

**Taking forward the
establishment of a body to
monitor and enforce
compliance with the
groceries supply code of
practice (GSCOP): The
Groceries Code Adjudicator**

**Government response to
the consultation**

AUGUST 2010



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2. The consultation on the establishment of a Groceries Code Adjudicator (GCA) to monitor and enforce the GSCOP applies to the UK. The proposals consulted on originate from a market investigation made by the Competition Commission (CC) under section 131 of the Enterprise Act 2002. Section 134 (1) of the Act requires the CC to decide whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition with the supply or acquisition of any goods or services in the UK or part of the UK. Competition issues are not devolved to Wales Scotland or Northern Ireland.

Additional copies:

3. This Government's response document is available electronically from the consultation page of the BIS website (<http://www.bis.gov.uk/Consultations>). You may make copies of this document without seeking permission. Other versions of this document can be made available on request in Braille, other languages, large fonts and other formats. Contact the Departmental contact above.

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Definition of groceries

5. For the purposes of the response 'groceries' includes food (other than that sold for consumption in the store), pet food, drinks, cleaning products, toiletries and household goods.
6. The term excludes petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers and magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products.

7. Other useful definitions

The Body – This is the person/entity appointed as the Groceries Code Adjudicator (GCA), the body to monitor and enforce the GSCOP, at any time when such an office is in existence.

The Scheme – This means the scheme set out to monitor and enforce the GSCOP

Dispute - This means a dispute arising under Articles 11(2) and 11(3) of the groceries (Supply Chain Practices) market Investigation Order 2009

8. Key Abbreviations

AEC – Adverse Effect on Competition

CC – The Competition Commission

EA – Enterprise Act 2002

GCA – Groceries Code Adjudicator

GSCOP – Groceries Supplies Code of Practice

NGO – Non Government Organisation

OFT – The Office of Fair Trading

Chapter 1: EXECUTIVE SUMMARY

1. This document sets out the Government's Response to the consultation on establishing a body to monitor and enforce the groceries supply code of practice (GSCOP) which took place between 5 February and 30 April 2010. The consultation document can be found at <http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/10-577-monitoring-gscop-consultation.pdf>.

1.1 The UK Government fully supports the need for such a body. The previous Administration accepted that a body was necessary to monitor and enforce the GSCOP and that it should have the power to receive anonymous complaints. It launched a public consultation as soon as the GSCOP came into force. The Coalition Government Programme, published on 18 May, committed the Government to introduce, as a first step, an Ombudsman, in the Office of Fair Trading, to enforce the Grocery Supply Code of Practice and curb abuses of power which undermine our farmers and act against the long-term interest of consumers. This body will be known as the Groceries Code Adjudicator.

1.2 In order to obtain views on the main policy issues, the consultation document identified 5 main areas stakeholders' perspectives where sought on:

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

1.3 Sixty responses were received during the course of the consultation. They came from a range of stakeholders including the major retailers, suppliers, trade associations, non government organisations (NGO's), unions, other Government bodies, church groups, charities and a number of private individuals (most of whom responded in support of ActionAid's "Who Pays?" campaign). Many of the responses were substantive, with strongly held opinions and reasoned arguments made for the majority of the questions asked in the consultation document. Responses from trade associations and other interested groups represented the views in some cases, of thousands of members, who had been surveyed in formulating their submissions.

1.4 The Government would like to place on record its appreciation to all those that responded. All of the responses have been considered carefully. We took the decision on this occasion not to publish the responses in full as a number of respondents submitted their views in confidence. In this summary of responses therefore, the Government has only attributed comments to those organisations that have given their consent.

1.5 Views were split on the need for the GCA and its role. Generally suppliers strongly supported the need for the GCA and the range of activities consulted on. Many respondents noted that they had been calling for greater intervention in the groceries market for some considerable time. The recent progress was very much welcomed.

1.6 The majority of retailers reminded the Government that the CC had found the grocery market to be in good health, serving customers well and mainly free of features likely to harm consumer's interests. Retailers stressed that they always aimed to deal fairly and establish good working partnerships with their supplier community. Whilst retailers obviously required them to be highly efficient in their costs, production and logistics management, they also provided incentives for them to invest.

1.7 Whilst many respondents recognised that there were many long standing and excellent working relationships between suppliers and retailers, something which primary producers rely on for the viability of their businesses, there was nonetheless a disparity of power with some retailers holding the advantage even over quite large suppliers. This was about fairness in the supply chain and many respondents urged the Government to move quickly and implement as recommended by the CC.

1.8 There was support for an independent GCA and a realisation that it could be housed in the OFT if arrangements could be put in place that made it distinct from the OFT's normal day to day activities.

1.9 All retailers strongly supported the revised and strengthened GSCOP which came into force in February. They had taken the necessary steps to comply, including training of staff, changes to processes and systems and the introduction of Code Compliance Officers to meet the new obligations. This was all undertaken at considerable cost. Retailers were, therefore, disappointed that the Government had taken the decision to set up an enforcement body before giving the GSCOP an opportunity to bed in and prove it could work effectively without the need for further enforcement. Retailers, therefore, generally opposed the creation of a GCA but supported it being placed within the OFT if implemented. Retailers were keen that the GCA should be focused on breaches of the GSCOP and not stray into other commercial areas. It must not transform itself into a supermarket regulator. It must not be a disruptive influence in the delicate competitive tension in the supply chain which until now has delivered significant benefits to the consumer.

1.10 The powers of investigation were of particular importance to suppliers. Those that supported the need for a GCA to enforce the GSCOP said that it was principally about ensuring a fair and equitable relationship between retailers and suppliers. This was considered essential for the food supply chain to work effectively for the benefit of consumers, whilst providing suppliers, including primary producers such as farmers, with a fair deal.

1.11 There were diverse views on how proactive the GCA should be and access to it, however there was general agreement that large suppliers should not be excluded. There was no consensus on who the GCA should receive complaints from. Views varied from restricting access to direct suppliers to allowing complaints from anyone.

1.12 There were also a range of views expressed on whether penalties were an essential deterrent or sanction for breaches. There was general support for a system of "naming and shaming" that would impact on a retailers' reputation and would be an effective deterrent. There was greater controversy around financial penalties, in particular the level they might be set at and when they would be most appropriate to use.

1.13 There was a general consensus around the principles dictating how the GCA should conduct its work and that it should be funded along the principles recommended by the CC.

1.14 In light of the views received during the consultation and the agreed Government position published on 18 May, the Government has decided to proceed to establish the GCA as follows:

- **Where the body is based** - In line with the Coalition Programme the GCA will be based within the OFT, but will be kept independent from the normal decision route in the OFT. The Government recognises that it is important to separate out this new role from the OFT's normal competition and consumer activities.
- **What powers the body should have** – The Government supports the view that the GCA should have the overriding objective to work in the long term interest of consumers. The GCA should not facilitate or encourage coordination among suppliers and retailers. The

GCA's main attention should be the GSCOP and avoid any activity that is not focused on the overriding objective of the Scheme. The Government agrees that the GCA should be able to receive complaints and conduct investigations where the body considers it necessary to do so. Investigations should be based on complaints that have merit or other appropriate information in the public domain.

The responses to the consultation identified some further activities that the Government is prepared to accept. These include the power to monitor emerging new practices and be able to recommend changes to the GSCOP. Among the other proposals Government accepts is for the GCA to visit overseas suppliers in appropriate circumstances and to issue warnings at certain times of the year when abuse is more likely to occur.

- **Access to the body** – The Government has decided that the GCA should have the power to receive anonymous complaints from anyone in the supply chain at home or overseas. This includes farmers who may not directly supply the large supermarkets and is consistent with the Coalition Programme to support farmers. Trade associations, NGOs and other organisations still have a useful role to play in offering advice and assistance to their stakeholders, but complaints must come direct from the business affected. Large suppliers should have access to the GCA.
- **Should a sanctions regime be introduced and how might it operate alongside any appeals mechanism** – The Government has listened to all sides of the debate in regards to penalties. It has decided that the deterrent that it expects to have the greatest impact on changes in retailer behaviour is that of reputation. However, powers will be provided in the primary legislation for the Government to introduce financial penalties should future experience indicate that reputation alone is not sufficient.
- **The funding of the body monitoring and enforcing compliance with the GSCOP** – The Government will reflect further on the fairest and most appropriate mechanism for retailers to fund the GCA.
- **The name of the body** – The Government has accepted the advice that “Ombudsman” is not an appropriate name for a body of this nature. An Ombudsman normally provides effective redress mechanisms for individual consumers and citizens. This body is concerned with business to business relationships within the groceries supply chain. The Government has decided that the body should be named the Groceries Code Adjudicator (GCA).

1.15 A more detailed summary of the responses to the questioned asked in the consultation can be found in Chapter 3 and the Government decisions in Chapter 4. An impact assessment containing the analysis of costs and benefits is attached at Annex D.

1.16 The 60 responses can broadly be broken down into the following categories:

Trade bodies - 21
Individuals - 14
Large retailers - 10
Non Government Organisations - 4
Government bodies - 3
Religious Groups - 3
Charities - 2
Suppliers - 2
Legal - 1

Chapter 2: INTRODUCTION

2. The CC's final report into the UK supply of groceries published on 30 April 2008 set out its findings and remedies following a 2 year investigation. Although the CC identified that the exercise of buyer power by grocery retailers could have positive implications for consumers, through lower prices, it also found that it could raise concerns in certain limited circumstances. When grocery retailers transfer excessive risks or unexpected costs to their suppliers, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes.

2.1 The CC concluded that if left unchecked, this will ultimately have a detrimental effect on consumers, by leading to lower-quality goods, less choice of goods, or less product innovation, which is not in consumers' long term interest.

2.2 To address the concerns that it identified, the CC decided to establish a new Groceries Supply Code of Practice (GSCOP). This Code, which came into force on 4 February 2010, applies to all firms which are active in the sector and have annual retail groceries turnover of £1 billion or more. The new GSCOP is based on the Supermarkets Code of Practice (SCOP) of 2001. The GSCOP represents a significant strengthening and expansion of the SCOP requiring retailers, for example, to put all contracts in writing and prohibiting retrospective adjustments to payments. The GSCOP also allows for independent binding arbitration of disputes and requires grocery retailers to provide reasonable notice and commercial justification before a supplier is delisted (the GSCOP provides that a retailer may only de-list a supplier for genuine commercial reasons).

2.3 Many suppliers had told the CC that they were reluctant to use the complaints process in the SCOP due to concerns over being identified and of being delisted by the retailers.

2.4 The CC considered that the GSCOP will be much more effective with an Ombudsman in place to address the "climate of fear" that many suppliers mentioned existed under the previous code of practice. The CC believes that a body, which will be known as the Groceries Code Adjudicator (GCA), is necessary both to enforce compliance with the GSCOP and to carry out investigations.

2.5 The CC does not have the powers to set up new public bodies. Despite a round of consultations the CC was unable to obtain undertakings from the grocery retailers to establish a GSCOP Ombudsman¹. On 4 August 2009 the CC formally requested that the Government take the necessary steps to establish an effective Ombudsman.

2.6 On 13th January the then Government announced its response to the recommendation, stating that it:

- Accepts the CC view that the GSCOP needs independent monitoring and enforcement to address fully the Adverse Effect on Competition (AEC);
- Agrees that the body monitoring and enforcing compliance with the GSCOP should have the power to hear anonymous complaints;
- Would consult after the GSCOP comes into force on 4 February 2010 on the specific powers that a body to monitor and enforce compliance with the GSCOP should have, and whether a new body should be set up or an existing body be given these powers.

2.7 A consultation was launched on 5 February and closed on 30 April. This consultation sought views on:

¹http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

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

2.8 All those who have an interest in the grocery supply chain were given the opportunity to provide views on the policy options. This included the largest grocery retailers directly covered by the GSCOP, alongside medium sized and smaller grocery retailers for which independent monitoring and enforcement might have an impact. We also wanted to hear the views of those who supply large grocery retailers either directly or through other routes as well as other third parties including charities and NGOs. The GSCOP itself applies only to those direct suppliers that deal with the 10 designated retailers.

Chapter 3: SUMMARY OF CONSULTATION RESPONSES

Q1. Should the body monitoring and enforcing compliance with the GSCOP be given all of these functions and powers?

3.1 A familiar theme of the responses to the consultation was the contrasting views over the precise functions and range of powers that the GCA should have.

3.2 Suppliers, NGOs, trade associations, unions, religious organisations, pressure groups, charities and private individuals all supported the proposed functions and powers set out in BIS' Consultation document. Acting as an arbitrator, receiving complaints and conducting investigations, making recommendations on compliance, publishing guidance and reporting publicly on the operation of the GSCOP were all regarded as necessary functions for the GCA. All of those functions were recommended by the CC and a number of respondents made it clear that they saw no reason to deviate from those recommendations. ActionAid added that these proposals were the least intrusive and most cost effective remedy to address the AEC that the CC had identified.

3.3 The Gangmasters Licensing Authority noted that the proposed functions and powers were relevant and complementary to each other. In supporting the proposals The British Brands Group noted that the aim of the CC's remedy was not to deliver a fair deal to suppliers, but to ensure compliance with the GSCOP – which in itself is about ensuring the market works well for consumers. A union agreed, adding that the ultimate objective of the GCA should be protection of the consumer's long term interests and not to promote any one sector. The powers and functions proposed in the consultation closely matched the CC's recommendation. CMS Cameron McKenna LLP submitted that without the establishment of the GCA to enforce and monitor the GSCOP with the proposed functions and powers, the CC's objectives would not be achieved and there would be no means of recourse for suppliers.

3.4 The major retailers, with one notable exception, supported by the British Retail Consortium, (BRC) submitted a range of views opposing some of the proposed functions and powers. They typically expressed some disappointment that the Government had accepted the need for an independent body to monitor and enforce the Code now. This was viewed as unnecessary as the GSCOP had been revised and strengthened to give adequate protection to suppliers, and had only recently come into force in February through the GSCOP Order. All the major retailers supported the new GSCOP and proposed that the Government should give this time to bed in before embarking on further regulation. A number of retailers suggested that the GSCOP should be given at least two years to bed down before making a decision on whether further enforcement was necessary.

3.5 Noting that Government had already accepted the need for an enforcement body, retailers emphasised that any proposed functions and powers must be strictly limited to the operation of the GSCOP and it should not become a supermarket regulator. All of the retailers expressed concern over the arbitration function where the body's suitability to rule on a complaint might be called into question if the body had already determined there were grounds for investigation and success in arbitration. There was also a risk that suppliers would pass over clear dispute mechanisms in the GSCOP and directly approach the GCA leaving retailers with no ability to defend their commercial interests at arbitration. Retailers also expressed the view that the GCA should only act in cases where they had been escalated via the dispute resolution procedure within the GSCOP. One major retailer suggested that the proposal to receive and investigate complaints should be limited to focus on dispute resolution to ensure compliance with the GSCOP, alongside issuing guidance and educating users.

3.6 Retailers were concerned about the GCA receiving anonymous complaints which it would investigate and assemble a case in secret, raising questions about due process, and checks and balances to ensure that the enforcement body was conducting inquiries on a sound footing. There were further concerns that such a power could provide incentives for parties to make speculative complaints or threats to retailers in the hope of obtaining improved commercial terms. There was also a danger of suppliers being encouraged by professional consultants to bring cases on a no win, no fee basis. For large suppliers, the role of the GCA should be restricted to arbitration only – a number of retailers said that large suppliers are multinational corporations with significant market power and did not require protection.

3.7 Two additional points of specific detail were raised. Independent Dispute Resolution Services noted that arbitration and resolution of disputes should not be conducted by, or directly on behalf of a body holding or exercising any degree of regulatory authority over one of the parties to the dispute. Such a relationship may impinge on Section 33 of the Arbitration Act 1996 which covers the duty of an arbitration tribunal to act fairly and impartially on the conduct of arbitral proceedings. It also adds, were the GCA to be given mandatory powers of arbitration, this will inevitably lead to perceptions of potential bias and conflict of interests and ultimately undermine its credibility.

3.8 The British and Irish Ombudsman Association made the point that ombudsman schemes are set up so that individual citizens and consumers have redress against suppliers of goods and services – not for the resolution of disputes of a business to business nature. The ombudsman body therefore risks being confused as a place where individual consumers can take their complaints regarding products and services purchased at supermarkets, which is not the intention. It suggested the term Adjudicator or Arbitrator as being more appropriate for this body.

Q2. Are some of the activities more important than others, if so what are they?

3.9 A number of respondents made the general point that the powers and duties should be viewed as a package of measures which are coherent and complimentary so that the GCA possesses the necessary strength and authority to ensure fair competition across the market. In short, no one measure carries more weight or importance than another.

3.10 Other opinions were spilt, however, on which activities are more important. Suppliers, trade bodies, NGO's, unions and others felt that the GCA's overriding objective should be to undertake investigations and arbitrate disputes. This included receiving and investigating anonymous complaints from affected suppliers and third parties. The GCA should also investigate where it had sufficient information to spot a pattern of non compliant behaviour. A number of trade bodies also proposed that the GCA should have robust systems in place to ensure complaints are heard and kept in strict confidence. Powers to gather relevant information was vital to the effectiveness of the GCA and the credibility of its investigations. The GCA should be able to issue decisions that were binding, though these should always be the last resort. ActionAid and Friends of the Earth added that any suppliers, including those based overseas, should be informed of their rights, and the GCA must be able to impose financial penalties, and name and shame retailers that breach the code.

3.11 Retailers noted that the revised and strengthened GSCOP allows suppliers to commence dispute resolution procedures at retailers cost and that combined with the added publicity of a breach would be extremely effective to ensure compliance with the Code. Therefore the new GCA should focus on monitoring compliance, as enforcement is already covered within the GSCOP through the dispute procedure. Also the GCA should focus on publishing guidance that covers interpretation of specific provisions of the GSCOP, practices and procedures necessary for the monitoring and enforcement body to operate. The Food and Drink Federation added that guidance issued by the GCA must also use examples to aid understanding to help

suppliers to reject unreasonable changes to contracts. The GCA should provide a quick and effective way of dealing with disputes when they arise.

3.12 The BRC noted that acting as an arbitrator and reporting on the operation of the Code, gives more than sufficient reassurance to suppliers than they asked for from the CC inquiry. Also, regular reporting on the Code would help reassure both suppliers and third parties of its effectiveness.

Q3. Are there additional activities that should be considered, if so what are they?

3.13 A number of trade bodies strongly felt that any further activities would represent an extension of the scope of the GSCOP scheme, go beyond the CC's recommendations and as such would not have the evidence base or analysis to justify inclusion. The emphasis must be an efficient application of the CC's recommendation. That was a big enough task to achieve without adding further activities that could trigger unnecessary opposition.

3.14 A number of additional activities were nonetheless suggested by a range of stakeholders. Heinz said that the body must enforce the spirit of the code as well as its strict interpretation. It had been concerned that retailers may seek retribution against a complainant supplier and that the GCA should have strict safeguards against such a reaction. It gave an example of holding or delaying payment of invoices or severe disruption to cash flow with a quick and effective process within a certain time frame would be important for suppliers.

3.15 ActionAid said that the GCA should proactively monitor supply chain practices by conducting surveys and spot checks without the need for complaints. The organisation also called for the vertical scope of the GSCOP to be extended to cover indirect suppliers. It referred to the CC's evidence that some direct suppliers held market power in relation to primary producers and indirect suppliers through the transfer unexpected costs and risk. Without an extension of coverage, the GCA would not be able to deal with those direct suppliers that pass on unexpected costs and risks to others in the supply chain. The Welsh Assembly made a similar point. It recognised that relationships between suppliers are a private contract matter, and that any breach may become undetectable where costs and risk are passed down the supply chain rather than a complaint being brought forward. Friends of the Earth added that the GCA must monitor the emergence of new practices that abuse buying power and have relevant powers to amend the Code in response.

3.16 Unite, the trade union, submitted that the GCA should also be able to source information from other places, such as workers whose jobs may be affected by certain practices. Workers, and the unions that represent them, should have access to the GCA. They often had a unique perspective on a situation and could inform the GCA of potential unforeseen consequences – particularly relating to jobs. Unite also said that clear time limits should be prescribed for each stage of the investigation or enforcement process in recognition of how quickly suppliers could be forced out of business if retailers act unreasonably.

3.17 Other trade bodies submitted that it was crucial that third parties could submit intelligence which could be used in proactive investigations – the GCA should be inclusive in accepting intelligence from any source. Retailers should also be required to publish or disclose all arrangements with third parties for which they receive a payment. The prohibition on tying pursuant to Article 11 of the GSCOP is weakened as it is impossible for suppliers to establish whether a retailer is receiving any payment. The GCA should also be able to provide and regulate 'safe havens' to allow interested parties to discuss concerns.

3.18 A major retailer suggested that suppliers must be given a responsibility when dealing with the GCA, not to bring superfluous or tactical complaints and must give sufficient information for the retailer to investigate and defend itself. Ideally, the GCA should strongly recommend

suppliers take their complaint to the relevant retailer first and should only approach the body after receiving a response from the retailer.

3.19 In its submission, the Office of Fair Trading (OFT) made a number of specific suggestions about the GCA's use of the range of powers it would have and whether or not that use could be discretionary (perhaps based on prioritisation or some other criteria) or merely prescribed. It urged BIS to consider the GCA's ability to dismiss complaints without investigation or through prioritisation, the type of complaints it will deal with and from whom (the GCA should define what a third party is), ensuring complaints distinguish themselves between those that are specific to one issue or instance or that relate to behaviour common across a retailer or a number of retailers, and in dealing with anonymous complaints with retailers in ensuring not to reveal the complainant.

