection it may give to suppliers raising a dispute, will be useful and assist them to understand their rights in the event of a dispute. We have therefore provisionally decided that the GSCOP should include a requirement that retailers provide this information at the time of establishing an agreement with a supplier.

Institutional arrangements for monitoring and enforcing the GSCOP

93. We discussed in our provisional findings the evidence that had been presented to us regarding the inadequacy of the current arrangements for monitoring and enforcing the SCOP. We have been told by a number of grocery suppliers and suppliers' trade associations that the current enforcement mechanism for the SCOP is ineffective.

¹⁹Delisting in this context could include circumstances in which a supplier loses a significant amount of business.

Suppliers have explained that they are reluctant to use the dispute resolution process in the current SCOP (ie mediation by an independent mediator, appointed and paid by the retailer, with the possibility of a complaint to the OFT if the dispute cannot be resolved), due to concerns about the independence of the mediation process and the likelihood of being delisted by the retailers.

94. Moreover, suppliers have accused the OFT of failing to be proactive in investigating disputes. Several parties have suggested that an independent mediator, conciliator or arbitrator should be appointed to hear disputes under the SCOP. It has also been suggested that an independent body should audit retailers' compliance with the SCOP on a more regular and detailed basis than the OFT currently does (for example, by taking confidential complaints from suppliers, which could provide market intelligence but do not necessarily result in disputes).
95. We have set out below (see paragraphs 117 and 127) our provisional decision regarding various aspects of the monitoring and enforcement of the GSCOP.

The role of the OFT, and a possible ombudsman

Views of parties

96. A number of submissions (ACS, 19 third parties including suppliers, supplier organizations, NGOs and primary producer organizations, and five consumers) have questioned whether the OFT is the best authority to supervise and enforce retailers' compliance with the SCOP, and, in addition, whether the monitoring authority should have a proactive role of reviewing retailer practices more generally. In contrast, most of the major retailers submitted that the OFT is the best-placed authority to carry out monitoring of the SCOP.

97. The OFT recognized that a dedicated body with industry expertise, which would build working relationships with supplier trade associations and retailers and monitor compliance and promote best practice, would have advantages. It suggested that this entity could also raise the profile of the SCOP and encourage best practice and monitor compliance. The OFT expressed reservations about the effectiveness of a remedy involving the creation of an ombudsman who would arbitrate on individual allegations of breaches of the GSCOP. It was concerned that the creation of an ombudsman would not fully address suppliers' fears of raising complaints, since dispute resolution would still require complainants to be identified.
98. In a large number of submissions, 'a climate of fear' among suppliers has been cited as a reason for suppliers failing to pursue disputes under the terms of the SCOP. Conversely, it has been suggested to us by the retailers currently covered by the SCOP that the lack of disputes is due to the effectiveness of the SCOP and their comprehensive dispute resolution procedures. We note that submissions from the Country Land and Business Association and ActionAid provided a detailed outline of the potential role of an independent ombudsman or adjudicator in the UK grocery sector in assisting to address the issue of the 'climate of fear'.²⁰ The prime function of the ombudsman/adjudicator proposed by CLA and ActionAid would be to monitor relationships between retailers and their suppliers. It could investigate complaints on an anonymous basis and arbitrate disputes, with the ability to impose a fine on parties where necessary. These submissions also suggested that:
- the proposed ombudsman/adjudicator should be independent with its own office and staff, and should have the power to initiate investigations;
 - operating costs should be funded by the industry;
 - protocols and rules should be developed and imposed;

²⁰We note that these parties are two members of 'The Cross Cutting Group' set up by Andrew George MP. This group has developed proposals based on agreement amongst a number of organizations.

- the proposed ombudsman/adjudicator should have a duty to promote best practice and fair dealing;
- the proposed ombudsman/adjudicator should arbitrate disputes and impose remedies;
- the proposed ombudsman/adjudicator should proactively monitor the grocery market and access information from retailers;
- the proposed ombudsman/adjudicator should publish its findings annually;
- the proposed ombudsman/adjudicator could refer serious cases to the OFT.

