

# Competition Commission Market Investigation: The Supply of Groceries by Retailers in the UK

## Groceries Ombudsman: Consultation on Draft Undertakings to the Competition Commission

### Comments by J Sainsbury plc

#### Introduction and overview

Sainsbury's welcomes the opportunity to engage in the formal consultation on the CC's draft undertakings to establish a Groceries Supply Code of Practice Ombudsman Scheme.

Throughout the course of the market investigation and our informal consultation discussions with the CC, Sainsbury's has expressed broad support for the new GSCOP. However, it has also made clear that it does not support the CC's proposals to establish a new regulator in the form of an ombudsman or to widen existing investigative powers (whether exercised by an ombudsman or by the OFT) concerning retailer / supplier relations<sup>1</sup>. We do not believe that these measures are necessary, that they would lead to consumer benefit, or that they would be an effective form of regulation. Whilst Sainsbury's is not opposed to regulation *per se*, we believe that the measures proposed are contrary to general principles of administrative fairness and natural justice and to the Principles of Better Regulation to which Government subscribes. Our fundamental position on these points has not changed.

The CC's draft Groceries (Supply Chain Practices) Market Investigation Order includes measures to broaden the scope of the existing SCOP, tighten its wording, include an overarching duty of fair dealing, expand internal procedures (including the appointment of a Code Compliance Officer), and provide for expedited dispute resolution via binding arbitration. All of these provisions, which Sainsbury's largely supports, should operate to reduce concerns regarding de-listing or the independence of the dispute resolution process which may have been the cause of the alleged supplier reluctance to bring complaints to the attention of retailers or the OFT. As we stated on a number of occasions during the CC's investigation, Sainsbury's introduced its own code of practice (*Working With Suppliers*) in advance of the SCOP and we do not recognise the so-called "climate of fear" in relation to supermarkets and suppliers. Throughout the course of the two-year inquiry Sainsbury's was not provided with any specific evidence to support the conclusion of an adverse effect in relation to suppliers with whom we trade. Regular and independent surveys of our suppliers (which preserve anonymity) indicate high levels of satisfaction with Sainsbury's, and concerns are addressed effectively via our internal escalation procedure.

In light of this, Sainsbury's believes that a more proportionate and equally effective approach to address the CC's concerns about supplier relations would be to allow the extended and strengthened GSCOP to take effect and, given that the scope of the Code will be tripled in terms of its coverage of grocery retailers, to review its effectiveness after sufficient experience.

We are therefore not prepared to offer the draft undertakings envisaged by the CC.

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<sup>1</sup> Sainsbury's response to Provisional Findings and Notice of Possible Remedies, Section E (December 2007); Sainsbury's Response to Provisional Decision on Remedies, Section D (March 2008)

Notwithstanding this fundamental position of principle, Sainsbury's engaged in a detailed review and discussion of the draft undertakings prepared by the CC for the purposes of its informal consultation. We have also given detailed consideration to the subsequent draft undertakings published for consultation on 28 April. We recognise that the CC has made a number of revisions to its original draft undertakings in an attempt to address the concerns raised by Sainsbury's and other parties during the informal consultation process. While we acknowledge that these revisions have partly mitigated some of the specific points that Sainsbury's raised, the draft undertakings as a whole reinforce Sainsbury's conviction and concern that, if accepted, the proposed measures will result in increased burden and disruption for retailers without providing any more effective regulation than that available under the GSCOP (regulated by the OFT).

In particular, Sainsbury's remains concerned by the unnecessary and excessively intrusive nature of the ombudsman's proposed appointment, the excessive discretion accorded to the ombudsman, the lack of specificity in relation to his terms of reference, the absence of suitable provisions enabling retailers to be consulted and to be able to raise objections in a number of areas, and the impractical and unfair nature of the proposed measures to investigate complaints. We also note that, to a very great extent, final responsibility for monitoring and enforcing the GSCOP will remain with the OFT, thus confirming our view that the ombudsman will be an unnecessary and ineffective layer of bureaucracy.