Q4. Are there some proposed activities that should be rejected, if so what are they?

3.20 A number of the major retailers said that the proposed investigatory role for the GCA was not necessary or justified and was an example of regulatory creep. The revised GSCOP, itself subject to extensive scrutiny, already contained mechanisms for suppliers to exercise their rights. If a matter did not amount to a breach of the GSCOP, there was no reasonable basis for the GCA to investigate; it should also refrain from involvement in wider matters such as the role of supermarkets in society or rural and planning policy.

3.21 Most retailers noted that investigation of complaints would place disproportionate burdens on retailers and that there was a danger that these could be influenced by pressure groups – something that was contrary to the CC's intention. One retailer urged BIS to consider whether the anonymous complaints scheme was of any significant benefit to complainants – not least because there was no duty to act on each individual complaint and the only available outcome was a recommendation to the retailer or to order improved compliance. BRC added that anonymous complaints should not lead to sanctions, but only give the GCA intelligence to consider whether the GSCOP is effective.

3.22 The BRC and a number of retailers were opposed to the GCA receiving anonymous complaints as they were not just and fair for retailers to respond to. Major retailers were concerned that anonymous complaints would mean a retailer's rights of defence were prejudiced. A fundamental role of natural justice is that defendants know the allegation against them and the identity of the claimant so that the allegation can be investigated and a defence prepared. As already summarised in question 1, retailers emphasised that it would be inappropriate for the GCA to conduct arbitrations where the conflict is being taken forward through a complaint. There was also some concern that the GCA would be writing guidance and then sitting in judgement using that same advice. In such cases an alternative arbitrator would be required.

Q5. The body monitoring and enforcing compliance with the GSCOP will require information gathering powers to perform effective investigations, How general or specific should these powers be?

3.23 There was widespread recognition amongst all stakeholders that the new GCA would need suitable information gathering powers in order for it to function effectively, and that strong safeguards were needed to protect confidentiality. However, views differed about the scope and application of those powers.

3.24 The Church of England said information gathering powers should be wide ranging and full enough to enable fair and informed investigations. The British Brands Group felt that without a full remit of powers the GCA would be toothless. ActionAid said that in order to remedy the AEC the GCA must have powers to build cases based on evidence other than that provided by anonymous complaints. This would also help to reconcile supplier anonymity with retailer rights

of defence. It would also allow the body to uncover infringements and reduce retailer grounds for taking punitive action against suppliers acting as whistle blowers.

3.25 Trade bodies pointed out that the CC report made clear that the GCA should have the right to require retailers to provide information. In so doing, respondents added that those powers needed to be strong and specific, including timescales for responses as retailers could delay or avoid providing information that is detrimental to their interests. Long standing disputes were not in the interests of the supplier which could reduce the viability of the business. Where there are accusations of unfair practices, the Welsh Assembly said that the body must be able to establish whether disputes have foundation or not, in order to restore trust where they were not.

3.26 The major retailers emphasised that information gathering powers should be very specific and relate only to potential breaches of the Code and that information should only be used once a high proof threshold had been achieved. The GCA should not be allowed to go on fishing trips or other unwarranted investigations which are an abuse of due process and add unnecessary costs to the supply chain. Such powers are time consuming and costly for business and therefore should be used when proportionate to do so. The GCA must also have regard to the Hampton principle where business should not have to give unnecessary information, nor give the same information twice. There should not be any peremptory powers, or powers to enter premises, and the GCA should consult with the retailer before using any information obtained.

3.27 One retailer felt that in the interests of natural justice, any investigation powers should also apply to suppliers. The Food and Drink Federation and the Groceries Market Action Group (GMAG) made similar points adding that suppliers should assist investigations. Most respondents emphasised that commercial confidentiality must be protected at all times. The greater amount of information collected increased the chances of confidentiality being violated. The GCA must have robust procedures to ensure information is rigorously protected and that there should always be a presumption against any disclosure unless absolutely necessary in communicating judgements and decisions. Dairy UK said that where there was a contradiction in protecting confidentiality and demonstrating transparency, the GCA should explain decisions on the basis of principles.

3.28 A number of stakeholders submitted that the existing information gathering powers contained in the Enterprise Act 2002 for the OFT, could easily be extended to the new GCA, including the confidentiality obligations set out in Part 9 of the Enterprise Act. The powers provided for under Section 16 of the Gangmasters (Licensing) Act 2004 were also recognised as a good template.

Q6. The body monitoring and enforcing compliance with the GSCOP takes a decision following arbitration or an investigation, the decision should be open to appeal. Who should hear the appeal?

3.29 There were a number of different responses as to who should hear an appeal. The Competition Appeals Tribunal (CAT) was put forward by a number of stakeholders as being the most appropriate. It had relevant expertise and a significant degree of flexibility in its rules and case management powers. Many disputes were likely to be of low value and the CAT's ability to limit the size of documents and length of hearings could assist in minimising costs and time. The High Court, which the CC recommended, was thought by some to take too long. One retailer also said that the CAT's appeal proceedings should be subject to the provisions of the Arbitration Act 1996.

3.30 A number of responses agreed with the CC's recommendation that the High Court should hear any appeal. Others suggested that appeals should be heard by either a separate body specially convened, or by an independent person appointed from a pool of suitability qualified people. Any panel must have at least one suitably qualified person with relevant expertise.

3.31 Tesco suggested that amending processes within the OFT could allow it to hear a merits based appeal on GSCOP matters. Dairy UK made a similar point adding that only in circumstances where the GCA was not part of the OFT should it play a role. The CC was also put forward as a body that could hear appeals in private. Lastly, the Food and Drink Federation said that appeals should be limited to errors in the interpretation of the GSCOP and heard by someone independent of interested parties and of the investigation process.

Q7. In considering the general principles that the body monitoring and enforcing compliance with the GSCOP should have regard to in the course of its work, should they last indefinitely?

3.32 A number of respondents pointed out that principles are fundamental and should not be subject to change. The principles identified were regarded as appropriate and should last indefinitely, or should endure as long as the GCA remained in place or until the AEC was remedied and there existed confidence it will not resurface. Retailers and a number of trade bodies emphasised that it was the role and effectiveness of the GCA itself that should be reviewed after between two to three years.

3.33 The Gangmasters Licensing Authority said that the principles should not last indefinitely and would need to be reviewed after about three years, to ensure they are in line with prevailing stakeholder thinking. The system should be fit for purpose and work as intended. The GMAG said the principles should remain as long as they continued to help protect the interests of consumers and suppliers and address the AEC found by the CC. Dairy UK said that the principles should only change at the discretion of BIS following a recommendation from the OFT or the CC after any evidence of deficiency. Any change of principles should not be left to the discretion of the GCA.

Q8. Are the suggested principles that the body monitoring and enforcing compliance with GSCOP in carrying out its duties appropriate?

3.34 There was wide agreement from those that responded to this question that the principles were appropriate, and appeared to be proportionate and sensible with a good degree of impartiality. A number of major retailers agreed, but emphasised that the principles must be restricted to matters relating to the operation of the GSCOP and that the GCA must be able to resist any pressure to get involved in wider matters. Enforcement of the GSCOP is not intended to replace the cut and thrust of commercial negotiations. A trade body added that the principles could reflect that consumer interest should also be seen through the perspective of commercial viability of suppliers.

Q9. Are the general principles too broad? Should they be made more specific? If so how?

3.35 There was a widespread view that the principles were well defined for now and that any deficiency may only become apparent with time. The GCA should, as a matter of procedure, seek to demonstrate that any course of action is consistent with its operating principles. A major retailer added that the principles should be tightly defined in limiting the GCA to dealing with small and micro suppliers in relation to GSCOP matters. Conversely, a trade body was concerned that if the principles are drawn too narrowly, big players will find loopholes and avoid changing their working practices. The principles, therefore, needed to be broad ranging.

3.36 The Gangmasters Licensing Authority suggested a further principle against 'conflict of interest'. No other body involved in the vested interest of relevant grocery activities should be simultaneously involved in execution of the GCA's regulatory duties. Also the principal of fairness should be added, meaning the relationship between supplier and retailer should be fair to both parties.

Q10. Should the principles be set out in legislation?

3.37 Responses were evenly split, though a few recognised the benefit of clarity and certainty of principles being set out in legislation whilst also being difficult to amend if necessary over time.

3.38 Some of the major retailers, trade bodies and NGO's submitted that the principles should be set in legislation, particularly if legislation is also required to establish the GCA itself, though additional legislation should not be produced just to embed the principles. Principles set out in legislation would help to clearly define the role and scope of the GCA and ensure that it has the appropriate legal links to the original intention of the CC's recommendation. One retailer also noted that this would also allow any party to challenge should the GCA exceed its role.

3.39 Those parties that submitted that the principles should not be set in legislation noted that by their very nature, principles are there to act as a guide when interpreting law and it would be inappropriate to set them out in legislation. The need for the principles to evolve and change over time would be difficult to achieve if they were set in legislation. They should only move to legislation if the non statutory approach was unsuccessful as a fall back. The principles main value was in being good working guidelines for the GCA.

Q11. Is there an existing body that could take on this role? If so who might this be?

3.40 There was a contrasting response focusing on whether the OFT was the right body to take on this role.

3.41 The major retailers and some of the trade bodies submitted that the OFT was ideally suited to take on the role, particularly as it already had a number of obligations to monitor and enforce the GSCOP. The Forum of Private Business said that the OFT should be able to naturally evolve its work streams to implement these duties. Specifically, it could achieve the CC's aim, have a strong working relationship throughout the sector and build on its already considerable expertise and distribute best practice. Dairy UK noted that as an authority that regulated markets, enforcing competition law and scrutinising commercial relationships between firms, it was appropriate for the OFT to take on this role.

3.42 ActionAid said that the OFT had performed poorly in enforcing the previous supermarkets code of practice (SCOP). As a result, it did not have the confidence of suppliers. Also housing the GCA within the OFT would result in a further loss of confidence and potentially limit the body's effectiveness. It must be a standalone entity as recommended by the CC. This view was echoed by a number of trade bodies, other NGO's and religious organisations.

3.43 Another trade body believed that the OFT was not geared up for the role and it did not appear keen to take it on. In line with the CC's recommendation, there was a need for a robust, independent and committed GCA that was unfettered by other pressures. A number of respondents were sympathetic to the view that another new body should not be created lightly. But its cost was small compared to the size of the UK grocery market and its importance to the UK economy. The British Brands Group suggested that the GCA could be included within the OFT umbrella, but must be independent of it. It gave as a potential model, the Contracts Rights Renewal Adjudicator which is ring fenced within OFCOM. The Chilled Foods Association suggested the CC could fulfil this role. It has significant experience and would make for a pragmatic, cost effective and timely use of resources.

3.44 In its own submission the OFT made clear that it did not see any special or significant synergies arising from the GCA being incorporated within the OFT, rather than another organisation. It shared the CC's view that it should be a completely independent body, which it assumed would require primary legislation. If the GCA were to be incorporated into the OFT, it would be important to keep the decisional route independent of the OFT's normal activities and

ensure it is not answerable to the OFT's Board. Separate arrangements would be required for information sharing with the GCA and the OFT due to existing statutory restrictions. A system of Chinese walls similar to that which exists for the CRR adjudicator function would be required. Finally, if the GCA is sharing back office functions, Government should expect the OFT or any other host, to charge so that the GCA was not be seen to be subsidised by or be dependent on its host.

Q12. What are the benefits or downsides of an existing body taking the monitoring and enforcing compliance with GSCOP?

Q13. Is it important that a brand new body be created and are there strong arguments for or against this?

3.45 The following summarises responses to questions 12 and 13.

3.46 Major retailers noted that the OFT already had an embedded mission to make markets work well for consumers. The new GCA would be susceptible to regulatory creep. Separating the enforcement role from the OFT potentially undermined its ability to take a more holistic and informed approach to assessing compliance. The Private Business Forum added that the OFT lent an element of credibility to the enforcement of the GSCOP as it understands the interplay between business and what should constitute unfair treatment. Dairy UK said that creating a new body would introduce uncertainty as to whether it would operate with the same outlook and discipline as the OFT. A new body would come under political pressure from a range of special interest groups and lobbyists keen to change retail behaviour. A new organisation may seek to meet these expectations, or efforts would be made to change its remit. This introduced unpredictability and evolution of the competition policy framework governing the grocery sector.

3.47 A major retailer also said that hosting the GCA within the OFT was likely to be a more cost effective option. For example there would be no start up costs and it could deploy staff with expertise in the grocery sector which would be difficult and expensive to attain elsewhere. These were important considerations for retailers who would have to pay for the GCA. Another major retailer noted that a lack of articulation in the nature of the benefits that accrued from the GCA, did not meet the standards that might reasonably be required before establishing a new body, in the light of the Government's agenda to rationalise arm's length bodies.

3.48 A trade body was concerned that the OFT did not appear willing to take on the role and this must have a bearing on its ability to pursue its role effectively. Another trade body said that the OFT had its own priorities and allocated resources accordingly. GSCOP monitoring and enforcement was unlikely to be a key objective – yet dedicated focus, resource and specialist expertise were what would be required if the body was to function effectively. Another trade body emphasised that it was crucial that the enforcement body had the confidence of both suppliers and retailers if it is to be effective. An existing organisation comes with baggage which hindered the building of confidence. ActionAid made a similar point adding that part of the problem with the SCOP was that it failed to provide enforcement which gave suppliers confidence and cooperation.

3.49 CMS Cameron McKenna LLP suggested that suppliers may be hesitant in raising disputes with OFT over commercial arrangements as they may have concerns that OFT would scrutinise those arrangements under its competition law obligations.

Q14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?

Q15. If important, how should the penalties be levied?

Q16. What levels should they be set at?

3.50 The following summarises responses to questions 14, 15 and 16.

3.51 A number of trade bodies, NGO's and other organisations emphasised that the levying of financial penalties was an essential role of the GCA providing a consequence of breaching GSCOP, and acting as a indicator of how seriously the authorities regarded such breaches. They also pointed out that financial penalties were an integral part of enforcement in other industries with a regulator. The supply of groceries should be no different.

3.52 In noting that the CC called on BIS to consider giving the GCA powers to issue "significant monetary penalties", the British Brands Group pointed out that it assumed that the CC meant penalties must be significant to the retailer. The exact level should be determined by turnover, profitability and seriousness of breach. Aggravating factors such as repeated or flagrant breaches should result in further increases. Another trade body said that penalties must be levied on the retailer, and that individual buyers or other executives should face personal repercussions to avoid the temptation to cut corners in order to meet profit targets. Fines should be set at levels that will work, relating them to the seriousness of the offence, retail turnover or individual salary. Any fine levied should be sufficient to be noticeable to shareholders. ActionAid added that where a supplier, or a group of suppliers won a dispute, any sum awarded was likely to be insignificant compared to the sheer size of retailer profits. The history of the sector shows there are powerful and ruthless players that will potentially try to limit effectiveness of any new regulations. Without proper penalties and the threat of large fines up to 10% of annual turnover, the GSCOP would lack teeth.

3.53 Dairy UK expressed general concerns over the effectiveness of any penalties regime, particularly as it feared many retailers may try to recover sums from suppliers through tougher contract terms. Reputational damage would appear to be the most cost effective deterrent. Absence of a fine would reduce the financial incentive on a retailer to appeal a decision. It also pointed out that where a supplier had suffered loss, it could ultimately claim damages with the support of a decision from the enforcement body. The Church of England said that penalties should only be imposed when there is very strong and convincing evidence.

3.54 Retailers were against levying of financial penalties for breaches of the GSCOP. They noted that there were already significant deterrents built into the GSCOP enforcement regime without penalties. The GSCOP is focused on providing a more balanced framework for bilateral negotiations between retailers and suppliers. The current benefit of the GSCOP regime to all parties was in providing a quick and efficient mechanism to escalate and deal with disputes. Introducing financial penalties would lengthen the process of investigation, increase the burden on the enforcement body and lead to more lengthy and detailed challenges to decisions. These factors would transform a simple and effective dispute resolution mechanism into a time consuming, expensive and difficult process for all parties. The last thing suppliers and retailers wanted was a protracted dispute process similar to the OFT's Competition Act investigations that typically take up to five years followed by appeals lasting two years.

3.55 One major retailer noted that the CC report contained no analysis of the proportionality of monetary penalties. This means there would be no proper factual or evidential basis to introduce such a scheme. Tesco said that the vast majority of commercial disputes were resolved by the parties through mutual agreement, including costs. A penal regime could encourage a litigious environment, rather than resolution through sound and proper negotiation.

3.56 Finally, the OFT noted that if the GCA was to be given powers to impose fines, it would also need a disclosure process, perhaps mirroring Competition Act 1998 procedures. It was inconceivable that a retailer could be fined without the opportunity to view the evidence against it which would most likely reveal the identity of its accuser.

Q17. Are there other deterrents that could be effective?

Q18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?

Q19. Who should hear any appeals and how should the process work?

3.57 The following summarises the responses to questions 17, 18 and 19.

3.58 A number of respondents felt that if financial penalties were set at the right level and a mechanism was in place to fully inform suppliers and consumers those procedures should be effective enough. The GSCOP already provided for retailers to compensate suppliers in certain circumstances. Bodies such as GMAG noted that any legislation should not go beyond the measures outlined by the CC.

3.59 A number of other deterrents were however, put forward. A trade body suggested that GSCOP breaches should be admissible evidence in planning decisions and should be taken into account when awarding government contracts. Breaches should be included in retailer annual reports and the GCA should provide such details in its own annual report. Transgressions should also be published as widely as possible (such as with consumer organisations, ethical investors and the media) without breaching the confidentiality of complainants – although it was recognised this may be difficult in practice.

3.60 The Gangmasters Licensing Authority said that it might be helpful to consider a public register of those that infringe the code and for those retailers that provoke the greatest number of complaints which are subsequently upheld should be required to pay a greater proportion of the GCA's cost. Though it noted that the power to launch proactive investigations where a breach is suspected is a significant deterrent underlining the importance of this aspect of the remedy.

3.61 Trade bodies suggested that there should be a specific duty under company law on Directors (or a named director) to comply with the GSCOP. Other suggested deterrents included that retailer directors should have their bonuses linked to complaints and findings in order to be held accountable. The naming and shaming of directors and buyers of the retailer responsible and a televised public apology to be paid for by the offending retailer were other suggestions. It was also suggested that the GCA should undertake overseas visits where it could learn more from those small suppliers on their home ground under more relaxed conditions.

3.62 Retailers stressed that the Government needed to take care to avoid overly heavy handed regulation in a market which was generally working well for consumers. There was the potential for serious distortion in commercial relationships between suppliers and retailers if they were to become subject to deterrents. Retailers also urged BIS to consider whether pure deterrence was the right approach to ensure compliance. The GCA should focus its resources to identify breaches where they occur and bring as many of them to light as possible. Such a policy would allow best practice to develop rather than simply rely on deterrence.

3.63 The BRC emphasised that the revised and strengthened GSCOP provided enough incentive for retailers to comply and that it did not anticipate any breaches and the GCA should not need to do more. A major retailer also said that if the GCA only imposed large fines, it seemed likely these decisions would be appealed, rapidly consuming the body's resources with the consequence of limiting the number of decisions it could take. Experience in competition law cases suggested that large fines were a blunt tool.

3.64 The majority of respondents referred BIS to previous answers given to question 6 in answering question 19, relating to appeals.

Q20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?

3.65 GMAG and the British Brands Group noted that the CC recommended all suppliers be given access to the GCA. ActionAid, the Fairtrade Foundation and a number of trade bodies submitted that the GCA would not be able to remedy the AEC effectively if indirect suppliers were excluded. The GCA should be able to accept anonymous complaints from indirect suppliers, other third parties such as trade associations and NGO's including those based overseas. If this was rejected the GCA would be deprived of an important source of information. The Fairtrade Foundation added that allowing indirect suppliers to complain directly would be unlikely to overwhelm the GCA; a single complaint would not necessarily lead to action. Even if a large number of complaints were submitted, they would be prioritised or grouped into a smaller number of categories.

3.66 ActionAid also said that excluding indirect suppliers would run counter to the Government's international development goals. It believed that the majority of overseas suppliers are indirect and would therefore be excluded from accessing the GCA. This represented an unfair transfer of wealth from small suppliers in developing countries and their employees, to retailers in the UK. ActionAid said that it had gathered evidence which suggested overseas suppliers may stop supplying UK retailers at a loss. This outcome would not be in the interests of UK consumers if certain products, in particular out of season fruit, were no longer available in supermarkets.

3.67 A number of private individuals responded to the consultation as supporters of ActionAid's "Who Pays?" campaign. They submitted their strong feelings that workers and farmers in poor countries producing goods for the UK market should not have to bear the brunt of supermarkets transferring excessive risk and unexpected costs.

3.68 Dairy UK said that the GCA should be given discretion to receive complaints from any party in order to fulfil its role. But it noted an investigation of a retailer based on evidence from third parties could seriously prejudice the commercial interests of a direct supplier if it did not support the complaint being made. It was difficult to see how the GCA could ensure the anonymity of the supplier referred to by the complaint. Therefore, a pattern of behaviour on the part of a retailer, or retailers, would need to be established, affecting a sufficient number of suppliers before proceeding with an investigation in order to protect anonymity. It was also stressed that no supplier, direct or otherwise, should be compelled to provide information where a complaint has been submitted by a third party. It should be presumed that if a supplier had not submitted a complaint, then it was not in its commercial interest to do so. The GCA should not accept complaints that are anonymous to it.