99. The BBG and ActionAid suggested to us in their submissions that the ITV Contract Rights Renewal (CRR) adjudication scheme could provide a useful model when considering how to secure the monitoring and enforcement of the SCOP. Further details regarding the CRR Scheme are provided in paragraphs 104 and 121 and Annex 1.

Our assessment

100. Monitoring and enforcing the SCOP will involve two principal functions being undertaken:

- (a) arbitration of disputes between retailers and suppliers arising under the GSCOP; and
- (b) gathering information (for example, by receiving confidential complaints from suppliers and primary producers regarding breaches of the GSCOP) and proactively investigating retailers' records in areas subject to complaint, in order to identify whether breaches of the GSCOP have occurred.

101. We have considered various models that might adequately identify and resolve widespread supply chain practices, including retaining the function within the OFT. It would appear that both retailers and suppliers support the conferral of monitoring and

enforcement powers on an independent and specialist body. Many submissions supported the continued involvement of the OFT in this role, although some were concerned that the OFT would require additional and specialist resources to effect a change in retailer practices.

102. We have assessed in detail two options in relation to the institutional arrangements for monitoring and enforcement of the GSCOP: a groceries supply code ombudsman, or a combination of dispute resolution by an independent arbitrator and monitoring overseen by the OFT. Our assessment of each of these options is set out below.

(a) Groceries supply code ombudsman

103. We agree with the submission of the OFT that a dedicated body with industry expertise, which could build working relationships with supplier trade associations and retailers, would be advantageous. Our strong preference is therefore for the establishment of a new groceries supply code ombudsman, the details of which are set out below. Given the importance of involving stakeholders in the process of establishing an ombudsman scheme, we propose to seek undertakings pursuant to section 159 EA from all retailers that we have provisionally decided should be covered by the GSCOP (listed in paragraph 29).
104. The ombudsman would be modelled on the Office of the CRR Adjudicator. The ombudsman would be appointed by the OFT. The OFT would set the ombudsman's annual budget (with a contingency), and would pay the ombudsman's salary and expenses. These sums would then be recouped from the grocery retailers covered by the GSCOP, according to a predetermined formula. In accordance with the CRR model, the ombudsman would be independent from the OFT, as well as all parties to any dispute on which he is asked to arbitrate.

105. The ombudsman would have an overriding objective of enforcing the GSCOP, with the aim of preventing the transfer of excessive risks and unexpected costs from retailers to suppliers, thereby promoting the long-run interests of consumers. The ombudsman would report to the OFT on a regular basis regarding the nature of the complaints that it has investigated, and this report would be published on the ombudsman's website.

106. The OFT will retain an overall supervisory role in relation to retailers' compliance with the SCOP, and so it is possible that certain obligations will also need to be imposed on retailers to provide information to the OFT (or to allow the ombudsman to pass such information directly to the OFT).

(a) An independent arbitrator, together with monitoring by the OFT

107. In the absence of such an ombudsman being established, the resolution of disputes under the GSCOP would be performed by an independent arbitrator, nominated by an external body with expertise in alternative dispute resolution, such as the CEDR.

108. Monitoring of retailers' compliance with the GSCOP would be performed by the OFT; we would recommend to the OFT that its monitoring activities should be modelled on those proposed for the groceries supply code ombudsman. This may require the OFT to allocate more of its resources to SCOP issues than it currently devotes. We acknowledge also that consideration will need to be given as to whether OFT' budget will need to be increased in respect of these functions.

109. In addition, those retailers covered by the GSCOP will be required to have their compliance with the GSCOP certified by an independent audit, conducted periodically, with the audit report delivered to the OFT.

