

Kevin Brennan MP  
Minister of State  
Department for Business Innovation & Skills  
1 Victoria Street  
LONDON  
SW1H 0ET

From: Peter Freeman  
*Chairman*

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I enclose a formal Recommendation from the Competition Commission.

Since the publication of our report on the supply of groceries in the UK in April 2008, we have been working hard to implement the remedies we prescribed. On relations between retailers and their suppliers (a key aspect of the report), we have progressed well on enhancing the existing code of practice and are ready to make a new Order establishing a stronger code—the GSCOP or Grocery Supply Code of Practice.

An important feature of the GSCOP is the proposed Ombudsman. This is needed to decide disputes, investigate complaints and give overall credibility. Here we have reached impasse. The CC does not have the power to do this on its own. The major retailers have refused to offer suitable undertakings so we are recommending that your Department should set up the Ombudsman, and do so as quickly as practicable.

The papers attached to this letter explain what the CC is recommending and why we have reached this position. I should be pleased to answer any further queries you may have.

Peter Freeman  
*Chairman*  
[peter.freeman@cc.gsi.gov.uk](mailto:peter.freeman@cc.gsi.gov.uk)

## **Memorandum: the need for a Groceries Ombudsman**

### **1. Summary**

- 1.1 This memorandum explains why the CC, having consulted formally the supermarkets and others, recommends that the Department for Business, Innovation & Skills (BIS) acts to create an Ombudsman. In particular, it sets out why the creation of the Ombudsman is important for the effectiveness of the CC Order on the Groceries Supply Code of Practice (GSCOP). This governs certain supermarket practices that can adversely affect suppliers. The CC intends to make this Order shortly. More generally, this memorandum reviews the background to and the consultation on the Ombudsman, and its results.
- 1.2 There are three attachments:
- (a) the CC press release on the Ombudsman consultation;
  - (b) the draft undertakings seeking to create an Ombudsman; and
  - (c) a review of the responses we received to the formal consultation round of the draft undertakings.

### **2. The need for a Groceries Ombudsman**

#### ***The evidence***

- 2.1 The CC's final report *The supply of groceries in the UK market investigation* considered a range of evidence in respect of the groceries supply chain and retailer/supplier practices. This came mainly from suppliers and suppliers' associations, a survey of suppliers and a review of emails between the grocery retailers Asda and Tesco and their suppliers.
- 2.2 The CC analysed the evidence carefully and concluded that certain of the supply chain practices of grocery retailers would have an adverse impact on the willingness of suppliers to invest in new capacity, products and production processes and this would, if left unchecked, ultimately have a detrimental effect on consumers.
- 2.3 In particular, the CC found that the exercise of buyer power by certain grocery retailers in relation to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers, was 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 large grocery retailers and some wholesalers and buying groups (paragraph 10.11 of the final report). The CC's conclusions on retailer supply chain practices are set out in paragraphs 9.40 to 9.49 and 9.82 to 9.85 of the final report.

#### ***The need for a recommendation***

- 2.4 The CC decided that the application of the GSCOP was a necessary and proportionate remedy for the adverse effect on competition (AEC) that it had identified and that (with one member dissenting) the creation of an Ombudsman was the preferred way of ensuring the effectiveness of the GSCOP.
- 2.5 After careful consideration, the CC concluded that the Enterprise Act did not give it the power to create an Ombudsman by way of an Order. Accordingly the CC decided

that if retailers did not voluntarily undertake to create an Ombudsman, it should recommend to BIS (at the time of the final report, the Department for Business, Enterprise and Regulatory Reform) that BIS should take the necessary legislative steps to establish the Ombudsman. The CC noted that primary legislation could give the Ombudsman greater powers to monitor and enforce the GSCOP than would be possible via undertakings (or an Order), and so increase the effectiveness of the Ombudsman. For this reason, the CC recommends that BIS take the steps necessary to give the Ombudsman the power to impose fines on retailers for non-compliance with the GSCOP.