3.69 The Welsh Assembly submitted that whilst access should be as open as possible, there was the potential for those waiting to come forward, such as primary producers with specific small scale distribution issues, to suddenly overload the enforcement body. Perhaps the level of access could be reviewed after 18 months. The Church of England said that the GCA should be able to accept complaints made jointly by suppliers and their intermediaries.

3.70 A number of retailers said that the GSCOP was contract driven and could understand retailers being held accountable for potential disputes with direct suppliers. However, a retailer should not be held accountable to indirect suppliers wanting to voice their issues where there was no contract that could have been breached. Therefore, the GCA should only police direct commercial relationships between retailers and their direct suppliers. The BRC noted it would be both novel and misguided for third parties to make complaints about relationships between two contracting parties.

3.71 It was also noted that retailers had very few relationships with primary producers meaning that the code would not be able to directly protect farmers. Retailers should not be held

responsible for disputes between farmers and their intermediaries over which they had no control. If the scope of the GSCOP was to be extended to cover indirect suppliers, it may then be appropriate for the GCA's remit to be similarly extended – but that should be subject to further review and consultation.

3.72 Other retailers pointed out that the financial burden on retailers for the new GCA could only be justified in order to remedy the AEC identified by the CC. The CC did not widen the scope of the GSCOP to apply to non grocery suppliers, or to suppliers that supply grocery suppliers themselves. The CC's report contained no analysis of the position of such other market participants. Also, as the GSCOP does not apply to these undertakings, it's not clear how the GCA could hear their complaints. A major retailer said that the GCA should consider relevant complaints by indirect suppliers for the purpose of information gathering only.

Q21. Should large suppliers be excluded so that the body monitoring and enforcing GSCOP compliance can focus on complaints from smaller ones who are more vulnerable because of their size?

Q22. If there is to be a threshold how should it be calculated?

3.73 The following summarises the responses to questions 21 and 22.

3.74 A number of trade bodies said that all suppliers, regardless of scale should have access to the GCA. They pointed out that the CC's report noted that a high proportion of products in supermarket came from large suppliers. It was therefore, essential to keep them in the process. Another trade body pointed out that smaller suppliers that may only supply a limited number of retailers had the option of finding alternative retailers to supply. Whereas large suppliers covering all retailers were not able to find alternative outlets for their products if relations break down and they consequently risk losing capacity. Large suppliers were just as vulnerable.

3.75 Another trade group said that large suppliers were more likely to raise a complaint; small firms did not have the management ability to devote the necessary resources.

3.76 ActionAid and another trade body supported the view that large suppliers were just as vulnerable as supermarkets were able to use their buying power against suppliers in a number of ways; for example, retailers target specific products rather than supplier companies and are able to influence consumer purchasing behaviour in their stores by deciding whether to list a product. They also influenced prices between retailer brand and competing labels and the allocation of shelf position and in store promotions.

3.77 A number of retailers said that the body should focus its resources only on small suppliers who may be less well equipped to identify and resolve disputes falling within the GSCOP and that may also require assistance or guidance. The Forum for Private Business, two retailers and a number of trade groups said that large suppliers should not be excluded but the GCA should use prioritisation principles to focus on smaller or vulnerable suppliers.

3.78 A number of respondents pointed out that any threshold separating large from smaller suppliers would be entirely arbitrary and difficult to justify, as well as subject to continual review. Some respondents did suggest that a threshold, if there is to be one, could look at the proportion of supplier output to a particular supermarket, including at product category level, and strength of a retailers own label in that category. One retailer said that the GCA should focus on suppliers with a turnover of less than £100 million, and another retailer said it should focus on small and micro enterprises with less than 50 employees or turnover of less than 10 million Euros. That would be a higher threshold than used in the Government's Prompt Payment Code initiative which applies to turnover of less than £1 million.

Q23. Is anything else which should be specified in 5.3 – i.e. is there an (e)?

3.79 Most respondents said no. One trade body said that the GCA should be able to rule that certain practices were prima facie against the code and that the onus would be on the supermarket to prove they were justified. A major problem would be getting suppliers to come forward – hiding their identity would be very difficult. The GCA needed to establish, on a non-attributive basis, issues which were against the GSCOP and which could be investigated in more depth.

3.80 The British Brands Group said that the potential impact of an effective GSCOP was that retailers would find new ways of transferring risk and costs to suppliers that were not covered by the code. The GCA should be able to monitor behaviour which may breach the fair dealing provision. This work could be important when the body and GSCOP were up for periodic review.

Q24. Is the CC's proposed formula the most appropriate way of calculating each party's share of body monitoring and enforcement compliance with the GSCOP's costs?

Q25. Should the funding of the body monitoring and enforcement with the GSCOP be based on other criteria, such as a flat rate charge for each of the designated retailers? If so what?

3.81 The following summarises the responses to questions 24 and 25.

3.82 The majority of those that responded supported the proposed formula included in the consultation paper or a similar combination of flat rate and top up based on complaints. Most believed this to be a fair and equitable way to apportion costs. Of that that did oppose the formula these were primarily made up of retailers.

3.83 Only one retailer supported the proposed formula noting its principle aim is to encourage compliance with the code. The Church of England said the formula was far too complicated, suggesting that a flat rate charge would be fairer.

3.84 The British Brands Group noted that retailers covered by the GSCOP vary significantly in size and as did their behaviour towards suppliers. Therefore, a flat rate would not be right or fair. The principle should be towards the total number of disputes and complaints upheld. Dairy UK said that in making funding contributions proportionate to number of recommendations made by the body to the individual retailer, the system invites retailers to recover costs from suppliers based on those recommendations. A payment based on annual turnover would remove this incentive.

3.85 A major retailer noted that a budget of about £3 million per year to regulate ten retailer relationships with their suppliers was disproportionate. Some form of mechanism to dispute the proposed budget or accrued costs should be provided to retailers, such as a speedy review by the NAO. If fines were included in the GCA's remit, this may lead to appeals and retailers should not be responsible for these costs.

3.86 Tesco said that the formula was problematic, it penalised those retailers who had no complaints upheld against them and placed too much emphasis on a retailer's scale. There was insufficient focus on the actual number of upheld complaints. Retailers who were compliant with the code should not be punished simply by virtue of their success. Suppliers whose complaints were unfounded or vexatious should be made to pay. CMS Cameron McKenna LLS said that perhaps when lodging a complaint, suppliers should lodge a fee which could be reimbursed if the complaint was upheld.

3.87 The BRC said that if policy makers believe the GCA is necessary for the public good, then the taxpayer should pay for it. To suggest it is legitimate for one sector to pay these costs on

the basis of having a large turnover was unfair and ran contrary to principles of better regulation. It also said that the budget of the GCA should come under full scrutiny and that those being asked to pay should have an opportunity to question how their contributions were being spent.

3.88 The OFT noted that there were a number of significant risks and highlighted the need for the GCA to have control over its priorities. The number of likely contacts in its first year was unknown and estimates would be unreliable, perhaps with a few high profile cases rather than many small ones. The OFT said it would be better to err on the side of caution, but provisions needed to be made in case further resource was required – logically from its host body. Some consideration would need to be given over how lost appeals should be funded as it would be unfair to levy this cost on retailers. Government would also need to consider whether funding should be sourced in advance or in arrears to cover up front costs in setting up the GCA.

Impact Assessment

26. Do you have any comments on the draft impact assessment at Annex D, including the costs and benefits of the options and any other specific issues? Please provide supporting evidence.

3.89 Most respondents commented on the difficulty of providing useful data on a system that has yet to bed down.

Specific Impact Assessment questions

27 Do you have further quantitative and qualitative evidence on the impact of supply chain practices on investment and innovation?

3.90 Some mentioned the significant impact of retrospective changes on suppliers' incentives to invest and the fact that in such a large market as UK grocery, a small loss of investment is likely to have a significant detrimental impact on consumers. Others provided examples of barriers to new products coming to market, or to scaling up supply, such as prohibitive payments for listing.

3.91 Retailers said that the available evidence does not support the CC's contentions as to what "*might*" happen; in fact that the evidence supports the conclusion that the supply chain practices identified by the CC have had no effect on investment and innovation. The evidence was that there was healthy investment and innovation in the industry.

28 Do you have other evidence regarding the potential costs associated with the GSCOP?

3.92 Those who responded were retailers. They reported that they had incurred significant costs in embedding the GSCOP within the business and expected that the costs associated in establishing the GCA would exceed those estimated. Estimates had been based on the setting up of a home credits comparisons website which was not a good match and understated the costs.

29 Are there other indicators that could inform current and future levels of compliance with supplier practices covered in the GSCOP?

3.93 It was hard to gauge compliance levels as there are many variables although surveys could be used to inform current and future levels.

3.94 One retailer considered that the BIS statement that "*compliance will rise to 73% at the very least*" understates the likely level of compliance. This was reported by suppliers with no requirement to provide evidence of breaches of the SCOP. In the absence of a requirement to be put to proof on these issues, retailers consider that the reporting of these issues is likely to be overstated.

3.95 Other retailers added that it was not appropriate to use compliance with the SCOP as a benchmark in this respect, given the significant additional provisions contained within the GSCOP and the fact that ten retailers are now covered. The presence of these additional provisions means that industry compliance with the GSCOP is likely to be significantly greater than estimated. The threat of de-listing is now the subject of detailed provisions in the GSCOP, and would itself be a cause of action for a supplier. The compliance reporting structure will give a comprehensive overview of industry compliance. Less weight should be placed on anecdotal evidence that is often misguided and represents the views of interested parties.

30 Do you have evidence that could help to quantify the impact of reduced supplier investment and innovation on consumers?

3.96 Many noted the difficulty that the CC also experienced in this area. There were suggestions that the information was based on hearsay rather than evidence.

3.97 Retailers did not have evidence to suggest that supply chain practices had an adverse impact on investment and innovation, and suggested that there was no specific evidence to support the CC's finding in this regard. Retailers claimed to enjoy strong and balanced relationships with a diverse set of suppliers of both branded and own label goods, in many cases operating in partnership to deliver a choice of innovative, high-quality products at great prices to customers.

31 Do you have any evidence that could help project the number of complaints and disputes under a GSCOP enforcement body?

3.98 It was very difficult to anticipate the number of complaints under this "Base case" scenario bearing in mind the variables involved. Some envisaged potentially more disputes than under the SCOP, primarily due to more and smaller retailers being included, they anticipated the numbers will remain very low because of the importance to suppliers of strong ongoing trading relationships.

3.99 Retailers generally agreed that the demand for, and success of, the GCA would very much depend on (a) whether it could accept complaints from indirect suppliers and (b) how credibly the GCA established itself and won the trust of suppliers and primary producers. Much of the initial work of an GCA could usefully centre on a small number of systemic complaints.

3.100 The lack of clarity around how the GCA would work increases the risk of parties with vested interests making unfounded complaints for 'tactical' commercial reasons under the GSCOP. To avoid this it is important that sufficient controls be put in place, including measures to deter claims without merit.

32 Are there other existing bodies, of which the GSCOP enforcement body could be part?

3.101 There was general consensus that OFT is best placed existing body to accommodate the GCA, given its knowledge of the industry including its knowledge of the principle participants and the legislative history in grocery retail

33 Do you have any other evidence on the costs and benefits of establishing a new body to monitor and enforce the GSCOP?

3.102 Some perceived that there are limited differences in cost between a body set up under the auspices of the OFT and a wholly independent body. Agree with the CC's view that there will be incremental net benefits to arise from an independent enforcement body.

3.103 By contrast retailers put forward Prof. Lyons views as to why a body such as the GCA would not serve the interests of consumers. They agreed that the set-up and operating costs of creating the GCA would be significantly higher for a new body than an existing body. There were concerns that the costs of creating the GCA may have been underestimated. Costs of the GCA will depend in particular on how disruptive the new complaints process proves in practice.

34 Do you have any further evidence on the likely costs associated with appeal of GSCOP arbitrations?

3.104 The new requirement for agreements to be in writing will make it easier to identify, with greater certainty, whether a breach of the GSCOP has occurred, strengthening the evidence base. These factors all combine to reduce the likely number of appeals by retailers, which we anticipate will be in the very low single figures.

3.105 One retailer considered that the CAT most likely to be well-placed to hear such appeals. In accordance with the CAT's judgment in *Napp Pharmaceuticals*, considers that it is likely that the standard of proof in relation to a penalty case would require "*strong and compelling evidence*". On this basis, full merits appeals of penalty decisions could ultimately be protracted and costly affairs (likely to be in excess of £100,000).

3.106 Another retailer commented that it had no direct evidence but expects that the costs will be even higher if suppliers choose to use the new complaint process for tactical commercial advantage. As well as appeals launched by parties for good faith reasons, suppliers may also (irrespective of the merits of the arbitrator's decision) be tempted to appeal in order to garner publicity for a cause.

35 Do you have further evidence on the effectiveness of fines as a deterrent?

3.107 One party felt that fines would not be a full deterrent but that compliance in the absence of fines will be markedly lower than if penalty powers were available.

3.108 One retailer said that the reference in footnote 55 to the OFT's study on the importance of fines in deterrence and enforcement in the context of infringements of the Chapter I prohibition of the Competition Act 1998 is inappropriate. By contrast, the GSCOP applies in the context of entirely contractual bilateral vertical agreements between a retailer and a supplier in writing, with the potential complainant, the supplier, being one of the parties to that written agreement. The prospects of detection are therefore 100 per cent and the recovery of any direct loss is likely to provide a total remedy to the harm caused by such conduct.

3.109 Another retailer considered that the GSCOP framework already provides significant incentives for retailers to comply with the GSCOP. Any incremental benefits arising from the availability of penalties would therefore be low. Fines may also be more liable to appeal, resulting in increased costs and delays for all parties, and may provide a less effective/direct solution for the supplier than an arbitration award or recommendation.

3.110 In the vast majority of cases any commercial disputes are resolved by suppliers and retailers through mutual agreement, including agreement on how costs are allocated. An

additional penal regime may encourage a litigious environment, rather than resolution through sound and proper commercial negotiation. It is inevitable that additional penalties will lead to additional legal appeals, which in turn will increase costs and delay resolution of disputes.

36 Do you have data on the number of direct and indirect suppliers in the UK groceries market?

3.111 The UK chilled prepared food manufacturing sector, which supplies all the major UK multiples, itself has more than 10,000 suppliers.

3.112 The industry is complex and it is very difficult to calculate or estimate the number of indirect suppliers overall. Some of the larger supermarkets estimated that they each had between 2-3,000 direct suppliers

Equality Impact Assessment Questions

37. Do you have any evidence on how the options around the activities, penalties, the body, access to the body and funding would have amongst different groups of business or consumers?

3.113 There was a view that the options would not disadvantage significantly any particular type of direct supplier and would treat all consumers equally, although there would be a bias towards suppliers without market power. Were large suppliers to be excluded from the GCA's activities, this would discriminate against them, depriving them of dispute resolution procedure and leaving courts as their only source of redress.

3.114 Another view was that the actions of the GCA will (a) add unnecessary costs to the industry; and (b) disrupt the bargaining relationship between suppliers and retailers, so that retailers are less able to obtain lower prices on behalf of consumers. It is essential that the right balance is struck between properly governing the industry and avoiding over regulation. If the GCA adds material costs, then different groups of consumers, businesses and communities will be negatively impacted through inevitable price rises.

38. Are there any other equality issues that we need to consider in this area?

3.115 If the GCA sits within the OFT structure then any equality concerns can be covered by the OFT's equality and diversity scheme. If the GCA sits outside the OFT structure, then further consideration would be needed for this area.

Chapter 4: THE GOVERNMENT RESPONSE

The following is the Government's responses to the questions asked in the consultation document.

Activities

1. Should the body monitoring and enforcing compliance with the GSCOP be given all of these duties and powers?

4.1 Respondents were split over the precise functions and range of powers that the GCA should have. Whilst the large retailers generally opposed the establishment of the GCA, all other stakeholders believed it to be necessary to ensure effective enforcement of the GSCOP. Those that supported the GCA said that the functions and powers set out in the consultation document were all appropriate. Whilst retailers were disappointed that the need for the GCA had been accepted, they stressed that the GCA should be restricted to the operation of the GSCOP. Retailers were concerned over the potential implications of receiving anonymous complaints. Some raised issues over the same body overseeing investigations and arbitration cases.

Government Response

4.2 The Government has decided that the GCA should undertake the range of duties set out in Chapter 2 of the consultation paper. These include acting as an arbitrator in relation to disputes arising under the GSCOP and receiving complaints in relation to breaches of the GSCOP and where appropriate conduct investigations. In the event of a conflict of interest in relation to a particular dispute the arbitration will be administered by another arbitrator.

4.3 The GCA should only act on the receipt of complaints or on other information in the public domain based on evidence and would not be obliged to investigate every single complaint. The GCA should also be able to publish guidance on the GSCOP and make recommendations to designated retailers on improving compliance and monitor progress on how those recommendations are implemented. The GCA would also publish a report at the conclusion of an investigation.

4.4 The GCA will also produce an annual report providing information on disputes, investigations, any recommendations made and other information on progress on implementing previous recommendations and areas where a lack of information has hindered progress.

2. Are some of the activities more important than others, if so what are they?

4.5 The powers and duties were regarded as a package by many. For suppliers, the ability to undertake arbitration and investigations were key. Retailers on the other hand supported the monitoring of GSCOP compliance and the publishing of guidance.

Government Response

4.6 The Government acknowledges that all of the listed duties are important to ensure an effective monitoring and enforcement regime.

3. Are there additional activities that should be considered, if so what are they?

4.7 Most responses said that the proposed activities went far enough, however, some parties did suggest additional activities for consideration. This included spot checks and surveys by the body, the extension of the GSCOP itself, the scope for sourcing intelligence and enforcing the spirit of the GSCOP as well as its strict interpretation.

Government Response

4.8 The Government accepts that the GCA should have a role in promoting awareness of the body's role throughout the supply chain and should monitor the sector for any new emerging practices. It should also consider issuing warnings at certain times of the supply cycle when abuse may be more likely to occur.

4. Are there some proposed activities that should be rejected, if so what are they?

4.9 Whilst suppliers supported the activities, retailers had most concerns over the proposed investigatory role, especially when based on anonymous complaints.

Government Response

4.10 None of the activities proposed in the consultation are to be rejected.

5. The body monitoring and enforcing compliance with the GSCOP will require information gathering powers to perform effective investigations. How general or specific should these powers be?

4.11 There was widespread recognition amongst all stakeholders that any new body would need suitable information gathering powers in order for it to function effectively, and that strong safeguards were needed to protect confidentiality. However, views differed about the scope and application of those powers. These ranged from being wide enough to enable full and fair investigations including timescales through to being very specific and only sought if necessary for a GSCOP breach.

Government Response

4.12 The Government has decided that the GCA should have powers to receive and investigate complaints regarding a party's obligations under the GSCOP. Complaints to the GCA will need to be made within a specified period of time of the alleged breach occurring. The GCA will, before commencing an investigation inform the party concerned of the general nature of the practices which the body intends to investigate and allow the party a reasonable time in which to respond. The GCA will be given appropriate means to require parties to provide information within a reasonable period of time. Government will require the GCA to develop its own practices and procedures for investigations except for the extent that they are provided for in legislation. The GCA will publish and consult on general advice and information on the procedures that will apply to investigations.

4.13 At the conclusion of an investigation the GCA must publish a report that contains a summary of the information that prompted the investigation, a description of the practices that instigated investigation, a summary of the information obtained during the investigation, the findings and the reasons for any action taken. Normal data protection rules will apply.

4.14 As a result of the investigation the GCA may undertake one or more of the following actions: recommend changes in practices, suggest in its annual report changes to the GSCOP, publish guidance on the interpretation of the GSCOP and advise a supplier of its obligations under the GSCOP.

6. Where the body monitoring and enforcing compliance with the GSCOP takes a decision following arbitration or an investigation, the decision should be open to appeal. Who should hear the appeal?

4.15 There were a number of different responses as to who should hear an appeal. The Competition Appeals Tribunal (CAT) was put forward by a number of stakeholders as being the most appropriate.

4.16 A number of responses agreed with the CC's recommendation that the High Court should hear any appeal. Others suggested that appeals should be heard by either a separate body specially convened, or by an independent person appointed from a pool of suitability qualified people. Any panel must have at least one suitably qualified person with relevant expertise.

Government Response

4.17 Any appeals in relation to arbitration from either party must be made on the grounds set out in sections 67 and 69 of the Arbitration Act 1996. The Government has decided that the High Court is the appropriate body to hear any appeals.

7. In considering the general principles that the body monitoring and enforcing compliance with the GSCOP should have regard to in the course of its work, should they last indefinitely?

4.18 A number of responses were of the view that the principles were fundamental to the operation of the GCA and should not change. Others felt that the GCA and its effectiveness should be periodically reviewed and therefore the principles should not be set in tablets of stone.

Government Response

4.19 The Government will review the effectiveness of the GCA after it has existed for a minimum period of 3 years. We will ensure that this review is consistent with the Government's commitment to impose 'sunset clauses' on regulations and regulators to ensure that the need for each regulation is regularly reviewed.

8. Are the suggested principles (paragraph 2.17, a-c) to be considered by the body monitoring and enforcing compliance with the GSCOP in carrying out its duties appropriate?

4.20 There was wide agreement from those that responded to this question that the principles were appropriate, and appeared to be proportionate and sensible with a good degree of impartiality. A number of major retailers agreed, but emphasised that the principles must be restricted to matters relating to the operation of the GSCOP

Government Response

4.21 The Government agrees the principles set out in the consultation document.

9. Are the general principles too broad? Should they be made more specific? If so how?

4.22 There was a widespread view that the principles were well defined for now and that any deficiency may only become apparent with time. The GCA should, as a matter of procedure, seek to demonstrate that any course of action is consistent with its operating principles.