In order to illustrate our general position further, and in the interest of continued constructive engagement with the CC and other interested stakeholders, we provide more detailed comments on a number of the proposed provisions below.

## **Draft undertakings - Sainsbury's concerns**

### **1 Overview**

The draft undertakings give rise to two main concerns.

- First, the excessive discretion accorded to the ombudsman (and in some cases the CC and/or OFT), the absence of specificity in relation to his terms of reference, and the absence of sufficient provisions enabling retailers to be consulted and/or raise objections in the exercise of their rights of defence are, in our view, unreasonable, disproportionate (especially in the context of the Principles of Better Regulation) and contrary to the principles of natural justice.
- Second, it appears that, even if the undertakings were accepted and implemented, final responsibility for monitoring and enforcing the GSCOP will, to a very great extent, remain with the OFT. This underlines our view that the CC's proposed measures will result in significant cost and burden to grocery retailers (and ultimately, consumers, as the costs of compliance may be passed on by retailers) without providing any more effective regulation than that already provided for in the draft GSCOP.

### **2 "Overriding" objective is overly broad and imprecise**

The draft undertakings state that the ombudsman's "overriding objective" will be "to undertake Investigations and arbitrate Disputes arising from the Code to promote the interests of consumers".

We acknowledge that the CC has attempted to confine the role of the ombudsman in paragraph 3.3(c) of the Scheme. However, we note that this paragraph is drafted using advisory rather than mandatory language (the ombudsman “should” confine his activities to evaluating the operation of the Code and “should” not consider other commercial elements of the Supply Agreement). Similarly paragraph 3.2 describes the ombudsman’s “principal” duties rather than a defined set of duties.

Ultimately we do not agree with the CC that the Scheme will prevent “regulatory creep”. If it is the case that the CC does not seek any additional role for the ombudsman, then the use of the words “overriding” and “principal” would be unnecessary in this context. Furthermore, the establishment of a separate ombudsman is not necessary to resolve Disputes under the GSCOP, which can be dealt with by the appointment of independent arbitrators on a case by case basis.

The CC also stated in its Final Report (at paragraph 11.339) that “we expect that the GSCOP Ombudsman will use its resources efficiently, focusing on those disputes and complaints concerning suppliers without market power over and above those concerning suppliers of major branded products”. However, no attempt has been made in the draft undertakings to differentiate between large and small suppliers, or to introduce a frame of reference or minimum thresholds within which the ombudsman should operate. Nor is any means of recourse provided (beyond seeking a judicial review of a decision or a formal review of the undertakings) for a retailer to raise objections or otherwise make its views known.

### **3 Appointment and conflicts**

We note the comment contained in Tim Oyler’s email of 27 April 2009 that “[w]e consider that the choice of person appointed to be Ombudsman is critical to the success of the office. We consider that someone with the standing to enjoy the respect of both retailers and suppliers will be required to establish the office.”

We consider that it would be challenging to identify a candidate for the role who meets the criteria set out by the CC, namely sufficient industry knowledge, independence from grocery retailers and suppliers, and the necessary skills and expertise to conduct arbitrations.

We also note with concern that there is no provision in the draft undertakings to ensure that any staff appointed by an ombudsman, or any temporary replacement that the ombudsman may appoint, are free from any conflict of interest. Nor is any reference made to the minimum qualifications and/or experience that must be satisfied by any individual, which is of particular concern where staff have the scope to perform the ombudsman’s role on a temporary basis.

Furthermore, there is no provision for retailers to raise legitimate objections to the appointment of a particular individual (most notably the ombudsman himself) or to assess the precise terms of such appointment (paragraph 2.3 of the Scheme states simply that “the terms of the Ombudsman’s appointment will include such provisions as are necessary to give effect to the Scheme”).