### ***Proportionality***

- 2.6 The CC evaluated the likely costs of creating the Ombudsman in the report. The CC accepted the OFT's view that the cost of monitoring the GSCOP and establishing the Ombudsman would be between £0.9 million and £2.4 million. In addition, retailers made submissions on the costs of complying with investigations instigated by the Ombudsman (which were based on costs incurred as a result of audits of the existing SCOP commissioned by the OFT). These retailer costs amounted to approximately £120,000 per year. The CC expected that Ombudsman investigations would be infrequent, perhaps one or two a year. The CC noted that these costs on retailers should be considered in the context of retail grocery turnover of around £110 billion.
- 2.7 The CC did not find it possible to quantify directly consumer benefits deriving from the continued survival and innovation by suppliers in the future, but a small loss in investment and innovation appeared likely to have a significant adverse effect on consumers. By way of context, there are around 7,000 suppliers in the UK. To the extent that the Ombudsman provides the benefits anticipated, the CC expects that many of these suppliers will gain greater certainty about their contractual payments, which in turn will lead to increased survival and greater investment in innovation. This should benefit consumers through lower prices, improved quality and a greater range of new and existing products or product design.
- 2.8 The CC considers that this positive effect on competition will best be protected by the creation of the Ombudsman and it would be a matter for concern if the process of creating the Ombudsman was subject to lengthy delay.

### ***Changes in the economic environment***

- 2.9 The CC recognizes that since the report was published there have been major economic changes in the retail trading environment. Several grocery retailers have suggested that these changes mean it is not a good time to create the Ombudsman. The CC disagrees. The need for the Ombudsman should be assessed in the current economic context, but the Ombudsman is a very important addition to the GSCOP which will help to make the groceries supply chain work more in the interests of consumers. In the prevailing economic conditions, a greater number of suppliers will be subject to the sort of pressure that the Ombudsman would be best placed to observe and, where necessary, act upon. In the CC's view, this suggests that there is an even greater need for the Ombudsman now than at the time the report was published.

## **3. The role of the Groceries Ombudsman**

- 3.1 The role of the Ombudsman will be closely linked to the GSCOP, since the GSCOP should not only be the subject of the Ombudsman's activity but also set out the limits of its activities. In this way there is a reduced risk that the Ombudsman could

inappropriately extend the scope of its activity. The attached draft undertakings present a tightly drawn role for the Ombudsman and these might be an appropriate start for the legislative drafting process. The CC believes that the Ombudsman would be the most appropriate body to act as the arbitrator for disputes arising from the GSCOP and clarify misinterpretations of the GSCOP. It will also be in the best position to identify widespread and harmful retailer practices and exercise appropriate powers to address these matters.

- 3.2 In the CC's view, the GSCOP will be much more effective with an Ombudsman in place. The GSCOP sets out a number of retailer practices which are prohibited or may be carried out only in a circumscribed way. The relationship between retailers and suppliers is complex and regularly renegotiated and it was not easy to achieve an appropriate balance between retailer and supplier interests in drawing up the Order. In this context the Ombudsman will enhance the effectiveness of the GSCOP, which will itself be subject to constant interpretation in numerous different situations.

### ***Relationship with OFT powers***

- 3.3 The Ombudsman will observe retailer supply chain practices. There is currently no government or consumer organization that has the resources and responsibility to review the practices to be regulated by the GSCOP in a proactive manner. A dedicated Ombudsman will develop knowledge and understanding of complex retailer/supplier relationships and provide guidance on the GSCOP and, where necessary, impose sanctions where breaches of the GSCOP have a negative effect on suppliers that may harm consumers.
- 3.4 Several retailers have suggested that an Ombudsman is not necessary as this role could be undertaken by the OFT. However, the CC, the OFT and a large number of supplier groups do not think that this is desirable. The OFT would in any case remain responsible for compliance with the GSCOP Order, but there is a clear need for a more focused and specific body to undertake the activities specified. The Ombudsman would, in turn, report to the OFT at a level appropriate for the OFT's statutory monitoring role of the GSCOP Order, and the Ombudsman would be structured to address specific concerns with appropriate recommendations. Undertaking the Ombudsman role would be a departure from the OFT's usual role of auditing compliance with the existing Supermarkets Code of Practice at a high level, with the assistance of specific industry expertise. The Ombudsman should provide industry expertise in a way that more directly addresses specific problems and the CC intends that the Ombudsman should have significant groceries industry experience.