Government Response

4.23 The Government believes that the general principles set out in the consultation document are of the right balance.

10. Should the principles be set out in legislation?

4.24 Responses were evenly split, though a few recognised the benefit of clarity and certainty of principles being set out in legislation whilst also being difficult to amend if necessary over time.

Government Response

4.25 The Government intends to set out in legislation the objectives and principles that the GCA should have regard to in carrying out or exercising its powers.

Who the body should be

11. Is there an existing body that could take on this role? If so who might this be?

4.26 The major retailers and some of the trade bodies submitted that the OFT was ideally suited to take on the role, particularly as it already had a number of obligations to monitor and enforce the GSCOP. It had a strong working relationship throughout the sector and could draw on its expertise.

4.27 Others were of the view that the OFT had performed poorly in enforcing the previous supermarkets code of practice (SCOP). As a result, it did not have the confidence of suppliers.

Government Response

4.28 The Government has decided that the GCA should reside within the OFT. This is consistent with the commitment made in the Coalition programme document. However, Government intends for the GCA to have decisional autonomy and to act independently of the OFT Executive and therefore be separate from the OFT's normal competition and consumer activities.

12. What are the benefits or downsides of an existing body taking this role?

4.29 The reported benefits of hosting the GCA within the OFT, included the existing mission to make markets work, and its understanding of the interplay between businesses. It would reduce the likelihood of regulatory creep. The GCA being housed within OFT would be more cost effective than outside.

On the downside the OFT was regarded as a body that was not very willing to take on the GSCOP enforcement role and would not have the trust and confidence of all of the suppliers.

Government Response

4.30 The Government acknowledges the request for an independent body to monitor and enforce the GSCOP. The OFT has some expertise in the sector. Government believes that the GCA can be established within the OFT in a way that makes it both effective and robust. Government has also had to consider the costs to business of a new stand alone GCA together with the drive to reduce the number of unnecessary "quangos".

13. Is it important that a brand new body be created and are there strong arguments for or against this?

4.31 There was a strong case made for an independent new body to take on the enforcement of the GSCOP. It was also accepted by many that a body within OFT could be set up to act independently of its day to day consumer and competition functions.

Government Response

4.32 See above.

Penalties regime

14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?

4.33 Most suppliers regarded penalties as very important as a deterrent and a message to show how seriously GSCOP breaches were being taken. However, some others including large retailers saw them as unnecessary. Retailers believed that parties should be encouraged to use the dispute process. A penalties regime could be counter productive in that it might lead to more lengthy and costly disputes and appeals rather than quick redress through arbitration.

Government Response

4.34 The Government has considered this very carefully. On balance Government believes that the strongest deterrent to breaching the GSCOP will come through impact on business reputation. Large retailers will benefit if customers believe that they treat suppliers fairly but they are likely to suffer loss of custom if their reputation is damaged through confirmed GSCOP breaches which are made public. The GCA will issue a report at the conclusion of an investigation and also publish an annual report with details of investigations and recommendations made. However, the Government intends to provide powers within the legislation to introduce regulations to impose penalties at a later date should evidence show that reputation alone is insufficient. We will base any decision in this area on advice from the GCA. Government believes that this is a proportionate approach to the issue.

15. If important, how should the penalties be levied?

4.35 There were a range of views on how penalties should be levied. Some were against any penalties; others said that they should be imposed only as a last resort and after obtaining very strong evidence. Some advocated penalties for repeat offenders only.

Government Response

4.36 To be determined at a later date should the need for regulations to introduce penalties be necessary.

16. What levels should they be set at?

4.37 There were varying views on how effective penalties might be. It was submitted that they would need to be very high to have any impact on some of the largest retailers. A penalty of up to 10% of global turnover was proposed by some. Others felt that penalties should be proportionate to the GSCOP breach. Guilty parties would also be made through higher fees to the GCA's running costs.

Government Response

4.38 To be determined at a later date should the need for regulations to introduce penalties be necessary.

17. Are there other deterrents that could be effective?

4.39 The most common deterrent put forward was the naming and shaming of guilty retailers. This ranged from being named in investigation reports, annual reports, reductions in salaries or bonuses for those involved, in store posters and media adverts. Some suggested that breaches should be taken into account when awarding public sector contracts and in planning decisions.

Government Response

4.40 The Government is considering additional or alternative deterrents that are both proportionate and effective.

18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?

4.41 Covered by 17 above.

Government Response

4.42 Covered by 17 above.

19. Who should hear appeals?

4.43 Most responses referred back to their answers to provided for question 6.

Government Response

4.44 The Government has decided that where the GCA upholds a complaint from a supplier that results in recommendations to the designated retailer that the retailer should have the right of appeal. However the retailer would not be able to appeal the merits of its decision in court. The GCA could be judicially reviewed by the courts. A judicial review will generally focus on the way in which an ombudsman has arrived *at* a decision, not on the individual facts and merits of the dispute itself. The High Court will hear appeals.

Coverage

20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?

4.45 A number of bodies called for all suppliers, trade bodies and third parties to be given access to the body. They felt that the AEC could not be fully addressed if certain bodies that could provide relevant information were excluded.

4.46 Retailers generally felt that the GCA should only police direct commercial relationships with retailers. Retailers should not be held responsible for disputes between suppliers and intermediaries over which they had no control.

Government Response

4.47 The Government has decided that anyone within the supply chain can raise complaints over GSCOP breaches with the GCA. This includes direct and indirect suppliers from both the UK and overseas. Trade associations, NGOs and other organisations still have a useful role to play in offering advice and assistance to their stakeholders, but complaints must come direct from the business affected. These can be anonymous in nature and they must be evidence based. The GCA may also act on other appropriate information that it obtains that is in the public domain.

21. Should large suppliers be excluded so that the body monitoring and enforcing compliance with the GSCOP can focus on complaints from smaller ones who are more vulnerable because of their size?

4.48 There was very little support for large suppliers to be excluded from having access to the GCA. It would be arbitrary and difficult to justify.

Government Response

4.49 The Government has decided that there is no justification for excluding large suppliers from access to the GCA. Therefore large suppliers will have the same access rights as other suppliers.

22. If there is to be a threshold how would it be calculated?

4.50 It was suggested that the enforcement body should focus on suppliers with a turnover of less than £100 million, and another retailer said it should focus on small and micro enterprises with less than 50 employees or turnover of less than 10 million Euros.

Government Response

4.51 See above.

23. Is there anything else which should be specified i.e. is there an (e) to paragraph 5.3?

4.52 Most respondents said no.

Government Response

4.53 The Government has decided that the GCA should be able to receive complaints from direct and indirect suppliers and other parties within the supply chain including those from overseas. That includes those at 5.3(a) and those persons who are within the supply chain at 5.3 (c). The GCA would also be able to obtain other information through the means set out in 5.3(d).

Funding the body monitoring and enforcing compliance with the GSCOP

24. Is the CC's proposed formula the most appropriate way of calculating each party's share of the body's costs?

4.54 The majority of those that responded supported the proposed formula included in the consultation paper or a similar combination of flat rate and top up based on complaints. Most believed this to be a fair and equitable way to apportion costs, although some commented on the formulas' complexity. Of those that did oppose the formula these were primarily made up of retailers.

Government Response

4.55 The Government wants to consider further the fairest way to calculate the share of each party's contribution to the GCA's costs, including the CC's formula.

25. Should the body's funding be based on other criteria, such as a flat rate charge for each of the designated retailers, if so what?

4.56 There was a call for the taxpayer to fund the GCA. Some thought that it was based too much on the size of the retailer and not enough on upheld complaints.

Government Response

4.57 As noted above, the Government proposes to reflect further.

Impact Assessment

4.58 The Government response to the information provided to questions 27 – 38 is to take account of it within the final impact assessment and equality impact assessment.

Chapter 5: NEXT STEPS

5.1 It is our intention to take forward the proposals to establish the GCA set out in this document through primary legislation. We will be seeking Parliamentary Business and Legislation Committee approval to publish a draft Bill later this year with the intention of bringing forward a Bill in the second Session.

ANNEX A: LIST OF RESPONDENTS TO THE CONSULTATION

ActionAid
Aldi
Andrew George MP / Grocery Market Action Group (GMAG)
Andrew Robinson
Asda
Association of Convenience Stores
Association of Labour Providers
British and Irish Ombudsman Association
British Brand Group
British Independent Fruit Growers Association
British Retail Consortium
Chilled Food Association
Christian Vaughan-Morris
Church of England - Ethical Investment Advisory Group (EIAG) & Mission and Public Affairs Council
Church in Wales
CMS Cameron McKenna LLP
Co-operative Group
Cris Rainbow
Dairy UK
Dorothy Firth
Fairtrade Foundation
Farmers' Union of Wales
Federation of Wholesale Distributors
Forum of Private Business
Food and Drink Federation
Food Ethics Council
Fresh Produce Consortium (FPC)
Friends of the Earth
Fruit South Africa
Gangmasters Licensing Authority
HE Hall & Son Ltd
H.J.Heinz Company Limited
Iceland
IDRS Ltd (Dispute Resolution Service)
Jean Davies
Lidl UK GmbH
Malcolm Verrall

Marks & Spencers
Morrisons
National Farmers Union (NFU)
OFT
Patricia Bower (Mrs.)
Paul Singleton
R Mistry
Retail Markets Alliance
Robert Barlow
Royal Association of British Dairy Farmers
Rural Shops Alliance
Ruth Mcgugan
Sainsburys
Scottish Grocers Federation
Steve Whiffen
Sydney Harrod
Tesco
Timothy I Mullen
Tom Tamplin
Unite
Waitrose
Welsh Assembly Government
WINFA (Windward Island Farmers Association)

ANNEX B: LIST OF CONSULTATION QUESTIONS

Activities

1. Should the body monitoring and enforcing compliance with the GSCOP be given all of these duties and powers?
2. Are some of the activities more important than others, if so what are they?
3. Are there additional activities that should be considered, if so what are they?
4. Are there some proposed activities that should be rejected, if so what are they?
5. The body monitoring and enforcing compliance with the GSCOP will require information gathering powers to perform effective investigations. How general or specific should these powers be?
6. Where the body monitoring and enforcing compliance with the GSCOP takes a decision following arbitration or an investigation, the decision should be open to appeal. Who should hear the appeal?
7. In considering the general principles that the body monitoring and enforcing compliance with the GSCOP should have regard to in the course of its work, should they last indefinitely?
8. Are the suggested principles (paragraph 2.17, a-c) to be considered by the body monitoring and enforcing compliance with the GSCOP in carrying out its duties appropriate?
9. Are the general principles too broad? Should they be made more specific? If so how?
10. Should the principles be set out in legislation?

Who the body should be

11. Is there an existing body that could take on this role? If so who might this be?
12. What are the benefits or downsides of an existing body taking this role?
13. Is it important that a brand new body be created and are there strong arguments for or against this?

Penalties regime

14. How essential is the levying of penalties to the role of the body monitoring and enforcing compliance with the GSCOP?
15. If important, how should the penalties be levied?
16. What levels should they be set at?
17. Are there other deterrents that could be effective?

18. Could other action taken by the body monitoring and enforcing compliance with the GSCOP to prohibit GSCOP breaches be effective?

19. Who should hear appeals?

Coverage

20. Should complaints to the body monitoring and enforcing compliance with the GSCOP be limited to those direct suppliers covered by the GSCOP?

21. Should large suppliers be excluded so that the body monitoring and enforcing compliance with the GSCOP can focus on complaints from smaller ones who are more vulnerable because of their size?

22. If there is to be a threshold how would it be calculated?

23. Is there anything else which should be specified i.e. is there an (e) to paragraph 5.3?

Funding the body monitoring and enforcing compliance with the GSCOP

24. Is the CC's proposed formula the most appropriate way of calculating each party's share of the body's costs?

25. Should the body's funding be based on other criteria, such as a flat rate charge for each of the designated retailers, if so what?

Impact Assessment

26. Do you have any comments on the draft impact assessment at Annex D, including the costs and benefits of the options and any other specific issues? Please provide supporting evidence.

Specific Impact Assessment questions

27. Do you have further quantitative and qualitative evidence on the impact of supply chain practices on investment and innovation? (paragraph 47)

28. Do you have other evidence regarding the potential costs associated with the GSCOP? (paragraph 61)

29. Are there other indicators that could inform current and future levels of compliance with supplier practices covered in the GSCOP? (paragraph 64)

30. Do you have evidence that could help to quantify the impact of reduced supplier investment and innovation on consumers? (paragraph 65)

31. Do you have any evidence that could help project the number of complaints and disputes under a GSCOP enforcement body? (paragraph 70)

32. Are there other existing bodies, of which the GSCOP enforcement body could be part? (paragraph 78)

33. Do you have any other evidence on the costs and benefits of establishing a new body to monitor and enforce the GSCOP? (paragraph 85)

34. Do you have any further evidence on the likely costs associated with appeal of GSCOP arbitrations? (paragraph 94)

35 Do you have further evidence on the effectiveness of fines as a deterrent? (paragraph 95)

36 Do you have data on the number of direct and indirect suppliers in the UK groceries market? (paragraph106)

Equality Impact Assessment Questions

37. Do you have any evidence on how the options around the activities, penalties, the body, access to the body and funding would have amongst different groups of business or consumers?

38. Are there any other equality issues that we need to consider in this area?

ANNEX C: RELATED LINKS

- 1) Code of practice on supermarkets' dealings with suppliers (SCOP)
http://www.offt.gov.uk/shared_offt/monopolies/supermarkets2.pdf
- 2) Office of Fair Trading Supermarkets: The code of practice and other competition Issues: March 2005
http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft783.pdf
- 3) Press Notice: OFT to refer grocery market to Competition Commission84/06: 9 May 2006
<http://www.offt.gov.uk/news/press/2006/84-06>
- 4) The grocery market: The OFT's reasons for making a reference to the Competition Commission OFT845: May 2006
http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft845.pdf
- 5) The CC's final report on the supply of groceries in the UK: 30 April 2008
http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf
- 6) The Government response to the final report ; 29 July 2008
<http://www.berr.gov.uk/files/file47089.pdf>
- 7) News Release 36/09: CC Publishes Code of Practice and Ombudsman Recommendation: 4 August 2009
http://www.competition-commission.gov.uk/press_rel/2009/aug/pdf/36-09.pdf
- 8) The revised groceries supply code of practice (GSCOP): August 2009
http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf
- 9) The CC's proposed undertakings to establish a GSCOP Ombudsman Scheme
http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/ombudsman_undertakings.pdf
- 10) The OFT role in GSCOP Order enforcement
http://www.offt.gov.uk/shared_offt/monopolies/GSCOP-OFT-advice.pdf
- 11) BIS Press Release Government Announces Go-Ahead for Supermarket Enforcer: 13 January 2010
<http://nds.coi.gov.uk/content/detail.aspx?NewsAreaId=2&ReleaseID=410284&SubjectId=2>
- 12) The CC groceries market page
<http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm>
- 13) Taking forward the establishment of a body to monitor and enforce compliance with groceries supply code of practice (GSCOP)
- Consultation: 5 February 2010
<http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/10-577-monitoring-gscop-consultation.pdf>

Title: Taking forward the establishment of a body to monitor and enforce the groceries supply code of practice (GSCOP): The Groceries Code Adjudicator Lead department or agency: Department of Business, Innovation and Skills Other departments or agencies: N/A	Impact Assessment (IA)
	IA No: BIS0116
	Date: July 2010
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Primary Legislation
Contact for enquiries:	

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

In its investigation of the UK groceries market, the Competition Commission (CC) found that large grocery retailers were transferring excessive risks and unexpected costs to suppliers, by exercising their buyer power. The CC considered that this might have an adverse effect on suppliers' ability to invest and innovate, which could ultimately reduce choice and value and /or increase prices for consumers, relative to a well functioning market. Under certain circumstances, retailers may have less incentive to take action to mitigate such risks, giving rise to moral hazard. Having failed to agree voluntary undertakings to establish a body to enforce the GSCOP, the CC has recommended that BIS set up such a body.

What are the policy objectives and the intended effects?

The principal objective is to promote innovation and investment in the groceries supply chain, which will ultimately be beneficial to consumers, as well as the wider economy. The objective of independent enforcement of the GSCOP is to prevent the practice of supply chain behaviour by grocery retailers that has an adverse impact on the ability and willingness of suppliers to invest and innovate.

This takes forward a Coalition commitment to "introduce, as a first step, an Ombudsman in the OFT who can proactively enforce the GSCOP and curb abuses of power, which act against the long-term interest of consumers".

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

The following elements have been analysed with reference to a "base case" (Option 1), which amounts to the establishment of an adjudicator with the power to accept complaints from suppliers (both direct and indirect) and deal with them anonymously:

- Option 2: whether establishing a Groceries Code Adjudicator requires the creation of a new body
- Option 3: whether the Groceries Code Adjudicator should have the power to levy penalties
- Option 4: whether the Groceries Code Adjudicator should only consider code related complaints from direct suppliers (i.e. those covered by the GSCOP)

The option being taken forward (Option 5) is a combination of Options 1 and 3 – i.e. the adjudicator will be part of an existing body (the OFT) and that powers will be provided for Government to introduce financial penalties at a later date.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

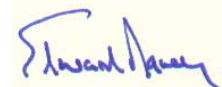
It will be reviewed
06/2015

Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

Yes

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the

***benefits justify the costs. Signed by the responsible Minister:
21 July 2010***

A handwritten signature in blue ink, appearing to read "Stewart Hogg", is written over a yellow rectangular highlight.

Date:

Summary: Analysis and Evidence

Policy Option 1

Description: Base case – introduction of a body to monitor and enforce the GSCOP with the power to conduct proactive investigations on the basis of anonymous complaints

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: -10.3 + unquantifiable benefits

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A		
High			
Best Estimate		Negligible	1.2

Description and scale of key monetised costs by 'main affected groups'

The costs associated with this option would be those incurred in carrying out investigations on the basis of complaints received. These will be funded by retailers with annual revenues greater than £1bn and have been estimated by the Competition Commission to be £120k per retailer covered by the GSCOP (i.e. £1.2 million per year in total, across the 10 relevant retailers). However, these costs may vary, depending on the number of complaints the adjudicator receives and the number of investigations it chooses to carry out.

Other key non-monetised costs by 'main affected groups'

Under the base case, it is assumed that the adjudicator will be based within the OFT. Although there may be some initial costs associated with establishing the adjudicator, these are not expected to be significant as the OFT has prior experience in enforcing the previous code of practice (SCOP) and already has built up considerable background knowledge in this area.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		
High			
Best Estimate		Unquantifiable	Unquantifiable

Description and scale of key monetised benefits by 'main affected groups'

The benefits associated with this option are those resulting from a potential improvement in investment and innovation within the groceries supply chain, which could ultimately lead to improvements in quality and choice for consumers, as well as lower prices in the long run. Although it has not been possible to quantify the potential improvement in investment and innovation and its consequent impacts, this will be monitored in the future and any refinements will be addressed as part of the post-implementation review.

Other key non-monetised benefits by 'main affected groups'

Where action by retailers transferring excessive risks to upstream grocery suppliers has contributed to their going out of business (generating costs through job losses and loss of livelihood), there could be some benefits under this option if such actions are prohibited (and hence the associated costs of supplier exit are avoided). However, it has not been possible to quantify these. Incentives for retailers to comply with the code should also help improve their conduct and relationships with suppliers.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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The main assumption impacting on both the benefits and costs is that the number of investigations undertaken (and disputes arbitrated) by the adjudicator. As both costs and benefits are non-negative (with negligible set-up costs), this implicitly assumes that compliance will be below 100%. In extremis, if all of the grocery retailers regulated by the Code are fully compliant, then the number of complaints (and therefore the costs under this option) would most likely tend to zero, though this is probably unlikely. A potential risk is that the establishment of the adjudicator does not lead to any improvement in the conduct of retailers in relation to their suppliers. This would render the intended remedy to the CC's findings redundant – i.e. generating costs for retailers but no benefits to suppliers or consumers – and would be mitigated by Review.

Impact on admin burden (AB) (£m): 0			Impact on policy cost savings (£m):	In scope
New AB: 0	AB savings: N/A	Net: 0	Policy cost savings:	No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	OFT				
What is the annual change in enforcement cost (£m)?	£1.2m				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	N/A				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: N/A	Non-traded: N/A			
Does the proposal have an impact on competition?	Yes				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs: 100		Benefits: 100		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Medium m	Large 0.12
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties² Statutory Equality Duties Impact Test guidance	Yes	37
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	37
Small firms Small Firms Impact Test guidance	Yes	37
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		

² Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	37
Sustainable development Sustainable Development Impact Test guidance	Yes	37

Description: Establishment of a new body to monitor/enforce the GSCOP

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -2.9	High: -3.9	Best Estimate: -3.4

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	3	0	2.9
High	4	0	3.9
Best Estimate	3.5	0	3.4

Description and scale of key monetised costs by ‘main affected groups’

One-off costs to retailers for establishing an independent body to monitor and enforce the GSCOP, which is estimated to be between £3m and £4m, based on comparable costs for setting up the Financial Ombudsman Service in 2001. Whether the Groceries Code Adjudicator is a newly-created body or part of an existing body would not be expected to influence its level of activity, hence the annual cost is the same as under the base case (£1.2m), but the marginal cost is zero.