Dispute resolution

110. The SCOP currently provides that a retailer must offer the services of a mediator (at its own expense) after 90 days of the dispute arising. However, the existing dispute resolution procedures under the SCOP are rarely invoked. More effective dispute resolution is a vital part of ensuring that the SCOP operates more effectively.
111. The SCOP currently allows the retailers to choose mediators and this arguably delays the development of a consolidated experience in dealing with retailer/supplier complaints. Moreover, a mediator appointed by the retailer may not be seen by a supplier as entirely independent. In addition, if the same organization was used for all dispute resolution under the SCOP, it would allow expertise to grow and possibly assist to bring a degree of consistency to agreements resulting from dispute resolution.
112. We have considered whether there are aspects of the Australian Produce and Grocery Industry Code of Conduct ('PGI Code') that may be worth incorporating in our GSCOP. Under the PGI Code, dispute resolution is coordinated by an independent ombudsman, who selects a mediator from a panel of approximately 40, all of whom are required to have a degree of industry knowledge. A single point for dispute resolution would be beneficial for these reasons and will also assist to identify any practices that that might be common or recurring.
113. We have also considered the nature of the dispute resolution that should be conducted under the GSCOP. Currently, the SCOP provides for mediation, rather than arbitration.²¹ However, we consider that arbitration will be more effective in resolving disputes where there is a significant imbalance of power between the parties to the dispute, which is often the case in a dispute involving a retailer and a

²¹We note that arbitration generally implies that an authority will make a decision for two disputing parties. This can be contrasted to mediation in which a third party assists the two disputing parties to come to a mutual resolution.

supplier. Accordingly, we have reached the view that the enforcement of the GSCOP will be more effective if it provides for arbitration of disputes, rather than merely mediation.

114. Sainsbury's and Tesco both suggested to us that a shorter timeframe for the dispute resolution procedure under the GSCOP would make it more useful for suppliers, as they generally want quick decisions to reduce uncertainty associated with a dispute. We consider that a shorter period would improve suppliers' confidence in the effectiveness of the process. We propose that a dispute could be given to an arbitrator as early as 21 days after the dispute was notified to the retailer pursuant to its internal dispute resolution processes. The internal process of the retailer might operate via either the traditional channel within the buying function of the retailer or using the in-house code compliance officer described in paragraphs 83 and 84. We have provisionally decided that this revised timeframe for dispute resolution will be adopted into the SCOP as it will assist in increasing certainty.
115. If a groceries supply code ombudsman can be established, the ombudsman will act as arbitrator in disputes between retailers and their suppliers and publish guidance on what are reasonable interpretations of the SCOP for the benefit of retailers and their suppliers.
116. If an ombudsman cannot be established, then disputes between retailers and suppliers under the GSCOP will be heard by an independent arbitrator nominated by an external body with expertise in alternative dispute resolution, such as the CEDR (discussed in paragraph 107 above). There will be a presumption that the cost of this arbitration will be borne by the retailer concerned (although the arbitrator will be able to reverse this presumption if he or she considers that the supplier's claim is vexatious or totally without merit).

117. In summary, we have provisionally decided that suppliers will be permitted to refer disputes under the GSCOP to independent arbitration as early as 21 days after the dispute was notified to the retailer pursuant to its internal dispute resolution processes. The arbitration will be conducted either by the new groceries supply code ombudsman or, if an ombudsman cannot be established, by an independent arbitrator.

Information-gathering and investigation of complaints

118. As well as undertaking dispute resolution, we propose that the ombudsman (if established) will also have the power to receive and, where appropriate, investigate complaints. We consider that there is an important distinction between these functions. Where a dispute is notified to the ombudsman, due process will require that a retailer has the opportunity to answer and address any particular allegations. Disputes will also proceed to arbitration only after the internal resolution process, noted in paragraph 110, has been exhausted. By contrast, we envisage that complaints could be received by the ombudsman on a confidential basis, as a form of information-gathering. We do not propose that a single complaint should result in any action other than it being collected and verified. Verification might involve meeting with the complainant to understand the scope of the complaint. Should a number of complaints be received, it is expected that a pattern of activity might be evident and an investigation into the conduct of a retailer or a number of retailers might be justified. The purpose of the investigation would be to understand the pattern of behaviour, not the individual complaints. On this basis, we do not consider that there would be any need to disclose the complainants that originated the investigation and they would be kept confidential from the retailer. By investigating areas of recurring complaints, the ombudsman would help build confidence in the operation of the groceries supply chain.