### **4 Remuneration provisions**

Sainsbury’s has reviewed the formula set out in Annex 1 to the draft undertakings which the CC proposes to use to calculate each Party’s share of the ombudsman’s costs. In Sainsbury’s view, the formula is flawed in two key respects.

First, the structure of the formula would result in a variable denominator for each retailer, as a result of which the combined contributions of the Parties would not equate with the total costs of the ombudsman (it would, on our calculations, be capable of producing a recovery of 1.5 times the actual cost).

Second, there remains significant scope for costs to be attributed unfairly given that the proposed formula takes no account of the number of complaints / investigations that the ombudsman may pursue against a particular retailer but is limited to recommendations made to the party in question (which will not necessarily accord with the number of complaints / investigations), disputes and turnover. Furthermore, no account is made for the relative size, length and ultimately cost of different proceedings. It would be entirely unfair if one retailer which was the subject of a minor investigation that required limited resources to conclude should bear the same proportion of costs as another retailer which was the subject of a major investigation that accounted for significant costs and resource. Nor is there any provision for periodic review of the contribution formula in order to evaluate its operation in practice.

## **5 Complaints provisions are impractical and contrary to principles of natural justice**

Section 5 of the Scheme grants the ombudsman extremely wide discretion to receive and investigate complaints from a wide range of parties beyond the suppliers with whom Sainsbury's has a relationship, including competitors and "any other person", without any minimum threshold or other limitation. Sainsbury's is concerned that these extensive powers would result in vexatious complaints from competitors and other parties (for example, farmers, other primary producers and lobby groups) with whom we do not have a direct supply chain relationship.

The section also provides, at paragraph 5.3, that "the Ombudsman will, before he commences an investigation, inform the Party (or Parties) concerned of the general nature of the practices which the Ombudsman intends to investigate, and allow the Party (or Parties) a reasonable time in which to respond to the proposed Investigation." [emphasis added]

As Sainsbury's has previously argued, we are concerned that the attempted preservation of anonymity in this respect is contrary to the principles of natural justice and due process. The drafting of this paragraph also highlights the impracticality of the CC's proposed measure: the ombudsman, in order to preserve confidentiality, will provide a retailer with only the "general nature" of the complaint against it, but yet the CC also recognises the need for a retailer, in the interests of natural justice, to have the opportunity to respond to the proposed Investigation. In practice, however, providing a retailer with only the "general nature" of a complaint is unlikely to be sufficient to enable the retailer properly to respond to the proposed "Investigation" and exercise its rights of defence.

Furthermore, it will be ultimately be very difficult for a retailer effectively to address any specific problems without knowing the details of a particular complaint.

## **6 Reporting obligations are unclear**

Paragraph 5.5 of the Scheme states that "[a]t the conclusion of an Investigation, the Ombudsman must publish a report which will include (but not be limited to):

- (a) a summary of the information that prompted the Ombudsman to commence the Investigation;
- (b) a description of the practices the subject of the Investigation;
- (c) a summary of any information obtained during the Investigation;
- (d) any findings of the Ombudsman in relation to the operation of the Code; and
- (e) the reason(s) for any action taken as a result of the Investigation.”

This paragraph suggests that such reports will be made generally available. However, there is no provision requiring the ombudsman to consult with the relevant retailer (or retailers) prior to the publication of such report in order that retailers may respond to any provisional findings (and their views given due consideration and reflected in any final report) and/or exercise their rights of defence with respect to the disclosure of commercially sensitive information.

Sainsbury's considers that the absence of sufficient consultation mechanisms is of serious concern given the extensive discretion that the CC proposes to grant to the ombudsman and the scope for vexatious and unfounded complaints to be pursued with the benefit of anonymity. In Sainsbury's view, failure to consult would be contrary to the principles of administrative fairness and natural justice underlying the statutory scheme with which the OFT and the CC themselves must comply, which could have serious consequences for retailers. In this regard, section 169 of the Enterprise Act 2002 requires the OFT or the CC, when proposing to take a "relevant decision" (as defined in section 169(6)) to consult those persons on whose interests it considers the decision is likely to have a substantial impact. While the reports of the ombudsman would not be relevant decisions for the purpose of the Act, their impact may be as significant as a number of the decisions in respect of which Parliament intended that the OFT or CC would consult with the relevant parties.