### ***Further powers of the Groceries Ombudsman***

- 3.5 Under the attached draft undertakings, the Ombudsman's role would have been limited to acting as arbitrator of disputes and as investigator of specific practices of retailers. This reflects the outcome of the consultation regarding the minimum powers necessary for the Ombudsman to be effective. However, the Ombudsman would be more effective if it had more comprehensive powers to investigate and penalize retailers for non-compliance with the GSCOP. The CC therefore recommends that BIS consider providing the Ombudsman with powers additional to those in the current draft undertakings.

#### **4. The consultation**

- 4.1 The proposal to establish an Ombudsman has received strong support from a number of parties throughout the process and, as might be expected, it has also received opposition from many of the retailers whose activities would be within the remit of the Ombudsman.

#### ***The pursuit of undertakings***

- 4.2 The CC did not consider that it had the statutory power under the Enterprise Act to create an Ombudsman by way of an Order. It therefore sought to agree undertakings with the ten largest grocery retailers in the UK to allow the Ombudsman to investigate their activities (and recover its costs based on the results of those investigations). This process had an initial informal stage and a second, formal, stage.



#### ***Informal consultation***

- 4.3 The CC prepared an initial draft of the undertakings following the final report and referred it to the main parties to the Groceries investigation for comment. The CC then met each of these parties and made several substantive amendments suggested by retailers and suppliers to address their concerns. The CC considered each provision of the undertakings carefully, following the round of informal consultation, against the submissions made by various respondents.
- 4.4 The draft undertakings published earlier this year were therefore the result of careful deliberation, and several respondents recognized that many of the concerns raised had been addressed.

#### ***Formal consultation***

- 4.5 The CC issued the attached draft undertakings for formal consultation in April 2009. The majority of the retailers who responded continued to seek amendments to the undertakings that the CC considered would make the Ombudsman ineffective. In contrast, several supplier associations and not-for-profit associations submitted that the draft undertakings should impose greater obligations and sanctions on retailers than those proposed. The CC considered that the more intrusive the undertakings, the less chance of obtaining retailer agreement. The attached draft undertakings were the minimum necessary to address the AEC. Most of the retailers have nonetheless stated that they are not acceptable. A summary of the main points arising from the consultation, and the response to those points, is attached.

#### ***The view of retailers***

- 4.6 Retailers representing over two-thirds of grocery sales in the UK said that they would not enter undertakings substantially the same as those consulted on: [  ]. Other retailers (taking the total sales share of all the responding retailers to three-quarters of all grocery sales) said that they would only enter undertakings in the event that all the other retailers also agreed: [  ]. No response was received from the remaining retailer.

## ***Others' views***

- 4.7 A large number of stakeholders supported the concept of creating an Ombudsman: Action Aid, the Association of Convenience Stores, The British Brands Group, Dairy UK, the Farmers' Union of Wales, the Food and Drink Federation, Friends of the Earth, Grant Thornton, the National Farmers Union, Tradecraft and the Ulster Farmers' Union. In addition, support was given by Sir Don Curry (an adviser to Defra), Andrew George MP (Chairman of the Grocery Market Action Group) and Richard Lockhead MSP on behalf of the Scottish Government. The CC considers that the ongoing support received for the creation of an Ombudsman has been important to the process.

## **5. Formal recommendation**

- 5.1 The CC recommends that BIS take the steps necessary to establish an effective Ombudsman as soon as practicable. It is further recommended that the Ombudsman be given the power to levy significant monetary penalties on retailers for non-compliance with the GSCOP.