Other key non-monetised costs by ‘main affected groups’

There may be some additional costs (either one-off or ongoing) in terms of lost benefits associated with the set up or conduct of the Groceries Code Adjudicator resulting from having the monitoring/enforcement body as part of the OFT, given its prior experience in building skills and background knowledge in this area from enforcing the previous code.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		
High			
Best Estimate		0	0

Description and scale of key monetised benefits by ‘main affected groups’

As above, the benefits associated with this option are primarily determined by the number of investigations undertaken and disputes arbitrated by the Groceries Code Adjudicator. However, given that we do not expect the nature of the adjudicator (i.e. whether it is a newly-created body or part of an existing body) to influence its level of activity, the marginal benefits are assumed to be zero.

Other key non-monetised benefits by ‘main affected groups’

There may be some advantages in how the adjudicator conducts its business, if a new body were created expressly for this purpose – i.e. a dedicated body with industry expertise, which would build working relationships with supplier trade associations and retailers and monitor compliance and promote best practice.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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As stated above, the key assumption impacting on both the benefits and costs is that the number of investigations undertaken (and disputes arbitrated) by the Groceries Code Adjudicator is assumed to be the same, regardless of whether it is a new body. As this number increases, so do both the associated costs and benefits. It is likely that both a new enforcement body and the OFT would be seen as independent. However, existing bodies may be less likely to be regarded as independent by suppliers or retailers, and this could affect both costs and benefits. A further potential risk is that the creation of a body to monitor and enforce the GSCOP does not lead to any improvement in the conduct of retailers in relation to their suppliers. This would render the intended remedy to the CC’s findings redundant.

Impact on admin burden (AB) (£m): 0			Impact on policy cost savings (£m):		In scope
New AB: 0	AB savings: N/A	Net: 0	Policy cost savings:		No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom			
From what date will the policy be implemented?			2010			
Which organisation(s) will enforce the policy?			OFT			
What is the annual change in enforcement cost (£m)?			0			
Does enforcement comply with Hampton principles?			Yes			
Does implementation go beyond minimum EU requirements?			N/A			
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A	Non-traded: N/A		
Does the proposal have an impact on competition?			Yes			
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: 100	Benefits: 100		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)		Micro N/A	< 20 N/A	Small N/A	Medium N/A	Large 0
Are any of these organisations exempt?		Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties³ Statutory Equality Duties Impact Test guidance	Yes	37
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	37
Small firms Small Firms Impact Test guidance	Yes	37
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	Yes	37
Sustainable development Sustainable Development Impact Test guidance	Yes	37

³ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Description: Conferring a power on the Groceries Code Adjudicator to levy penalties

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -21.5	High: 3.9	Best Estimate: -8.8

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A	2	6.4
High		10	31.8
Best Estimate		6	19.1

Description and scale of key monetised costs by ‘main affected groups’

Transition costs are expected to be zero, as there are no significant set-up costs – for example, there is no need to establish new appeals procedures. As regards ongoing costs, in the absence of any better information, we have conservatively assumed that the costs of an appeal will be roughly £200,000 per case (£100,000 of costs to Government for staff time/overheads, £100,000 of legal costs for parties) and that there are between 1 and 5 appeals per retailer per year (i.e. 10-50 appeals annually), declining over time.

Other key non-monetised costs by ‘main affected groups’

Adding penalty powers could lead to the adjudicator erroneously finding breaches of the GSCOP or breaches that do not have an adverse effect on supplier investment and innovation. This could induce behaviour by retailers that is costly rather than beneficial. In addition, penalties imposed by the adjudicator could be passed on to consumers in the form of higher prices. This could be particularly problematic for low-income consumers, for whom expenditure on food makes up a higher proportion of their income.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		
High			
Best Estimate		1.2	10.3

Description and scale of key monetised benefits by ‘main affected groups’

In addition to the deterrence effect associated with negative publicity under the base case, penalty powers will increase the potential cost to retailers of not complying with GSCOP, and hence should increase the incentive for retailers to comply with the GSCOP. It has been assumed that this marginal impact on compliance has had the effect of improving compliance to 100%, which should eliminate the cost associated with investigations and dispute resolution identified in the base case (i.e. £1.2m per year).

Other key non-monetised benefits by ‘main affected groups’

A potential additional benefit under this option is the avoided costs for individual complainants of undertaking a follow-on action (in the absence of penalty powers) to cover the punitive elements of a breach of GSCOP, which evidence indicates could be £250,000-£300,000 per case. However, as we do not have any data on the likely number of follow-on actions, this is very difficult to quantify. There is also further realisation of benefits under full enforcement of the GSCOP, though these are unquantified.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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Assumptions have been made about the cost of an appeal case and the likely number of appeals in a given year; additional assumptions have been made about how cases might decline over time as 'learning' effects take hold. However, the appeal costs per case could be significantly higher and the number of appeal cases per year could be much higher (or lower). For example, a response to the BIS consultation suggested that the new requirement to have agreements in writing would make breaches of GSCOP more clear-cut and easier to identify, leading to a low incidence of appeals.

Impact on admin burden (AB) (£m): 0		Impact on policy cost savings		In
New AB: 0	AB savings: N/A	Net: 0	Policy cost savings:	No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kindom		
From what date will the policy be implemented?			2010		
Which organisation(s) will enforce the policy?			OFT, High Court		
What is the annual change in enforcement cost (£m)?			1m-5m		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A	Non-traded: N/A	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: 100	Benefits: 100	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Mediu m	Large 0.1-0.5
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties ⁴ Statutory Equality Duties Impact Test guidance	Yes	37
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	37
Small firms Small Firms Impact Test guidance	Yes	37
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	

⁴ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	Yes	37
Sustainable development Sustainable Development Impact Test guidance	Yes	37

Description: Limiting the scope of those organisation who can raise code-related complaints with the Groceries Code Adjudicator to direct suppliers only

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 5.2	Best Estimate: 2.6 – unquantifiable costs

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A		
High			
Best Estimate		0	Unquantifiable

Description and scale of key monetised costs by ‘main affected groups’

Although it has been assumed that limiting the scope of potential complainants to direct suppliers only could reduce the number of complaints by up to 50%, it has not been possible to estimate the potential costs that indirect suppliers may incur through retailer practices to transfer risk to them. As with the benefits associated with Option 1, these will be monitored and can be refined through the post-implementation review.

Other key non-monetised costs by ‘main affected groups’

Under this option, indirect suppliers would be severely impaired in terms of redress for any breaches of GSCOP, which could lead to costs being transferred onto them from intermediaries. In extremis, these costs could lead to some suppliers being forced to exit the market. This could then lead to negative distributional effects through the geographic distribution of loss of employment (e.g. in key farming areas). This would limit the scope for realising the full benefits of enforcement of the GSCOP.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A	0	0
High		0.6	5.2
Best Estimate		0	0.3

Description and scale of key monetised benefits by ‘main affected groups’

Limiting the number of potential complainants is likely to reduce the number of overall complaints and disputes that the adjudicator will have to deal with, leading to a reduction in the costs associated with enforcement under the base case (£1.2m). We have assumed that the potential reduction is between 0% and 50%, resulting in an overall reduction – compared to the base case – of between £0 and £0.6m.

Other key non-monetised benefits by ‘main affected groups’

It has been suggested that some suppliers may seek to raise a complaint for ‘tactical’ reasons (or other ulterior motives). Limiting the number of potential complainants may reduce the number of such vexatious complaints and the costs (to both suppliers and retailers) associated with these.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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We have not been able to obtain firm figures about the comparative numbers of direct and indirect suppliers. Given that a potential reason for not directly supplying a grocery retailer could be a lack of scale, it could be that indirect suppliers are more likely to be smaller, hence more susceptible to the exercise of buyer power by grocery retailers. However, in the absence of any further information, it has been assumed that the reduction in the likely number of complaints could be up to 50%. Even if the GSCOP and adjudicator is successful in preventing retailers from exercising their buyer power, the Code does not cover contracts between primary producers and intermediaries. Therefore, an adverse effect on competition may still exist in the supply chain if the adjudicator limits its scope to direct suppliers.

Impact on admin burden (AB) (£m): 0			Impact on policy cost savings		In
New AB: 0	AB savings: N/A	Net: 0	Policy cost savings: Zero		No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	United Kingdom				
From what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	OFT				
What is the annual change in enforcement cost (£m)?	-0.3				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	N/A				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded: N/A		Non-traded: N/A		
Does the proposal have an impact on competition?	Yes				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs: 100		Benefits: 100		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Medium	Large -0.03
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties ⁵ Statutory Equality Duties Impact Test guidance	Yes	37
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	37
Small firms Small Firms Impact Test guidance	Yes	37
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	

⁵ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	Yes	37
Sustainable development Sustainable Development Impact Test guidance	Yes	37

Description: Introduction of a Groceries Code Adjudicator within the OFT. The GCA has a power to levy penalties but this will not be invoked until there is sufficient evidence that penalty fines are necessary.

Price Base Year 2010	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate: -10.3 + unquantifiable benefits

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A		
High			
Best Estimate		Negligible	1.2

Description and scale of key monetised costs by ‘main affected groups’

The costs associated with the Government’s preferred option would be those incurred by the GCA carrying out investigations on the basis of complaints received. The power to levy penalties will not be utilised unless there is clear evidence that a further deterrent is required to change retailer behaviour. The costs of a penalty power are therefore not included as they will not be incurred in the first instance. If the power is used in the future, the total annual cost to retailers of the GCA is estimated to be between £3.2-11.2 million.

Other key non-monetised costs by ‘main affected groups’

There may be some initial costs associated with establishing the adjudicator but these are not expected to be significant as the OFT has prior experience in enforcing the previous code of practice. Invoking the penalty power in the future may lead to higher prices in the grocery market if firms pass on their increased costs to consumers. Of course, if retailers are fully compliant with the Code then there will be no policy costs.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		
High			
Best Estimate		Unquantifiable	Unquantifiable

Description and scale of key monetised benefits by ‘main affected groups’

The benefits arise from a potential improvement in investment and innovation within the groceries supply chain, which could ultimately lead to improvements in quality and choice for consumers, as well as lower prices in the long run. As discussed above it is not yet possible to quantify these. If the penalty power is used in the future, it should increase retailer’s compliance with the GSCOP. This would lead to a benefit of £1.2 million per year.

Other key non-monetised benefits by ‘main affected groups’

Where action by retailers transferring excessive risks to upstream grocery suppliers has contributed to their going out of business (generating costs through job losses and loss of livelihood), there could be some benefits under this option if such actions are prohibited (and hence the associated costs of supplier exit are avoided). However, it has not been possible to quantify these. Implementing the penalty power may result in complainants avoiding the costs of follow-on action.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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The main assumption impacting on both the benefits and costs is that the number of investigations undertaken (and disputes arbitrated) by the adjudicator. Costs will change if the number of complaints and investigations is different to the expected amount. Without the penalty power, it is assumed that compliance will be below 100% given this was the case under the previous code of practice. A potential risk is that the establishment of the adjudicator does not lead to any improvement in the conduct of retailers in relation to their suppliers. This would render the intended remedy to the CC's findings redundant – i.e. generating costs for retailers but no benefits to suppliers or consumers - and would be mitigated by Review. The potential costs of the penalty power will also change depending on the number of appeals per year.

Impact on admin burden (AB) (£m): 0			Impact on policy cost savings	In
New AB: 0	AB savings: N/A	Net: 0	Policy cost savings:	No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			2010		
Which organisation(s) will enforce the policy?			OFT		
What is the annual change in enforcement cost (£m)?			£1.2m		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A	Non-traded: N/A	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			Costs: 100	Benefits: 100	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro N/A	< 20 N/A	Small N/A	Medium m	Large 0.12
Are any of these organisations exempt?	Yes	Yes	Yes	Yes	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties⁶ Statutory Equality Duties Impact Test guidance	Yes	37
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	37
Small firms Small Firms Impact Test guidance	Yes	37
Environmental impacts		
Greenhouse gas assessment	No	
Wider environmental issues	No	
Social impacts		

⁶ Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	Yes	37
Sustainable development Sustainable Development Impact Test guidance	Yes	37

Evidence Base (for summary sheets) – Notes

References

No.	Legislation or publication
1	Groceries market investigation – Competition Commission report: http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm
2	Letter from CC to BIS recommending establishment of GSCOP: http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf
3	BIS consultation on establishment of a body to monitor & enforce compliance with GSCOP: http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/10-577-monitoring-gscop-consultation.pdf
4	

Evidence Base

The following table shows how the costs and benefits of the Government's preferred option (Option 1) will materialise over a ten year period. The figures in parentheses include the costs and benefits of using a penalty power (Option 3). However, given that these will not be invoked until there is sufficient evidence that it is necessary, they are not included in the final policy calculations.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs										
Annual recurring cost	1.2 (7.2)	1.2 (4.8)	1.2 (3.6)	1.2 (3.0)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)
Total annual costs	1.2 (7.2)	1.2 (4.8)	1.2 (3.6)	1.2 (3.0)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)	1.2 (2.4)
Transition benefits										
Annual recurring benefits	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)
Total annual benefits	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)	0+NQ (1.2)

* For non-monetised benefits please see summary pages and main evidence base section

** NQ indicates benefits that are not quantified

Figures in brackets indicate additional illustrative costs that would be incurred if the power for the adjudicator to levy penalties were enacted

Evidence Base (for summary sheets)

Overview

1. On 9 May 2006, the Office of Fair Trading (OFT) referred the supply of groceries by retailers in the UK to the Competition Commission (CC) for investigation. The CC had previously conducted an inquiry into the grocery retailing sector in 2000, stemming from criticisms of the prices and profits of UK grocery retailers during the late 1990s. During that investigation, the CC uncovered supermarket practices that were operating against the public interest in terms of the behaviour of five grocery retailers (Asda, Sainsbury's and Tesco) towards their suppliers. This led to the establishment of the Supermarket Code of Practice (SCOP)⁷ which regulated the conduct of the (now) four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco)⁸ with respect to their suppliers.
2. Following the 2000 investigation, the OFT continued to provide oversight of the SCOP and also conducted competition assessments of various mergers (e.g. Safeway and Somerfield).⁹ In carrying out its responsibilities, the OFT continued to receive complaints and representations about grocery retailing with regards to the operation of SCOP, pressures facing convenience stores and the market position of Tesco. In response to continuing concerns about the effectiveness of the SCOP, the OFT commissioned and published the results of a compliance audit in 2005.¹⁰
3. In addition to inviting parties to present evidence related to the SCOP audit, the OFT also invited evidence on whether there were aspects of the supply of groceries by retailers that adversely affected competition. The OFT initially decided that there was no ground for a market investigation but following a challenge of this decision in the Competition Appeal Tribunal (CAT) by the Association of Convenience Stores (ACS) and Friends of the Earth, the OFT withdrew its decision. After further investigation the OFT referred a market investigation to the CC in May 2006.
4. On 30 April 2008, the CC published its final report (hereafter referred to as the 'CC report').¹¹ It found that, in many respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers. However, there were concerns that grocery retailers transfer excessive risk and unexpected costs to their suppliers through various supply chain practices. This was deemed to have an Adverse Effect on Competition (AEC) and as such the CC proposed the following remedies:
 - A new strengthened code of practice – the Grocery Supply Code of Practice (GSCOP) established by the Groceries Market (Supply Chain Practices) Investigation Order 2009;
 - A Supermarkets Ombudsman to oversee and enforce the GSCOP, and to arbitrate disputes arising under it.
5. In August 2009, the CC concluded consultation on these remedies and established the GSCOP (or Code) using its powers under the Enterprise Act (2002). It also recommended that the Government establish a GSCOP Ombudsman, with the powers to impose penalties

⁷ http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_7.pdf

⁸ Somerfield was one of the original five but did not become a signatory of SCOP because its market share was less than 8 per cent, the threshold at which the CC decided that the SCOP should apply.

⁹ Morrisons' proposed acquisition of Safeway in 2003 (http://www.oft.gov.uk/shared_of/mergers/morrison.pdf) and Somerfield's acquisition of 114 stores from Morrisons in 2005 (http://www.oft.gov.uk/shared_of/mergers_ea02/2005/somerfieldmorrisondecision.pdf)

¹⁰ OFT, *Supermarkets: The code of practice and other competition issues*, OFT783, March 2005.

¹¹ http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm

for breaches of the Code, after retailers failed to voluntarily establish such a body.¹² The Government's response, published on 13 January 2010, accepted the need for an enforcement body to monitor and enforce the Code.¹³

6. Since the end of the consultation, a new Government has been elected. In the coalition agreement, the Government has stated its intention to introduce an Ombudsman based within the OFT to "proactively enforce" the GSCOP (i.e. not to create a new body) and "and curb abuses of power, which...act against the long-term interest of consumers".¹⁴ Nevertheless, Government recognises that it is important to separate out this new role from the OFT's normal activities and has decided that the enforcement body will remain independent.
7. Taking into account the evidence provided by responses to the consultation, Government expects that the deterrent which will have the greatest impact on changes in behaviour is that of reputation. However, powers will be provided in the primary legislation for the Government to introduce financial penalties should future experience indicate that reputation alone is not sufficient. In relation to complaints, Government has decided that the body should have the power to receive anonymous complaints from anyone in the supply chain. This includes farmers who may not directly supply the relevant retailers and is in line with the Coalition Programme. Trade associations, NGOs and other organisations still have a role to play in offering advice and assistance to their stakeholders, but complaints should come direct from the business affected.
8. Government has also accepted advice that "Ombudsman" is not an appropriate name for a body of this nature. An Ombudsman normally provides effective redress mechanisms for individual consumers and citizens. This body is concerned with business to business relationships within the groceries supply chain. The Government has therefore decided that the body should be named the Groceries Code Adjudicator (GCA).
9. This Impact Assessment accompanies the government response, and incorporates stakeholder views following the consultation from 5 February to 30 April 2010. It will be updated just before the Bill enters Parliament to reflect the elements of the Bill, and again if the Bill receives Royal Assent, to reflect the elements of the Act.

One In, One Out

10. A Coalition Commitment is that red tape will be cut by introducing a 'one-in, one-out' rule whereby no new regulation is brought in without other regulation being cut by an equivalent or greater amount. The current expected cost to the ten retailers covered by the GSCOP of implementing a Groceries Code Adjudicator is £1.2 million per year. A One Out will be sought for this measure in due course. If the Adjudicator decides that invoking the penalty power is necessary, another One Out of total equivalent cost will be required to compensate once that decision has been taken.

Background

11. In 2009, an estimated £146.3 billion of grocery sales were made through 93,000 grocery stores in the UK. It is an important sector, with food and grocery expenditure accounting for over half of total retail spending.¹⁵ Groceries include food, pet food, drinks, cleaning products, toiletries and household goods.¹⁶

¹² http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

¹³ <http://www.berr.gov.uk/files/file54194.pdf>

¹⁴ http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

¹⁵ <http://www.igd.com/index.asp?id=1&fid=1&sid=17&tid=0&folid=0&cid=94>

¹⁶ This is the definition of groceries that was given in the CC's terms of reference and does *not* include: petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers and magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware,

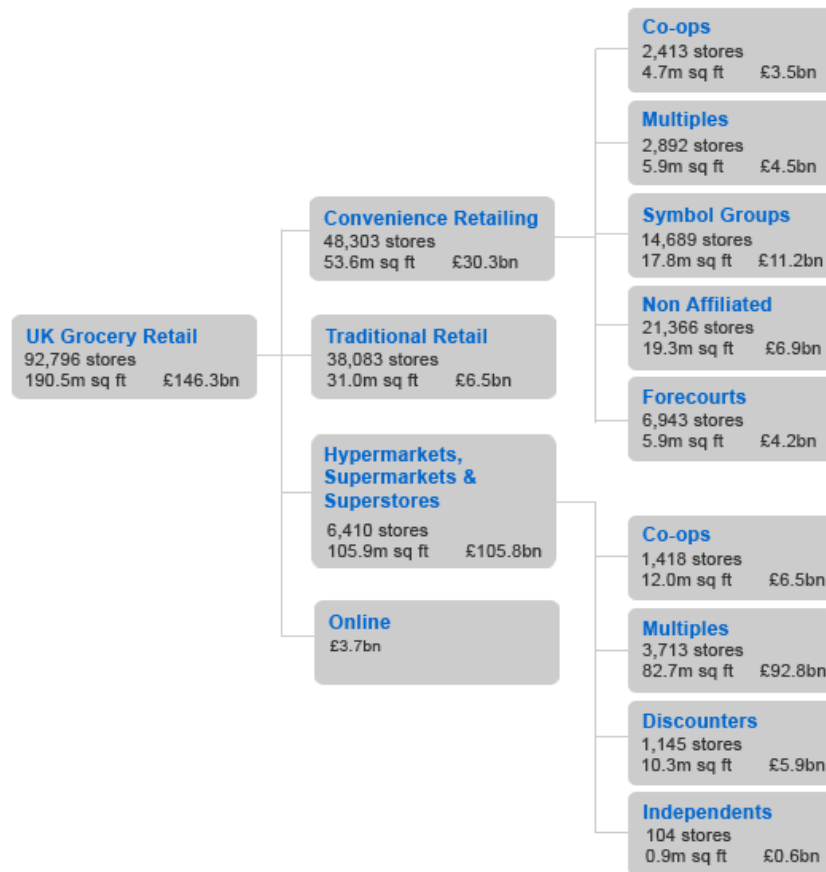
12. The CC identified seven major categories of grocery retailer in the UK.