119. We have also provisionally decided that primary producers and other suppliers to intermediaries and processors should be given the right to complain to the ombudsman about the conduct of grocery retailers with respect to their suppliers.
120. In order to carry out investigations, the ombudsman would require information-gathering powers. The CRR Scheme provides a model—there, ITV has consented to Ofcom providing the Adjudicator with documents and information received by Ofcom from ITV which are relevant to the operation of the CRR Adjudication Scheme and CRR Adjudication Rules, and ITV has in turn also undertaken to provide to Ofcom or the OFT such documents and/or information as they may from time to time require for the purposes of ascertaining whether ITV has complied with the relevant undertakings. In addition, ITV and the Adjudicator have entered into a memorandum of understanding, under which ITV agrees to provide documents that the Adjudicator requests for the purpose of ascertaining whether ITV has complied with the relevant undertakings. Clearly, the record-keeping obligations discussed in paragraph 88 will assist the ombudsman in carrying out this function.
121. In the course of undertaking investigations, the ombudsman might also identify areas that may need inclusion within the GSCOP (should guidance on an issue not be appropriate). It is expected that where this occurs, a recommendation will be made to the OFT regarding the possibility of seeking amendments to the GSCOP. Otherwise, the ombudsman will be limited to arbitrating and investigating matters covered by the GSCOP.
122. Trends in a retailer's behaviour or behaviour in categories of groceries across a number of retailers might be observed from a number of sources. We propose that once adverse and recurring behaviour is observed, this behaviour should be

investigated to determine if it needs to be addressed. We anticipate that evidence might be obtained from:

- complaints from suppliers;
- recurring disputes involving a retailer;
- recurring complaints from retailers about another retailer's behaviour; and
- publicity surrounding a particular practice.

123. We have considered the relevant experience of other competition authorities. The German competition authority, the Bundeskartellamt, obtained an amendment to the German competition law (the GWB) to enable protection of the identity of complainants, at least initially, so that individual complaints could be investigated 'anonymously'. The view of the Bundeskartellamt was that this measure had not been particularly effective in encouraging individual complainants to come forward but that were it to receive a number of complaints, indicating that the particular practice was widespread, it may be easier for it to investigate the practice without the names of individual complainants being revealed.

124. In regard to any investigation initiated from a number of complaints, anonymity would be a critical issue and it would be essential to ensure that individual complainants are not able to be identified during the course of an investigation or published reports. It is envisaged that the scope and timing of an investigation would be carefully selected to ensure that the identity of a particular supplier was not inadvertently disclosed.

125. In the absence of such an ombudsman being established, the role of monitoring compliance with the GSCOP will continue to rest with the OFT. We will recommend to the OFT that its monitoring of retailers' compliance with the GSCOP should be extended, so that it undertakes functions similar to those sought for the ombudsman:

- (a) gathering information (for example, by receiving confidential complaints from suppliers and primary producers regarding breaches of the GSCOP) and proactively investigating retailers' records in areas subject to complaint, in order to identify whether breaches of the GSCOP have occurred;
- (b) publishing guidance on specific provisions of the GSCOP where it considers that differences in interpretation exist; and
- (c) reporting annually to the public on operation of the GSCOP.

126. In summary, then, we have provisionally decided that the groceries supply code ombudsman would monitor retailers' compliance with the GSCOP by collecting and verifying confidential complaints from suppliers and primary producers. If it considered that amendments to the GSCOP are required, it could make appropriate recommendations to the OFT. If a groceries supply code ombudsman is not established, then we will recommend to the OFT that its monitoring of retailers' compliance with the GSCOP should be extended, so that it undertakes functions similar to those sought for the ombudsman.