## **7 Consultation on proposed amendments to the Code**

We note with concern that the CC has removed from the informal draft undertakings one of the few instances in which it envisaged consultation between the ombudsman and the retailers. The informal consultation draft stated that the ombudsman would consult with the parties to the undertakings before taking action to recommend to the OFT that it amend the undertakings and/or the Code, but this does not feature in the present draft. No reason has been given for the deletion of this proposal.

As noted above, the absence of sufficient consultation provisions is, in Sainsbury's view, of serious concern given the extensive discretion that would be granted to the ombudsman and the scope for vexatious and unfounded complaints to be pursued with the benefit of anonymity.

## **8 Ombudsman's substantive powers are ineffective**

Ultimately, the ombudsman appears to have few substantive powers of his own, and it rests with the OFT to take substantive action. The ombudsman therefore appears to be nothing more than an extra layer of bureaucracy which the OFT could fulfil perfectly adequately. We are also concerned that there would be a significant risk of duplication between the ombudsman and the OFT. For example, it rests with the OFT to decide whether to designate the ombudsman as arbitrator in any disputes (and the draft undertakings acknowledge that it may be inappropriate for the ombudsman to act as arbitrator in connection with matters

which he has already investigated). It appears, therefore, that the OFT must consider the detail of any dispute brought forward for arbitration. In the event that the ombudsman is unqualified to act as arbitrator, or cannot do so due to a conflict of interest, then presumably an alternative arbitrator will have to be appointed.

The ombudsman would also have no power to take substantive action against any retailer found to have breached the GSCOP beyond making a recommendation to a retailer or to the OFT, or by publishing guidance, or by advising a supplier on the nature of obligations under the GSCOP.

### **The amended GSCOP will be sufficient to address the CC's concerns**

We continue to believe that the amended GSCOP will be sufficient to address the limited adverse effect on competition identified by the CC in its Final Report and that any further changes should only be considered after reviewing the effectiveness of the GSCOP.

Additional investigative powers are unnecessary given the other measures proposed to broaden the scope of the GSCOP, tighten its wording, include an overarching duty of fair dealing, expand internal procedures (including the appointment of a Code Compliance Officer), and provide for expedited dispute resolution via binding arbitration. All of these provisions, which Sainsbury's largely supports, should operate to reduce concerns regarding de-listing or the independence of the dispute resolution process which may have been the cause of the alleged supplier reluctance to bring complaints to the attention of retailers or the OFT. The enhanced provisions for dispute resolution contained in the CC's draft Groceries (Supply Chain Practices) Market Investigation Order will be an effective means of enforcing the GSCOP, together with the existing provisions for periodic review of compliance by the OFT.

Nor is an ombudsman necessary. The OFT has a history and experience of effectively monitoring compliance with the SCOP. Arbitration and consulting expertise can be appointed on a case-by-case basis without the need to incur significant additional costs or create a new body prone to external pressure and regulatory creep, in line with the established Principles of Better Regulation. The extensive powers proposed would involve unnecessary time and expense to retailers, suppliers and the regulatory authorities, with no likely benefit for consumers that could not otherwise be achieved through the existing structure.

Ultimately Sainsbury's does not believe that the draft undertakings represent a reasonable, practicable or effective solution to the CC's concerns. We strongly believe that a more proportionate and effective approach would be to allow the widened and strengthened GSCOP to take effect, given that the scope of the new Code will be tripled in terms of its coverage of grocery retailers, and to review its effectiveness at the end of, for example, a two-year period of operation. Sainsbury's is not therefore prepared to offer undertakings in the terms envisaged by the CC.