- **Large grocery retailers** carry a full range of grocery products and have an integrated wholesaling function that purchases directly from food and drink manufacturers.¹⁷ There are currently eight large grocery retailer brands: Asda; Morrisons; Co-operative Group Limited (CGL, which now also incorporates Somerfield); Marks and Spencer (M&S); Sainsbury's; Tesco and Waitrose.
- **Regional grocery retailers** (e.g. Booths in north-west England, Dunnes in Northern Ireland and regional Co-ops) operate in a particular part of the UK with mid-sized and/or larger grocery stores and may also operate convenience stores. They carry a full range of grocery products and generally use wholesalers to source supplies or use buying groups to negotiate on their behalf with their suppliers.
- **Symbol group retailers** (e.g. Spar, Londis and Costcutter) operate stores under a common fascia (or symbol). They may be independently owned or directly owned by the symbol group or affiliated wholesalers. Symbol group retailers generally source supplies through affiliated wholesalers.
- **Convenience store operators** are all operators of convenience stores (smaller than 280 square metres) and include large grocery retailers, regional grocery retailers, symbol group retailers and independent non-affiliated convenience store operators. According to IGD, there are approximately 50,000 convenience stores in the UK (see below).
- **Limited Assortment Discounters** (LADs) carry a limited range of grocery products and base their retail offer on selling these products at competitive prices. The three major LADs in the UK are Aldi, Lidl and Netto.
- **Frozen food retailers** (e.g. Iceland and Farmfoods) specialise in the sale of frozen foods and generally carry a limited range of other grocery products.
- **Specialist grocery retailers** primarily sell an individual grocery product category and include bakeries, budgets, greengrocers and off-licences.

gardening equipment, books, tobacco and tobacco products.

¹⁷ Large grocery retailers, however, tend to purchase fresh produce from produce wholesalers rather than directly from primary producers

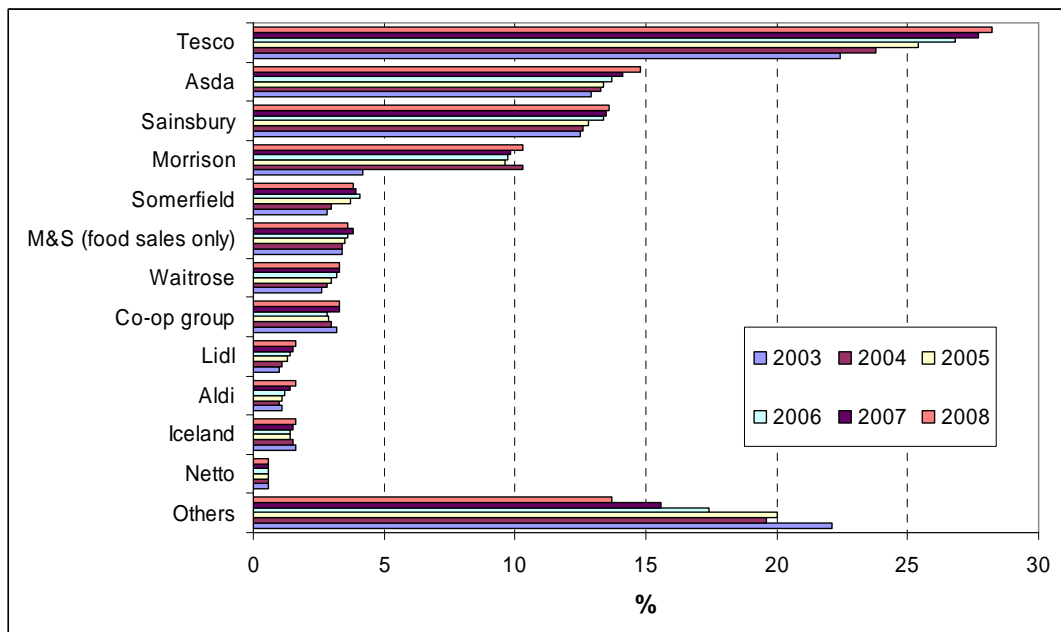
Figure 1: UK grocery retailing – store numbers & sector value



Source: IGD research (2009)

13. In 2008, large grocery retailers accounted for approximately 85% of total grocery market, with the biggest four (Asda, Morrisons, Sainsbury's and Tesco) accounted for two-thirds of the total. Figure 2 shows how market shares have developed since 2003, with a notable increase for Tesco and Morrisons (with the latter primarily due to the acquisition of Safeway in 2004).

Figure 2: Market shares by grocery retailer, 2003-2008



Source: Verdict – UK food & grocery retailers 2009

The UK groceries supply chain

14. As stated earlier, large grocery retailers purchase most goods directly from food and drink manufacturers while regional retailers, symbol group retailers and convenience store operators tend to purchase goods through wholesalers and buying groups. The latter are affiliations of several wholesalers that have been established to obtain more favourable terms from suppliers. The value of the groceries supply chain is of the order of £70 billion in annual sales to grocery retailers.¹⁸
15. There are a large number of firms that supply groceries to UK retailers, including food and drink manufacturers, primary producers and fresh food wholesalers (e.g. packers and processors). There are approximately 311,000 farm holdings, 3,600 fresh food intermediaries and 6,600 food and drink manufacturers in the UK (although not all of these necessarily supply grocery retailers).¹⁹
16. According to the CC, grocery retailers purchase relatively little of their fresh produce directly from UK farmers, as most of it is supplied through intermediaries such as packers, processors and fresh food wholesalers. Retailers told the CC that this is a more efficient method than dealing individually with a large number of farmers and intermediaries have a greater ability to source alternative supplies where there is a shortfall in domestic production. In 2006, six large grocery retailers (Asda, M&S, Morrisons, Sainsbury's, Somerfield and Tesco) informed the CC that the combined value of their direct purchases from farmers amounted to approximately £295 million. This compares to £14.3 billion in total agricultural production annually and £16.7 billion in fresh food sales by those grocery retailers in total.²⁰
17. Nevertheless, the limited value of direct purchases by grocery retailers from primary producers can understate the importance of their relationship. Farmers may be members of, or shareholders in, intermediary businesses that market their produce to grocery retailers. Furthermore, the figure of £295 million does not include transactions with processors that are vertically integrated with primary production.

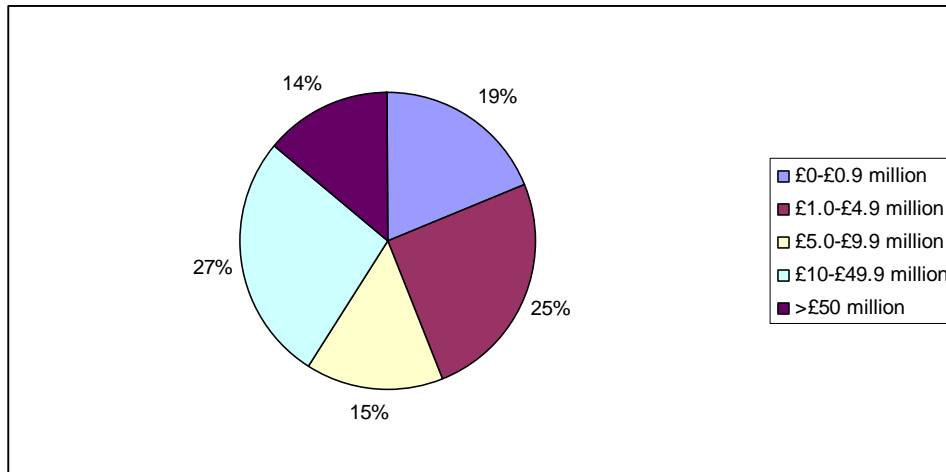
¹⁸ CC report, paragraph 10.16

¹⁹ CC Report, paragraph 3.31

²⁰ CC Report, paragraph 3.32

18. There is large variation in the size of businesses supplying grocery retailers. Suppliers include branded goods' producers such as Coca-Cola, Unilever, Kimberly-Clark and Procter & Gamble as well as small businesses and primary producers. Figure 3 shows the proportion of suppliers to grocery retailers according to their revenue. Comparing the revenues of grocery retailers and suppliers, it is clear that the majority of the latter are of a smaller size, with almost 60% having annual revenue below £10 million.

Figure 3: Suppliers to UK grocery retailers, by grocery revenue



Source: GfK, *Research on suppliers to the UK grocery market: A Report for the Competition Commission, January 2007*

Note: The GfK sample size was 426 suppliers

Rationale

19. The relevant market failure in this case is that of market power, which occurs through the exercise of buyer power. Buyer power is a form of market power that a firm – in this case a grocery retailer (or wholesaler or buying group) – is able to exercise in relation to its suppliers. Exercising this power allows the grocery retailer to extract a better deal from its suppliers than would otherwise be the case, for example by obtaining lower prices or preferable purchasing terms from the supplier.
20. In general, the exercise of buyer power by grocery retailers is likely to have positive implications for consumers. For example, if retailers pass on the lower prices they obtain from suppliers (through the exercise of buyer power) this can result in lower retail prices for consumers. In addition, grocery retailers' buyer power may act as a countervailing force to any market power possessed by suppliers. Furthermore, the exercise of buyer power can spur innovation in the supply chain by creating incentives for suppliers to develop new products and ensure that their operations are cost-efficient.
21. However, the exercise of buyer power by grocery retailers (and wholesalers or buying groups) may have a detrimental effect on suppliers – for example, a supplier is likely to earn a smaller profit margin on goods sold to a grocery retailer with buyer power than those sold to grocery retailers that do not have buyer power. As outlined in the evidence above, grocery retailers account for a significant proportion of the total potential market for suppliers, limiting their opportunities to sell to other customers.
22. In particular, the exercise of buyer power by grocery retailers may raise concerns in certain limited circumstances, if it allows retailers to impose excessive risks and unexpected costs on suppliers, which reduces suppliers' incentive or ability to invest and innovate. In the long run, this could lead to reduced capacity, reduced product quality and fewer new product offerings, and ultimately, a detriment to consumers.
23. In assessing the behaviour of grocery retailers in relation to suppliers, the CC particularly looked at the supply chain practices of grocery retailers that might transfer excessive risks or unexpected costs on suppliers and thereby reduce supplier investment and innovation,

when compared with the levels of investment and innovation that would be observed in a well-functioning market.

24. In their analysis, the CC concluded that there are circumstances where allocations of risk may be agreed up-front between a retailer and supplier, but that the extent of risk transferred to the supplier is excessive. In particular, the CC raised concerns regarding the transfer of risk from grocery retailers to suppliers in situations where this transfer gives rise to 'moral hazard'.
25. In this case, such a situation arises where the retailer has the ability to affect the degree of risk incurred, but as a result of the transfer, the retailer has less incentive to minimize that risk. In these situations, the transfer of risk increases the total risk borne by the parties, and also increases the costs to the supplier. As an example of this, the CC references practices whereby retailers may impose liability for losses suffered as a result of 'shrinkage' (i.e. losses that arise where stock is lower than it should be, due to theft, the goods being lost or accounting error) on some of its suppliers. The CC felt that suppliers had almost no capacity to address losses due to shrinkage and that retailers were best placed to control risks associated with shrinkage (e.g. by improving security at depots or stores, or improving stock accounting procedures).

Issue

Existence of buyer power in the groceries supply chain

26. The CC study concluded that large grocery retailers (and some large wholesalers and buying groups) have buyer power in relation to at least some of their suppliers, although it could be offset by the market power possessed by suppliers of the most prominent branded goods. This conclusion was based on the fact that the majority of suppliers have significantly fewer sales than most of the retailers and because large retailers generally pay lower prices for grocery products. An econometric analysis showed that the four largest grocery retailers paid, on average, between 4 and 6 per cent less than the mean.²¹ By contrast, large wholesalers pay, on average 2 to 3 per cent above the mean while small wholesalers pay prices that are, on average, 8 to 9 per cent above the mean. Further support for the existence of buyer power in the grocery market was provided by a supplier survey, commissioned by the CC as part of its investigation (see Table 1).

Table 1: Supplier customers from whom the lowest gross margins are received

Customers from whom the lower gross margins are received	%
Any of the four largest grocery retailers	53
Any other grocery retailers	17
Wholesalers/buying groups	8
Independent retailer	6

Source: GfK, *Research on suppliers to the grocery market: A Report for the Competition Commission, January 2007*

Supply chain practices that may affect supplier investment and innovation

27. Grocery suppliers make investments in an uncertain commercial environment where demand may fall or costs may rise unexpectedly. Investment decisions are made by estimating the likely returns and balancing this against the risks involved. The supply chain practices of grocery retailers are likely to have an important bearing on this calculation. In particular, if they transfer more risk and greater cost to suppliers then it may diminish suppliers' incentives to invest in new products, capacity or production processes.
28. The transfer of risks or costs between grocery retailers and suppliers is not necessarily a problem, but if excessive risks or unexpected costs are transferred, these may affect

²¹ CC Report, Appendix 5.3: http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_5_3.pdf

suppliers' willingness to invest or innovate. In deciding which supply chain practices might give rise to the transfer of excessive risks or unexpected costs, the CC considered both complaints submitted to them by suppliers regarding grocery retailers' conduct and evidence from suppliers as to the supply chain practices that would be most prone to reduce their investment or innovation.

29. Of the 52 practices considered by the CC during its investigation, it found that half had the potential to result in the transfer of excessive risks or unexpected costs from grocery retailers to suppliers.²² In some cases, the impact of these practices depends on the specific way in which the practice is carried out by a grocery retailer. In other cases, certain practices will almost always have this effect.
30. The principal manner in which excessive risks or unexpected costs can be transferred from grocery retailers to suppliers is through retailers making retrospective adjustments to the terms of supply. Retrospective changes to previously agreed supply arrangements in favour of retailers will almost always create additional uncertainty, shifting risk and added costs to suppliers.²³
31. Further, such retrospective adjustments are likely to diminish significantly suppliers' incentives to fund investments for the development of new products or improved production processes. Consequently, suppliers may come to expect that these retrospective changes might take place, hence they may become reluctant to undertake 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. There was some support for this in responses to the BIS consultation – one party submitted that retrospective changes can have a significant impact on suppliers' incentives to invest, with even a small loss of investment likely to have significant detrimental impact on consumers.
32. Other practices may initially appear acceptable, but are also open to exploitation by grocery retailers as a means of effectively lowering the price paid to suppliers or transferring excessive risks to suppliers.²⁴
33. A number of grocery retailers have made submissions to the CC stating that it is in their interest to establish strong relationships with suppliers and ensure that they invest.²⁵ The CC determined that while this is in the long-term interest of the retailers, it can be overshadowed by the short-term necessity of extracting the best possible terms and conditions from suppliers in order to compete effectively with other grocery retailers.
34. Effectively, a potential side-effect of competition between retailers with buyer power in the grocery market is reduced incentives to invest and innovate on the part of suppliers, which is also detrimental to consumers in the long run. However, they may have benefited in the

²² These 52 practices refer to specific supply chain practices of grocery retailers that were identified in the CC's 2000 investigation. A full list of these can be found in Annex 3 of Appendix 9.8 of the CC's final report (http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_8.pdf)

²³ For example, a requirement for a price adjustment after goods have been ordered or after products have been delivered is a typical practice that is a source of unexpected costs to suppliers. Similarly, requirements for financing or promotions that were not agreed in advance with suppliers are also retrospective adjustments that are a source of uncertainty.

²⁴ For example, it may be quite legitimate for a grocery retailer to deduct sums from a supplier invoice where the supplier has not provided goods to the correct specification or as otherwise agreed between it and the grocery retailer. However, withholding payment either without cause or on a spurious basis may also be a means of imposing unexpected costs on suppliers.

²⁵ CC Report, paragraph 9.43

short term from buyer power because large grocery retailers have passed lower supplier prices to consumers in the form of lower retail prices. Indeed, retailer responses to the BIS consultation included reference of their obtaining lower retail prices for consumers.

Evidence of supply chain practices

35. On the basis of the evidence collected, the CC concluded that supply chain practices which transfer excessive risks and unexpected costs to suppliers, including through the use of retrospective payments and other adjustments to supply agreements, are sufficiently prevalent to cause concern.
36. In a survey of 50 UK grocery suppliers conducted by Grant Thornton, the effects of commercial uncertainty on suppliers were studied.²⁶ It was found that:
 - 31 per cent of suppliers felt that an order from a large grocery retailer was 'secure' only when the goods had been delivered to the retailer;
 - 24 per cent of suppliers reported that they had experienced unexpected last-minute changes or cancellations and had received no form of compensation from the retailer concerned;
 - only 50 per cent of suppliers felt highly confident at the time of delivery that the sale price would not be reduced by retrospective contributions sought.
37. One respondent to the BIS consultation submitted that they had received anecdotal evidence of practices resulting in barriers to either new products coming onto the market or scaling up of supply, such as prohibitive payments for listing. These are payments that suppliers make to retailers for listing new (and in some cases existing) products and they are now prohibited under the GSCOP, unless they are made in relation to a promotion or are for products that have not been listed by the retailer for at least one year in 25 per cent or more of its stores. It was also suggested that actions that have the effect of reducing the profitability (and hence viability) of primary producers are a recurrent complaint amongst suppliers.

Limitations of SCOP in preventing certain supply chain practices

38. Supply chain practices of the largest four grocery retailers were previously regulated under the SCOP, which was established after the CC's 2000 investigation. The OFT's compliance audit in 2005 did not identify widespread evidence of breaches. However, during the CC's recent investigation, 380 concerns were raised by suppliers and supplier associations and almost half were related to the transfer of excessive risks or unexpected costs from grocery retailers to suppliers. One-third were related to requirements for retrospective payments or other adjustments to previously agreed supply arrangements.²⁷
39. As part of the CC's supplier survey, information was collected from suppliers regarding a number of practices addressed under the SCOP. Table 2 shows that one-third to one-half of suppliers experienced practices such as payment delays, excessive payments for customer complaints and retrospective price adjustments from all grocery retailers (i.e. including retailers not regulated by the SCOP). Retailer responses to the BIS consultation suggest that they believe the reporting of certain retailer practices in the context of the CC inquiry to be overstated.
40. It also shows that the SCOP constrained the largest four retailers' buyer power to some extent but not completely. This is supported by evidence collected by the CC in a round-table discussion with grocery suppliers. The latter claimed that in many cases, retailers not

²⁶ Grant Thornton UK LLP (2007), *Redressing the balance: Forging a more certain future for the UK grocery supply chain*, <http://www.grant-thornton.co.uk/pdf/11910GTFoodsuppliersreportFINAL.pdf>

²⁷ CC Report, paragraph 9.59

covered by the SCOP sometimes imposed trading conditions that were worse than those imposed by the four largest retailers.²⁸

Table 2: Suppliers reporting various practices (addressed under the SCOP) carried out by grocery retailers in the past five years

Practice reported	All grocery retailers %	Four grocery retailers covered by the SCOP %	Increased frequency in the past 12 months %
Obligatory contributions to the marketing costs of grocery retailers	61	38	53
Delays in receiving payments from a grocery retailer substantially beyond the agreed time	48	28	37
Required to make excessive payments to grocery retailers for customer complaints	48	36	40
Additional services required in relation to packaging and distribution	37	29	49
Requested price reductions for products soon before or after delivery	37	26	58
Obligatory payments in return for stocking or listing products	35	22	33
Not being given standard terms of business by a customer when asked for them	19	12	32

Source: GfK, research on suppliers to the grocery market: A Report for the Competition Commission, January 2007

41. During their investigation, the CC also reviewed correspondence, predominantly email, between two grocery retailers (Asda and Tesco) and their suppliers during the period 18 June and 22 July 2007.²⁹ This highlighted a number of instances where the retailer did not breach the SCOP but still had the effect of transferring excessive risks or unexpected costs to suppliers. This was either due to the fact that, in most cases, the SCOP regulated a practice (e.g. requires that the retailer undertake the practice reasonably) rather than prohibiting it outright or because the SCOP did not sufficiently address a poor practice.³⁰
42. Furthermore, the correspondence reviewed by the CC provided examples of retailers levying an agreed flat-rate charge in instances of wastage (permitted under the SCOP) even though it may have been grossly disproportionate to the loss suffered by the retailer or the

²⁸ CC Report, paragraph 11.280

²⁹ CC Report, Appendix 9.1: Case study of retailer and supplier correspondence, http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_1.pdf

³⁰ For example, the SCOP indicates that a supplier should only be required to make a payment for wastage where it arises because of the supplier's negligence or default or there is an agreement in writing setting out the terms of such a payment. However, wastage is not technically defined and is capable of an interpretation that includes products that have deteriorated as well as those that have been ordered in excess of demand.

supplier may not have been provided with an opportunity to review the evidence and confirm that the fee was legitimately charged. The latter was raised as a concern by a number of suppliers to the CC and such a practice could give retailers an incentive to over-compensate customers at the expense of suppliers.

43. Another example where the SCOP failed to effectively prevent the transfer of excessive risk is the issue of shrinkage.³¹ Amongst the concerns raised by suppliers and supplier associations to the CC, the latter found instances of retailers imposing liability on some of its suppliers for losses suffered as a result of shrinkage. These are losses that arise where stock is recorded on a company's books but is not on hand, due to theft, the goods being lost or accounting error. In the vast majority of cases, the supplier has no capacity to address shrinkage losses suffered by the retailer, who by contrast can improve security at depots or stores and improve stock accounting procedures. This highlights the potential for moral hazard in the grocery supply chain, as set out in the rationale section above.
44. For further evidence regarding retailer behaviour towards suppliers and the effectiveness of the SCOP, the reader should refer to Section 9 of the Competition Commission's final report³² and Appendix 9.8.³³

Evidence of impact on supplier investment and innovation

45. The evidence on supplier investment and innovation is not entirely clear. A number of studies reviewed by the CC have shown fairly stable, sometimes increasing, levels of investment and R&D expenditure by food and drink manufacturers during the period 1995-2006.³⁴ In addition, there was a steady growth in new grocery product launches in the UK during the period 2001 to 2005.
46. The GfK survey of suppliers provides further evidence that innovation has remained robust in recent years³⁵:
- 90 per cent of respondents claimed to have developed new product lines in the past two years;
 - 87 per cent had developed existing product lines;
 - 82 per cent had improved their production processes, and
 - more than one-third stated that they had carried out some other type of innovation.
47. There were few differences between types of supplier but, as one might expect, larger companies conducted more product and process innovations – more than 90 per cent had developed new and existing product lines and improved their production processes, whilst almost half conducted another type of innovation. Furthermore, most suppliers (almost 70 per cent) stated that they had a budget for developing new product lines and existing lines, while 59 per cent stated that they had a budget for improving production processes.
48. However, almost 20 per cent of suppliers had no budget for innovation. Although a significant proportion of suppliers (43 per cent) claimed to be spending more on R&D for grocery products than five years ago (as a proportion of groceries revenue), a substantial minority (14 per cent) said they were spending less.