Additional remedies proposed in consultation

127. Our Remedies Notice included a proposal to change the SCOP such that only certain suppliers were covered by it. This proposal was based on our finding in our provisional findings that, in some circumstances, 'the buyer power of even the largest grocery retailers may be offset by the market power of their suppliers, particularly the market power of suppliers of the most prominent branded goods' (paragraph 8.19 of our provisional findings). We received submissions from Sainsbury's and M&S on this issue; both retailers stated that it would be very difficult to establish appropriate inclusion and exclusion criteria and that such a distinction would not encourage consistent standards of fair dealing across all suppliers. In the round-table discussion, the largest suppliers generally considered that, although they were

unlikely to ever rely on the SCOP, it was beneficial to have the security of the existence of the SCOP. It was also noted in that discussion that even the largest suppliers have small brands that might benefit from the provisions in the SCOP. Given the difficulty of drawing an appropriate threshold and the potential application of the SCOP to all suppliers, we do not intend to restrict the coverage of the SCOP with respect to suppliers.

128. Our Remedies Notice also proposed the implementation of a framework for publishing and improving best practice in the industry. However, we are concerned that such a scheme could inadvertently encourage a degree of anti-competitive information exchange between retailers. In addition, we note that a healthy and well-publicized supply chain is increasingly becoming a competitive advantage for some retailers. We note that a number of industry organizations already publish various aspects of retailer best practice that are widely available.
129. We also considered the possibility of prohibiting supplier delisting for certain periods of time after a supplier had made a complaint under the GSCOP—this was suggested by the British Retail Consortium as a means of encouraging suppliers to raise their concerns with retailers and, to some extent, addressing the ‘climate of fear’ that we have noted. However, we were concerned that this would result in sub-optimal outcomes, by distorting suppliers’ incentives to raise disputes.
130. We note that the BBG suggested that the terms of the SCOP be extended to certain retailer actions in regard to its own-label products such as copycat packaging and misleading on-pack claims. However, these were not provisionally found to be features of the reference market/s and so are not within the ambit of this remedy.

131. The ACS submitted that the SCOP should be extended to cover selling activity by retailers which may distort competition. However, these were not provisionally found to be features of the reference market/s and so are not within the ambit of this remedy.

Assessment of possible remedies in relation to supply chain practices

132. We note our statutory obligation to have regard to the need to achieve as comprehensive a solution to the AEC, and any resulting detrimental effect on customers, as is reasonable and practicable.

133. In our view, each element of this remedy is needed to effectively address the exercise of buyer power through supply chain practices which we have identified as preventing, restricting or distorting competition in the market, thus resulting in an AEC. Specifically, our concern that supply chain practices carried out by grocery retailers that transfer risks and increase costs to suppliers, including retrospective payments and other unexpected changes to supply agreements reduce suppliers' incentives to invest in new and improved products. We consider that the individual elements of this remedy will achieve this objective. Overall, we consider that our chosen remedies in relation to the supply chain together constitute as comprehensive a remedy to the AEC we have provisionally found in relation to the supply chain as is reasonable and practicable.

134. By targeting retrospective transfer of risk and cost, we expect that suppliers will have a better environment in which to invest and innovate. We expect that this will at least maintain current levels of innovation and, in turn, preserve or improve the range of grocery products available to consumers through the grocery retailers.

Relevant consumer benefits

135. Notwithstanding the consumer detriment we expect will result if the supply chain practices we have identified as having an adverse effect on competition are left unchecked, we accept that it is possible that those practices have resulted in lower prices for consumers, at least in the short-term. This could be considered a relevant customer benefit and we have considered whether our chosen supply chain remedies might jeopardize this benefit.
136. It might be argued that restricting the ability of retailers to adjust prices retrospectively for unforeseen events that occur after delivery of goods may increase costs that, in turn, might be passed on to consumers. However, we consider that this is an unlikely result given that the groceries supply chain is extremely sophisticated and capable of allocating risk prospectively and through the agreement of both parties. We anticipate that retailers and suppliers might consider including a formula in their specific terms of agreement that sets out the allocation of risks between retailer and supplier.
137. In any event, on balance, we have judged that the proposed remedy to the AEC that has been identified outweighs these incidental negative effects on consumers. Having had regard to these possible relevant customer benefits, we have therefore provisionally decided not to modify our chosen remedy.

The Contract Rights Renewal Scheme

1. In March 2003, the merger of Carlton Communications plc (Carlton) and Granada plc (Granada) was referred to the CC. The CC made an adverse finding and recommended that advertisers and media agencies should have the right to retain the contractual arrangements that they had enjoyed prior to the merger. This remedy was known as Contract Rights Renewal (CRR). Given the level of contractual complexity in the airtime sales market, it was decided that an additional entity should be established which could specialize in adjudicating on contractual disputes between the merged entity, ITV plc (ITV), and advertisers/media buyers.
2. The undertakings offered by Carlton and Granada, and accepted by the Secretary of State, created the Office of the Adjudicator²² which is responsible for monitoring compliance on behalf of the OFT and Ofcom. The Adjudicator's main functions are:
 - to deal with complaints arising from incremental changes from the basic contract, and to ensure that changes in price are fair;
 - to deal with any disputes arising from advertisers switching media buyers and to ensure that ITV's conduct is reasonable; and
 - to resolve general disputes in relation to contract enforcement and interpretation.
3. The Office of the Adjudicator (CRR) is a limited company with one issued share, owned by Ofcom. The Office is staffed by an Adjudicator (appointed by Ofcom) and a Deputy (appointed by the Adjudicator), both of whom have significant industry knowledge.²³ There is a full-time administrator, completing the team structure. Under

²²See <http://www.adjudicator-crr.org.uk/>.

²³Legal advice is provided to the Adjudicator on a consultancy basis. The Office has access to the standard industry data sources: BARB, Donovan Data Systems and Nielsen Media Research. The Office has also signed a Memorandum of Understanding with ITV for the provision to the Office of information and documents that do not relate to specific disputes. These include copies of all sales contracts and reports on ITV's trading balance by region.

the CRR Scheme, the Adjudicator is able to make swift decisions which are binding on ITV. Contracts with ITV will contain a clause to the effect that, in the event of a dispute which the parties are unable to resolve themselves, both parties agree that it would be sent to the Adjudicator at the buyer's request and that both parties agree to be bound by the Adjudicator Rules and Scheme. The decision of the Adjudicator is binding on ITV, but not the buyer, as buyers have a right of appeal from the Adjudicator to Ofcom. The Office is paid for by Ofcom, which is reimbursed by ITV.

4. Buyers have the ability to raise issues anonymously with the Adjudicator, or to seek general guidance, at any time. If a formal complaint is raised in relation to a specific contract, an official dispute is triggered, and the Adjudicator receives evidence from both the buyer and ITV, according to a set timetable.
5. Ofcom's guidance states that the Adjudicator is to be proactive in the market. If issues become apparent or anomalous contractual terms are agreed, it is within the remit of the Adjudicator to bring such issues to the attention of Ofcom and the OFT. In addition, the Adjudicator is expected to have very close ties with industry associations, such as ISBA and the IPA and other broadcasters. All of these organizations can raise issues about the operation of the CRR with the Adjudicator informally. In its periodic reports, the Adjudicator includes statements from the ISBA and the IPA on the functioning of the CRR scheme.
6. Specifically on retribution, the CRR technical guidance says 'Ofcom would consider any form of threatening behaviour...on the part of (ITV) as a possible indication of inappropriate exercise of market power and would act accordingly'. It goes on to say that it is 'essential that you have confidence in taking issues to the Adjudicator without any fear that this will affect your relationship with (ITV)'. Finally it makes clear that complaints can be made to Ofcom in the strictest of confidence.

7. In determining disputes, the Adjudicator is guided by a general duty on ITV to offer commercial airtime on 'fair and reasonable' terms. The informal guidance that the Adjudicator publishes on its website in relation to buyers' rights, and the process that buyers can use if they do not consider that they are being treated in a fair and reasonable manner, assists parties within the market to apply the Adjudicator's expertise when contracts are being negotiated. In a similar way, a groceries supply code ombudsman could act as a repository of information and publish examples of reasonable and unreasonable practices where there is uncertainty on the part of retailers or suppliers.