³¹ CC Report, paragraph 9.48

³² http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf

³³ Categorization of, and evidence on, supply chain practices of grocery retailers (http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_8.pdf)

³⁴ CC Report, Appendix 9.2: Supplier profitability and investment in innovation, http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538_9_2.pdf

³⁵ GfK, *Research on suppliers to the grocery market: A Report for the Competition Commission*, January 2007

49. Of this latter group, the majority (77 per cent) claimed that they did not have enough money to invest and/or that margins were being squeezed, whilst the next most common reason (25 per cent) was that there was insufficient return on the investment due to customers demanding low prices. Other notable responses were that margins could not be improved through R&D (13 per cent), and that there was insufficient return on investment due to copycat products (11 per cent).
50. The CC also received submissions from suppliers, a number of which claimed to be spending less on capital maintenance than is required.³⁶ This would affect product quality and new product development in the future. The Country Land and Business Association claimed that large grocery retailers' practices resulted in margins that are too tight for suppliers and, therefore, leave insufficient funds for investment in new equipment and product innovation. Other submissions indicated that higher input costs for suppliers could not be passed on to retailers, also leading to lower margins and a reduced ability to invest. The views put forward by these organisations may reflect a concern about likely future trends in product innovation, given the current actions of UK grocery retailers.
51. It should be noted that product innovation is difficult to measure and a number of factors other than grocery retailers' buyer power might affect suppliers' propensity to invest and innovate. The CC concede that current trends in, and levels of, product innovation may not indicate a cause for concern. However, a simple appraisal of the level of investment and innovation does not take account of the fact that their levels might have been higher in a well-functioning market or whether this level of product innovation could be expected to continue in the future.
52. Evidence from the supplier survey (Table 2) indicates that the prevalence of practices that may adversely impact on investment and innovation is increasing. This raises concerns that current levels of innovation or investment would not be maintained in the future were these practices to continue.
53. In their responses to the BIS consultation, most retailers expressed their poor opinion of the CC findings. They felt that the CC's conclusions were very weak and based on evidence about what might happen, rather than what the evidence showed. Most retailers either asserted or gave evidence to show that levels of innovation were strong in relation to grocery retail, with customer satisfaction on choice and quality remaining unchanged since 2000, despite a strong rise in customer demand and expectations. It was almost universally felt that the most appropriate conclusion regarding supplier investment and innovation based on the evidence was that supply chain practices have had no effect. One retailer also submitted that innovation was a source of competitive advantage in the industry; this gave firms an incentive to invest to increase their own profitability and to avoid ceding any potential advantage to competitors.

Remedies

54. To address the Adverse Effect on Competition that buyer power creates, the CC established the Grocery Supply Code of Practice (GSCOP) using its powers under the Enterprise Act (2002).³⁷ This came into force on 4 February 2010 and is based on the previous SCOP but includes a number of amendments such as:
- applying the code to retailers that are controlled by corporate groups with, or which themselves have, an annual retail groceries turnover of £1 billion or more;³⁸

³⁶ CC Report, Appendix 9.2, paragraphs 40-45

³⁷ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

³⁸ Although there is an element of judgement in setting the threshold, the CC took into account the identity of the retailers where particular issues had been brought to its attention during the course of the investigation. There were very few cases which involved a grocery retailer with an annual turnover of less than £1 billion. Using this

- an outright prohibition on suppliers being held liable for losses due to shrinkage;
 - a provision that ensures that suppliers are less subject to customer complaint charges;
 - a prohibition on retailers from making retrospective adjustments to the terms of supply;
 - a clear definition of wastage and a prohibition on retailers directly or indirectly requiring a supplier to pay for wastage unless it is due to the negligence or default of the supplier.
55. Therefore, the GSCOP clearly clarifies and addresses retailer practices that transfer excessive risk and unexpected costs to suppliers and prohibits practices where necessary, rather than regulating that they are undertaken reasonably.
56. Furthermore, the CC sought undertakings from retailers to establish a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP, in order to ensure its effectiveness. The large grocery retailers refused to offer suitable undertakings and so, as a result, the CC recommended that the Department for Business, Innovation and Skills set up the Ombudsman.³⁹ The department received many representations in writing and held a number of face-to-face meetings on the issue. On 13 January 2010, it published a response and agreed that monitoring and enforcement of the GSCOP is necessary to ensure its effectiveness.⁴⁰
57. In responses to the BIS consultation, a number of retailers felt that the creation of an additional enforcement body was a disproportionate response, with one feeling that it was based on groundless expectation by CC members that it would be better to have such a body than not. Other retailers felt that the GSCOP should be given more time to become properly established before taking further enforcement action, so that a full and accurate assessment of the associated costs and benefits could be carried out.
58. One retailer felt that the creation of a monitoring/enforcement body would lead to the imposition of unnecessary costs on industry and disrupt the bargaining relationship between suppliers and retailers, which would inhibit the ability of retailers to obtain lower prices on behalf of consumers. In their opinion, a balance needs to be found between properly governing the industry and avoiding over-regulation, with the creation of a new enforcement body being too far towards the latter.

Policy objectives

59. The principal objective is to promote innovation and investment in the groceries supply chain, which will ultimately be beneficial to consumers, as well as the wider economy. The objective of independent enforcement of the GSCOP is to prevent the practice of supply chain behaviour by grocery retailers that has an adverse impact on the willingness of suppliers to invest and innovate.
60. The previous Government accepted the need for a body to enforce the GSCOP and consulted on the nature and scope of its powers.⁴¹ The previous Government also decided that the adjudicator should have a mechanism to hear anonymous complaints. This was considered to be particularly important, as a number of suppliers expressed concerns to the CC over being identified in an investigation of a retailer's supply chain practices. They believed this could have detrimental consequences, such as being delisted by the retailer. The CC acknowledged the existence of this 'climate of fear' among suppliers in relation to disputes under the previous SCOP.

threshold, 10 grocery retailers will be subject to the GSCOP: Aldi; Asda; CGL (incorporating Somerfield); Lidl; Iceland; M&S; Morrisons; Sainsbury's; Tesco; and Waitrose.

³⁹ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

⁴⁰ <http://www.berr.gov.uk/files/file54194.pdf>

⁴¹ <http://www.berr.gov.uk/files/file54425.pdf>

61. The adjudicator will have regard to the overriding objective of the GSCOP Scheme to work in the long term interest of consumers and the findings of the CC. It will not facilitate or encourage coordination among retailers or suppliers, nor will it engage in any activity that is not focused on the overriding objective of GSCOP.⁴² In particular, the adjudicator will confine its activities to evaluating the operation of the Code and should not consider other commercial elements of the supply agreement.

Options considered

62. The following options for the Groceries Code Adjudicator are analysed:

- Do nothing (i.e. GSCOP is introduced without a separate enforcement body);
- Self-regulation;
- Base case (an adjudicator with the power to accept anonymous complaints);
- Whether establishment of the Groceries Code Adjudicator requires the creation of a new body;
- Whether the Groceries Code Adjudicator should have the power to levy penalties on retailers that breach the GSCOP;
- Whether the Groceries Code Adjudicator should limit consideration of code-related complaints to only those direct supplier relationships covered by the GSCOP.

63. Given that the previous Government accepted the need for a GSCOP enforcement body, based on the evidence presented above, implementing the Code without such a body is not analysed here. Furthermore, an option allowing retailers to voluntarily ensure that the GSCOP is monitored and enforced has already been proposed by the CC but failed to materialise. Therefore, the 'do nothing' and 'self-regulation' options are purely hypothetical and are only included in this impact assessment for completeness.

64. The Government consultation sought views on the scope and nature of a GSCOP enforcement body, specifically:

- activities of the body;
- who the body should be;
- penalties regime;
- supplier coverage;
- and funding.

65. It was not possible to conduct a detailed analysis for each of these proposals. Certain activities of the body – for example, whether it publishes guidance on specific provisions of the Code or reports publicly on the operation of the Code and enforcement scheme – are relatively marginal measures between which we are not able to easily distinguish analytically. Similarly, the allocation of funding for the Groceries Code Adjudicator has little effect on overall costs and benefits.

66. Therefore, the options analysed in this impact assessment are the last three (i.e. whether establishment of the Groceries Code Adjudicator requires creation of a new body, whether the Groceries Code Adjudicator should have the power to levy penalties and whether the Groceries Code Adjudicator should limit consideration to direct suppliers). In this context, the 'base case' represents the introduction of a Groceries Code Adjudicator that has the following characteristics: it has power to accept anonymous complaints; it is an existing body; it does not have the power to levy penalties; and it considers code-related complaints from both direct and indirect suppliers.

⁴² Such coordination could arise from, for example, round-table meetings and the encouragement of any dialogue between suppliers and retailers outside normal bilateral commercial arrangements.

Do nothing

67. The GSCOP order has been established by the CC and took effect from 4 February 2010. Therefore, under this option the ten largest grocery retailers would still be regulated by the Code but it would not be monitored or enforced by a specific body.

- costs

68. The CC originally estimated the upfront cost to retailers of establishing the GSCOP to be approximately £1 million, which comprises training and legal costs, as well as redrafting terms and conditions.⁴³ The ongoing annual cost associated with compliance with the GSCOP was estimated by the CC to be approximately £168,000 per retailer.⁴⁴ Aggregated across the 10 retailers that generate more than £1 billion in annual revenue, this gives a total ongoing cost of £1.7 million per year.

69. Most retailers who responded to the BIS consultation felt that this estimate significantly understated the true costs associated with implementation of (and compliance with) GSCOP. One retailer submitted that 2 full-time staff had been employed to prepare training and respond to GSCOP-related queries, along with legal advice about the application of GSCOP and staff training. Other retailers estimated that GSCOP compliance had entailed 'significant costs' (with one estimating costs of around £850,000 in the last 6 months), but could not be firmer about ongoing costs given that the GSCOP had only been in place since February 2010.

70. In light of these responses, the CC's original estimate of one-off costs does not seem suitable. Therefore, if it is assumed that the estimate of £850,000 is typical across all the covered retailers (and that such costs are front-loaded, to the extent that the total upfront costs would be around £1m), the one-off costs of implementing the GSCOP may be estimated at **£10 million**. In the absence of any further evidence, we do not have any reason to amend the CC's estimate for ongoing costs – i.e. **£1.7 million per year**.

71. There would also be operating costs associated with GSCOP arbitrations, which would depend on the number of such arbitrations. In the absence of an adjudicator, the resolution of disputes under the GSCOP would be performed by a single independent arbitrator, nominated by an external body with expertise in alternative dispute resolution. However, as arbitrations are required anyway under the GSCOP, costs of arbitration do not represent an additional cost associated with the Groceries Code Adjudicator.⁴⁵

- benefits

72. The CC did not find it possible to directly quantify the consumer benefits associated with continued investment and innovation by suppliers in the future, which the GSCOP should ensure by preventing the exercise of excessive buyer power (provided compliance is high enough, in the absence of a designated enforcement body).

73. It is not possible to accurately forecast the level of compliance for GSCOP with and without an enforcement body. However, an alternative proxy indicator for the likelihood of compliance is the supplier survey conducted by GfK for the Competition Commission. Using the data in Table 2 and by taking the mean average of the seven practices reported, it

⁴³ CC Report, paragraph 11.413. The figure is based on the result of the OFT commissioned audits of the SCOP and costs reported by Tesco and Asda of introducing the existing SCOP.

⁴⁴ This cost includes the following elements: regular training; code compliance management time; internal audit compliance; external legal advice; answering queries; and responding to disputes from named complainants (the latter of which is estimated to account for approximately £0.7 million of the ongoing cost).

⁴⁵ Unless it is expected that the costs associated with arbitration for a body to monitor and enforce the GSCOP would differ significantly from those of an ordinary arbitrator, which we would not.

74. A number of respondents addressed the expected compliance level, though few provided any specific estimates. Most respondents acknowledged the difficulty of estimating likely compliance levels due to the range of potential influencing factors (e.g. economic, commercial), but most retailers believed that compliance would be much higher than the estimated 73%. One retailer felt that the significant additional provisions and broader coverage of retailers would lead to GSCOP compliance levels being much higher relative to SCOP compliance, hence this would not be an appropriate benchmark.
75. Under the GSCOP it is expected that compliance will rise to 73% at the very least, as it represents an improvement to the previous SCOP and includes other large retailers with annual grocery turnover greater than £1 billion.⁴⁶ For those retailers that are not regulated by the GSCOP, the CC received very few cases during its investigation.⁴⁷
76. Nevertheless, the CC determined that a small loss in investment and innovation would have a significant adverse effect on consumers, which was supported by one respondent to the BIS consultation. They noted that, in the context of annual retail grocery turnover of £110 billion and the value of the groceries supply chain (approximately £70 billion), even a small loss in investment and innovation by suppliers could have a significant detrimental impact on consumers.
77. Given that the Government has already accepted the need for a GSCOP enforcement body, based on the costs and evidence presented above, implementing GSCOP without such a body is not a feasible option for this impact assessment and has not been considered further.

Self-regulation

78. A self-regulatory option will also not be assessed in detail. Even under the SCOP, practices that transfer excessive risk and unexpected costs to suppliers appear to have persisted, as discussed above. Furthermore, large grocery retailers have twice been given the opportunity to voluntarily establish a GSCOP enforcement body to monitor and enforce compliance with the new code.
79. After the CC report was published in April 2008, it prepared an initial draft of undertakings. Failing to receive agreement from any of the grocery retailers, the CC published a formal consultation to accept undertakings from grocery retailers for an ombudsman scheme in

⁴⁶ However, the CC expressed a view that effective monitoring and enforcement of the GSCOP requires both the resolution of disputes *and* proactive investigation of retailers' behaviour in respect of particular practices (based on anonymous complaints). If the Code solely relies on formal dispute resolution, which is the case under this option, it is possible that the effectiveness of GSCOP would be undermined. This is because a retailer must be told the identity of a supplier if the latter brings a dispute which, as discussed above, creates a disincentive for the supplier to complain if there is a risk that they will be de-listed. In this case, compliance with the GSCOP may not rise significantly above 73%.

⁴⁷ Given that the CC introduced the GSCOP as a remedy for selected grocery retailers, we would not expect retailers outside of GSCOP to be exercising buyer power that results in the transfer or excessive risk and/or unexpected costs.

April 2009.⁴⁸ Some retailers were opposed to any attempt to establish an enforcement body whilst some were prepared to sign up to undertakings, subject to changes that the CC felt would not be consistent with the final report. Other retailers were prepared to sign up provided that other retailers also signed up to them.⁴⁹ Without full agreement, however, the body could not be established. Therefore, an option allowing retailers to voluntarily ensure that the GSCOP is monitored and enforced has already been proposed by the CC and failed to be agreed.

Options analysis

Alternatives to Regulation

80. Although the regulation of markets is a measure of last resort, as discussed above a self-regulatory approach to establishing the GSCOP enforcement body has been proposed on two previous occasions and in both instances it failed to materialise. Therefore, it was not considered in the Government's consultation. Implementing the GSCOP without an enforcement and monitoring body was also not considered because such a solution was applied under the SCOP and it failed to fully address the adverse effect on competition.
81. Other proposals that were included in the consultation, namely the activities of the enforcement body and how it is to be funded, are not substantively analysed in the impact assessment as their overall impact on costs and benefits is likely to be marginal.

Option 1: Base case (Groceries Code Adjudicator with power to accept anonymous complaints)

82. As set out above, the base case constitutes the introduction of a Groceries Code Adjudicator with the power to conduct proactive investigations on the basis of anonymous complaints. Such a body would be created within an existing body and consider code-related complaints from both direct and indirect suppliers, but would not have the power to levy penalties on retailers in the event of a breach.

- costs

83. Under this option, the role of the adjudicator would go beyond arbitration to include receiving complaints and carrying out investigations on the basis of this information. These costs are very difficult to forecast as they will depend on the number of complaints the adjudicator receives and the number of investigations it chooses to carry out. For example, if compliance were 100%, then it could be expected that the additional costs associated with this option would be zero, as there would be no (meritorious) complaints that would require investigation.
84. Responses to the BIS consultation did not provide any further evidence that might help to estimate the likely level of complaints under the GSCOP. One respondent felt that there might be potentially more dispute than under the SCOP due to broader retailer coverage, but the number would remain low because of the importance to suppliers of strong trading relationships. Another respondent felt that much of the work of an adjudicator would be to focus on a small number of systemic complaints. One retailer felt that the most likely indicator of disputes under GSCOP was the number of complaints under SCOP. A couple of retailers submitted that most complaints were currently resolved internally through mutual agreement, which would continue to be the case.
85. In estimating the costs associated with investigations undertaken on the basis of anonymous complaints, the incremental additional costs under this option are those pertaining to complaints that would not have been made under the base case (i.e. under a scenario where complainants would have to identify themselves). On the basis that

⁴⁸ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/ombudsman_undertakings.pdf

⁴⁹ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_ombudsman_response.pdf

complaints could be received from all parties (not just direct suppliers), but that the adjudicator did not have the power to impose penalties, the CC estimated the cost of enforcement (including OFT oversight) to be approximately £120,000 per retailer.⁵⁰ Across the ten grocery retailers subject to GSCOP, this would suggest an incremental additional cost of **£1.2 million per year** associated with this option, though it is difficult to estimate whether this is an upper bound.⁵¹

86. One retailer submitted that the cost of the adjudicator would be heavily determined by how disruptive it would be, but that the estimated costs were in any case likely to be an underestimate. It was suggested that a comparison could be drawn with the FSA, which was originally estimated to cost £15m-20m, but now had a funding requirement in excess of £450m. While this may indicate the potential degree of imprecision regarding estimates of likely complaint levels, the FSA is unlikely to be a good comparator, either in terms of its functions or coverage.
87. Costs associated with arbitration are not additional to this option as they would be incurred in the absence of an adjudicator in any case (i.e. under the hypothetical 'do nothing' option).

- *benefits*

88. As set out above, under the GSCOP it is assumed that compliance across the groceries market would rise from 68% to 73% (at least). The existence of an adjudicator should increase the level of compliance to a level above 73%.⁵² However, even if this level of compliance could be accurately assessed, it is still not possible to quantify the potential costs incurred by suppliers as a result of retailer practices that transfer excessive risk to them. This will be monitored in the future and more information will be gathered on this specific area as part of the post-implementation review.
89. In the absence of an adjudicator with the power to accept anonymous complaints, the resolution of disputes requires the identification of the supplier bringing the dispute. Under the previous SCOP, a number of suppliers claimed that they ran the risk of being de-listed by retailers if they were identified during a dispute.⁵³ However, in the case of complaints made on a confidential basis, the adjudicator would investigate areas of recurring concern and help build confidence in the operation of the groceries supply chain.
90. Experience from Germany suggests that the power to initiate proceedings on the basis of anonymous complaints can be helpful in encouraging complainants to come forward (and also remedy cases informally without having to issue a decision).⁵⁴ This should help ensure

⁵⁰ Covering the cost of inquiries based on anonymous supplier complaints (CC Report, paragraph 11.408). This cost is determined by a number of factors, including the likely number of investigations, such as: the nature of the investigations, how retailers decide to respond to investigations, amount and nature of regular monitoring, and retailers' responses to regular monitoring.

⁵¹ This cost will be maximised where there is no overlap between those complainants who are willing to be identified and those who are not. If there is some overlap, the costs associated with enforcement will be lower, as some of these complainants have already been accounted for by dispute costs assessed under 'do nothing'.

⁵² Unlike the SCOP, where disputes were mediated by an independent mediator appointed and paid for by the retailer, the proposed enforcement body would act as an arbitrator and also conduct proactive investigation of retailers' behaviour in respect of particular practices. The latter is important because it can be done on the basis of anonymous complaints.

⁵³ CC report, paragraph 11.348

⁵⁴ In Germany, the Bundeskartellamt (BKA) has conducted a number of investigations into the exploitation of buyer power by grocery retailers under German Competition Law and in 1999 was given the power to initiate proceedings based on anonymous complaints.

that suppliers can make investments with a reasonable degree of certainty regarding their expected returns and the allocation of risk.

91. An additional benefit that has not been quantified is the avoided potential cost of upstream grocery suppliers potentially going out of business, as a result of actions taken by retailers that have the effect of transferring excessive risks and unexpected costs to them. Such costs could result from job losses and/or loss of livelihood, which could also have a consequential deleterious impact on the local economy.

- risks and assumptions

92. The estimated cost of this option, £1.2 million per year, will vary depending on the number of disputes and anonymous complaints that the adjudicator receives and is based on CC assumptions. If all of the grocery retailers regulated by the Code are fully compliant, then the number of complaints (and therefore the costs under this option) would most likely tend to zero. However, 100% compliance has not been assumed given that this did not exist under the previous SCOP.
93. A risk identified by one of the six CC Members who conducted the groceries inquiry (Professor Bruce Lyons) was that anonymity will not be protected in all cases. In Germany, the BKA stated that if an informal solution to anonymous complaints cannot be found, it has to issue a formal decision. In this case, the identity of the complainant needs to be revealed. However, given that the adjudicator will only investigate recurring practices or specific patterns (e.g. complaints related to a certain retailer or a specific sector), which will involve a number of suppliers, this risk should be mitigated to some extent.

Decision

94. As explained earlier, the base case represents the establishment of an adjudicator with the power to conduct proactive investigations on the basis of anonymous complaints. Therefore, the costs and benefits associated with this option will be incurred – in terms of those that can be quantified, this amounts to annual costs of £1.2m.

Option 2: Creation of a new body

95. A Groceries Code Adjudicator could, as recommended by the CC, be a stand-alone body (but with the adjudicator appointed, and its budget set, by the OFT) or it could be part of an existing body, such as the OFT.
96. In considering these proposals, we acknowledge the action that is taking place across Government to reduce the number of regulators, as set out in the recent ‘Smarter Government’ document.⁵⁵ In light of this, we would need to receive clear evidence that the role being considered here could not be conducted by an existing body to consider creating a new body specifically for this purpose.

- costs

97. The costs associated with an independent Groceries Code Adjudicator would include both the one-off costs of setting up and operating the adjudicator’s office and the ongoing costs incurred by retailers (and suppliers) in interacting with the adjudicator.
98. Based on the cost incurred by the CC in setting up a home credit comparisons website,⁵⁶ the one-off costs associated with establishing an independent body as the body to monitor and enforce the GSCOP could be up to £0.2m. It is likely that this cost would be met (along with other set-up costs for the adjudicator) by grocery retailers.
99. One retailer submitted that a home credit comparison website was not a good comparator for evaluating the potential costs associated with setting up a new enforcement and

⁵⁵ <http://www.hmg.gov.uk/media/52788/smarter-government-final.pdf>

⁵⁶ Which was similar in that it was operated by an independent body and funded by the home credit companies

monitoring body for the GSCOP. A better comparator might be the creation of the Financial Ombudsman Service, the set-up costs for which were estimated to be **£3-4 million**.⁵⁷

100. The level of ongoing costs would primarily be determined by the number of investigations undertaken and disputes arbitrated by the adjudicator. Whether the adjudicator is a newly-created body or part of an existing body would not be expected to influence its level of activity. Therefore, in either case the annual cost should be the same as under option 1 (i.e. the base case). However, the CC received views from different parties who felt that this was not the case (see below).
101. One respondent to the BIS consultation felt that there would be limited differences in cost between the adjudicator being sited within the OFT or as an independent body, but that there may be incremental benefits under the latter.

- benefits

102. It might be argued that – given its prior experience in building up skills and background knowledge through enforcing the SCOP – there might be some advantage in the OFT being the Groceries Code Adjudicator. These advantages would then be lost if a new body were to be created expressly for this purpose. On the other hand, 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 also have advantages. The body may also monitor warnings at certain times of the supply cycle when abuse may be more likely to occur.
103. Overall, five of the six CC Members who conducted the inquiry expressed a strong preference for appointing an enforcement body independent of the OFT. The remaining CC Member (Professor Bruce Lyons) disagreed, as he was concerned that an ombudsman may find a role ‘proactively’ representing the interests of suppliers, including global manufacturers and large intermediaries, which he considered would reduce the benefits of competition. However, he believed the OFT was well placed to refrain from undesirable intervention because it had an embedded mission to make markets work well for consumers. He also expressed concerns that set-up and operating costs would be substantially higher for a new enforcement body than for the OFT.⁵⁸ In response to the BIS consultation, one retailer agreed with Professor Lyons’ view, in that set-up and operating costs were likely to be significantly higher for a new body and the costs of creating such a body may have been underestimated.
104. The CC majority view implies there would be incremental net benefits from having the functions carried out by an independent enforcement body rather than an existing one. However, the lack of unanimity suggests there is uncertainty over the extent of these benefits.

- risks and assumptions

105. As discussed above, the costs of setting up a new body are based on the creation of the Financial Ombudsman Service. This is not completely analogous to the Adjudicator as it receives complaints from consumers (rather than businesses) and arbitrates disputes in the financial services sector. However, whilst Government is conscious of these important differences, there is no other body that offered a more suitable comparison.
106. It is likely that both a new enforcement body and the OFT (as a general competition enforcement body) would be seen as independent. However, existing bodies including the OFT may be less likely to be regarded as independent by suppliers or retailers, and this could affect both costs and benefits.
107. Almost all respondents to the BIS consultation expressed support for the OFT to be the most appropriate existing institution to house the new body, given its knowledge of the

⁵⁷ Based on figures given in Financial Ombudsman Service reports, 2000-1 and beyond

⁵⁸ CC report, paragraphs 11.347 and 11.418

industry and legislative history. One respondent felt that the independence of the adjudicator was a crucial element to its success, in line with the original CC recommendation. However, if this were impossible, they felt that the OFT would be the only suitable organisation. A further suggestion was to site the body within an existing ombudsman office, though there would not be as many knowledge-related synergies under this scenario.

108. For example, suppliers told the CC that the OFT was not proactive in investigating disputes under the SCOP and expressed support for an independent mediator, conciliator or arbitrator. Many other parties questioned whether the OFT was the best authority to supervise and enforce retailers' compliance.⁵⁹ By contrast, many submissions from retailers supported the continued involvement of the OFT in this role.

Decision

109. As set out earlier, the Government has stated its intention to introduce an Ombudsman based within the OFT. Therefore, the costs and benefits associated with this option will not be incurred.

Option 3: Power to levy penalties

110. The CC has recommended to BIS that the adjudicator should have the power to impose monetary penalties on retailers in respect of breaches of the GSCOP. However, the CC did not carry out any specific analysis of the proportionality (i.e. benefits versus costs) of giving the adjudicator powers to impose penalties.
111. Under the base case, if the Groceries Code Adjudicator found in favour of a complainant, she would only have the power to award financial costs equal to the amount originally imposed on the complainant – i.e. the original costs imposed on the supplier would be given back to them to compensate for their loss. However, there would be a deterrence effect under the base case, due to the reputational risk associated with breaches of GSCOP, where such breaches could be identified and publicised by the adjudicator. This would be likely to result in negative publicity for the retailer, which would deter further breaches, both by the individual retailer and potentially across all retailers subject to GSCOP.
112. Under this option, the adjudicator would have the ability to impose a punitive element in addition to the original costs incurred by the supplier. That is, the Groceries Code Adjudicator would be able to impose a fine or penalty on the retailer that has breached GSCOP in excess of the costs incurred by the supplier as a result of the breach. In relation to the original scenario (i.e. where the adjudicator does not have this power), the only route available to claiming any money would be to take a follow-on case, based on the judgement of the adjudicator.

- costs

113. Adding the power to impose penalties could affect both the costs and benefits of the adjudicator. For example, the possibility of penalties might give retailers more incentive to prolong investigations by disputing every point, however small, which would increase the cost of each individual investigation.
114. As there would also need to be a right of appeal, costs could also increase to the extent that decisions are appealed and it may be noted that the adjudicator is unlikely to have a strong incentive to avoid appeals since its budget needs to be flexible.⁶⁰

⁵⁹ For example, the ACS, suppliers, supplier organizations, non-governmental organizations, primary producer organizations and consumers

⁶⁰ The CC recommended that the enforcement body should have a flexible budget with a large contingency as it was concerned about the possibility that retailers would attempt to exhaust the enforcement budget in the

115. The cost of an appeal case varies widely according to the specifics of each case. The use of an existing appeals body for this purpose is likely to be more efficient in terms of overheads, staff costs etc. According to the GSCOP Order made by the CC⁶¹, the High Court or Court of Appeal will be the relevant route. However, it has not been possible to gather accurate data on the costs associated with a case in this court. Data from the Competition Appeals Tribunal (CAT) for 2009 suggests that average case costs (in terms of staff costs, overheads etc) are around £102,000 per year.⁶²
116. We have not been able to accurately assess how many appeals there might be in any given year and responses to the BIS consultation did not provide any further evidence to address this. One respondent suggested that the new requirement to have agreements in writing would make breaches of GSCOP more clear-cut and easier to identify, leading to a low level of appeals (possibly even single figures). One retailer felt that the CAT would be best placed to hear appeals, but the likely standard of proof required could lead to protracted and costly cases (i.e. in excess of £100,000 per case). Another retailer felt that appeal costs could be even higher, if suppliers used the new complaint process for tactical commercial advantage, or potentially to raise publicity for a cause.
117. In the absence of any better information, we have used the conservative estimate of £200,000 for the costs associated with an appeal (£100,000 for costs to Government associated with the appeal court, £100,000 in legal costs to the parties involved) and have assumed that the number of appeal cases per year could vary from 1 to 5 per retailer. Across the ten retailers, that gives an overall number of between 10 and 50 appeal cases per year, at an average cost of £200,000 – i.e. a total ongoing cost of **£2m-£10m per year**.
118. However, it is probable that the number of appeals will decline (as precedent is set and there is a ‘learning’ effect that impacts on behaviour), which has been assumed to decrease over the first 5 years of the policy so that the number of cases in year 1 is 10-50, year 2 is 6-30, year 3 is 4-20, year 4 is 3-15 and year 5 onwards is 2-10). Over a 10-year period (discounted at 3.5%), this implies a net present value of **£6.4m-£31.8m**. Of course, if retailers are fully compliant with the Code then there will be no additional policy costs.

- benefits

119. In addition to the deterrence effect associated with negative publicity identified above, penalty powers will increase the potential cost to retailers of not complying with GSCOP, and hence will increase the incentive for retailers to comply with the GSCOP. A key factor affecting the size of benefits from penalty powers is the extent of GSCOP compliance in the absence of penalties. If compliance (in the absence of penalties) is high, then the incremental benefit of better compliance will be small. On the other hand, if compliance in the absence of penalties is low, improving compliance may realise the additional benefits of implementing the original recommendation.⁶³
120. Responses to the BIS consultation on the effectiveness of a penalty regime were mixed. One respondent felt that the availability of fines would be unlikely to lead to full compliance, but that compliance in the absence of fines would be markedly lower. However, one retailer submitted that, given that the GSCOP would apply in the context of a legislative agreement between retailer and supplier (with the supplier as one of the parties to the agreement), the

knowledge that effectiveness of monitoring and enforcement would be compromised (see footnote to paragraph 11.338 of the CC report).

⁶¹ http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/revised_gscop_order.pdf

⁶² Composed of £80,000 staff costs and £22,000 operating costs

⁶³ An OFT study on enforcement of competition law found that most companies and lawyers considered that fines were important or very important in deterring infringements, supporting the idea that compliance would be lower in the absence of financial penalties (http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/of962.pdf; Table 5.11, Table 18 in Annex A and Table 15 in Annex B).

likelihood of detection would be 100% and there would be no improvement to compliance as a result of introducing penalties.

121. In general, retailers felt that the existing GSCOP framework would already provide significant incentives for retailers to comply, such that the incremental benefits arising from availability of penalties would be low. It was also felt that the introduction of penalties may lead to a more litigious environment and an increase in the likelihood of appeals rather than resolution through negotiation or arbitration. As a consequence, it was felt that this would then lead to increased costs and delayed resolution.
122. Currently, the adjudicator has not yet come into operation and the GSCOP has only just been introduced. Consequently, there is no direct basis for assessing compliance in the absence of penalties. It may be possible to get a better view after the new regime has been in operation for a period of time.
123. For the purposes of this impact assessment, we considered whether data on compliance with the SCOP would enable us to make an estimate of GSCOP compliance by an adjudicator without penalty powers. However since the inadequacy of the SCOP and the absence of an enforcement body was the reason for establishing the GSCOP and recommending the establishment of the adjudicator, we concluded that SCOP compliance data was not useful in estimating GSCOP compliance by an adjudicator without penalty powers.
124. An alternative proxy indicator for the likelihood of compliance is the supplier survey conducted by GfK for the Competition Commission. This suggests that 68% of suppliers had undertaken action that would be in breach of the GSCOP, once it comes into force.
125. In the absence of more precise information, we have assumed that the marginal impact of conferring penalty powers on the adjudicator is to increase compliance to 100%. As set out earlier, that would mean that the ongoing cost associated the adjudicator is reduced to zero – i.e. an avoided cost (benefit) of **£1.2m per year**.
126. A potential additional benefit under this option is the avoided costs for individual complainants of undertaking a follow-on action, following a favourable judgement by the adjudicator. Estimates from work on implementing the Consumer Advocate suggest that the average cost per action could be around £250,000 and £300,000.
127. Unfortunately, in the absence of information about the likely number of complaints once GSCOP comes into force, it is not possible to predict how many follow-on actions there might be in any given year and therefore quantify any associated costs that might be avoided.

- risks and assumptions

128. As mentioned above, the costs of introducing a penalty power is heavily dependent on the number and level of penalties issued and will also vary depending on the number of appeals. A response to the BIS consultation suggested that the new requirement to have agreements in writing would make breaches of GSCOP more clear-cut and easier to identify, leading to a low incidence of appeals
129. An important factor that may affect the net benefits of adding penalty powers is the risk of the adjudicator's investigations finding 'false positives'. These involve erroneously finding breaches of the GSCOP (though these will ultimately be corrected by the appeals process), or finding breaches of the GSCOP that do not contribute to the adverse effects on supplier investment and innovation identified by the CC. To the extent that there are 'false positives', penalty powers could induce behaviour by retailers that is costly rather than beneficial.
130. An additional risk is that the punitive element imposed by the adjudicator in upholding a complaint could then be passed on to consumers in the form of higher prices. This could be particularly problematic for low-income consumers, for whom expenditure on food makes up a higher proportion of their income.

131. The adjudicator would only impose penalties where there is strong and convincing evidence that a retailer has committed a breach of the GSCOP. The CC accepted that it would not be appropriate to impose penalties based on anonymous complaints from suppliers.⁶⁴ Therefore, any dispute that could result in the imposition of a penalty would involve the supplier(s) being identified to the retailer. This may deter suppliers from seeking such resolutions if they consider the risk of de-listing to be sufficiently high.

Decision

132. It has been decided that powers will be provided in the primary legislation for the Government to introduce financial penalties, should future experience indicate that reputation alone is not a sufficient deterrent for retailers. Without more accurate information on how these penalties will be levied in practice, we have calculated some illustrative impacts above, but more precise impacts will be calculated if this power is exercised.

133. With regards to the penalty fine itself, this would represent a transfer from the retailer in breach of the GSCOP to the Adjudicator or Government. The use of these funds has not yet been decided, for example whether it will be used to help fund the enforcement of the Code or whether it will be used for other Government objectives. These details will be developed should the penalty power be invoked by the Adjudicator.

Option 4: Limiting the scope of the Groceries Code Adjudicator

134. As set out earlier, there are a large number of firms that supply groceries to UK grocery retailers, either directly or indirectly. This includes food and drink manufacturers, primary producers and fresh food wholesalers, including packers, processors and wholesalers. It is unclear precisely what proportion of total supply to grocery retailers is delivered directly (e.g. from wholesalers, manufacturers or primary producers) or indirectly through intermediaries.

135. The CC report that the majority of grocery retailers' fresh produce is supplied via intermediaries such as packers, processors and fresh food wholesalers, as retailers feel there are certain advantages to this supply channel.⁶⁵ Data provided to the CC during their inquiry suggests that the average value of direct purchases from farmers by large grocery retailers in 2006 was approximately £49 million per year.⁶⁶ As an example, the CC report mentions about 20,000 milk producers compared to 200 milk processors, of which three (Arla, Dairy Crest and Wiseman) account for over 90 per cent of total processed liquid milk sold to grocery retailers in the UK.

136. In their letter recommending the creation of a GSCOP enforcement body, the CC makes reference to there being 7,000 (direct) suppliers in the grocery supply chain.⁶⁷ This seems to be a very small number, especially taken in context of the earlier figures regarding the number of farm holdings, fresh food intermediaries and food & drink manufacturers. However, given that the CC reports that the market for grocery wholesale is relatively concentrated, with the 15 largest grocery wholesalers accounting for more than three-

⁶⁴ CC report, 11.372

⁶⁵ Such as: efficiencies arising from a single intermediary undertaking processing/packing on behalf of a number of farmers; the costs to a grocery retailer of trying to deal individually with the large number of farmers; the effectiveness of intermediaries at carrying out quality assurance activities compared with grocery retailers, and intermediaries' greater ability to source alternative supplies where there is a shortfall in production.

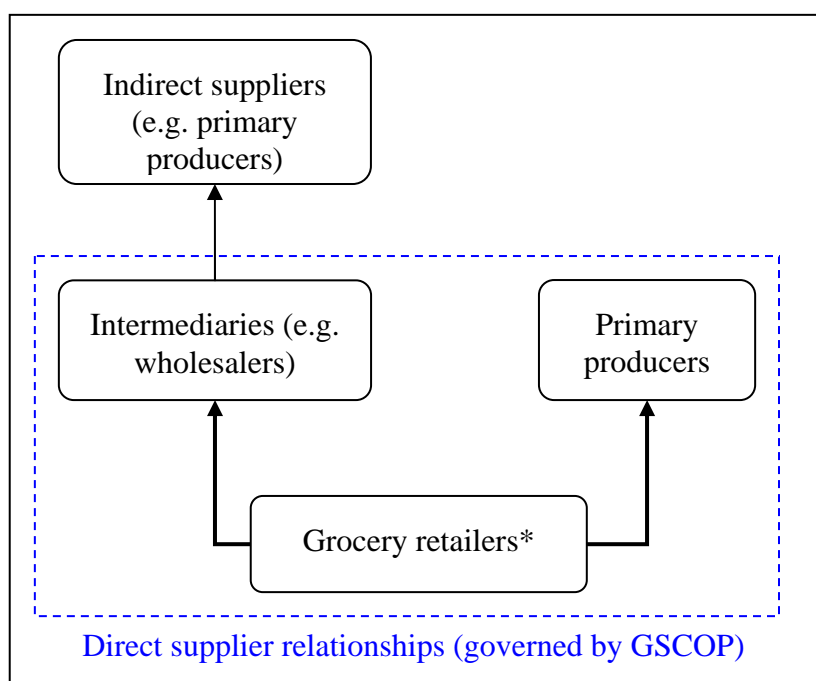
⁶⁶ £295 million across 6 retailers (Para 3.32, CC report), compared to £16.7 billion in fresh food sales for these retailers; it should be noted that the comparatively large proportion purchased by Morrison's through this channel is likely to distort an average figure across all retailers.

⁶⁷ Para 2.7 of http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/gscop_2_bis_letter.pdf

quarters of grocery wholesaling revenue, these 7,000 suppliers could account for a significant proportion of the overall supply of groceries to retailers.⁶⁸

137. Responses to the BIS consultation did not provide any further evidence on the number of (direct or indirect) suppliers in the grocery supply chain. One trade association estimated there to be over 10,000 suppliers within one part of the food manufacturing sector, while responses from retailers indicated that they had 2,500-3,000 direct suppliers (though it is difficult to know the potential for overlap between these suppliers for different retailers).
138. The original SCOP was designed to govern the relationship between retailers and their direct suppliers, not between intermediaries and primary producers. However, during their investigation, the CC reviewed some complaints from primary producers and found that it was not uncommon for processors and other intermediaries, in discussions with their suppliers (including primary producers), to attribute particular supply chain practices to direct intervention or pressure placed on the processor or intermediary by grocery retailers. The CC was told by grocery retailers that, in many cases, this attribution was incorrect and that the supply chain practices were in fact instigated unilaterally by the processor or intermediary, with no input from the retailer.
139. In order to increase transparency with respect to supply chain practices, the CC considered that primary producers and other suppliers to intermediaries and processors should also be permitted to make complaints to the adjudicator about alleged breaches of the GSCOP (i.e. retailers' conduct with respect to processors and intermediaries) where the primary producer or other supplier reasonably considers that the breach has had a direct or indirect effect on its interests.⁶⁹ Increased transparency would help to reveal supply chain practices and the exercise of buyer power, which might in turn benefit those parts of the groceries supply chain with little or no market power.

Chart: Groceries supply chain



* - Only those grocery retailers covered by GSCOP (i.e. with turnover in excess of £1bn)

⁶⁸ CC report, paragraph 3.27

⁶⁹ It should be noted that retailers' contracts with suppliers based outside of the UK are also regulated by the GSCOP (as they were under the SCOP) and those suppliers have the right to arbitrate and make complaints to the enforcement body. There is no distinction based on country of origin and, in the case where the enforcement body receives complaints from indirect suppliers, this also applies to foreign intermediaries and primary producers.

- costs

140. A subsequent impact of this option would be that indirect suppliers further up the supply chain would be severely impaired in terms of redress for any breaches of GSCOP, which could lead to costs being transferred onto them from intermediaries. As envisaged by the CC, this would then limit the scope for realising the full benefits of enforcement of the GSCOP. As the grocery supply chain at primary producer level is likely to be significantly less concentrated (with more small-scale enterprises), the benefits to these smaller suppliers from the increased marginal revenue could exceed the cost saving set out below.
141. As set out below, an estimate has been made of the potential benefits under this option in the form of lower enforcement costs. However, it is possible that significantly limiting the number of parties able to make complaints would lead to a loss of benefits greater than the cost saving.

- benefits

142. There are a large number of primary and other producers who are not direct suppliers to grocery retailers. Taking action to limit the scope of potential complainants to direct suppliers only – i.e. excluding the possibility for indirect suppliers to initiate a complaint against a grocery retailer who has breached the GSCOP that has ultimately resulted in this action transferring the costs up the supply chain via intermediaries – could significantly reduce the costs associated with enforcement.
143. Based on earlier figures, it could be assumed that there are around 350,000-400,000 suppliers in the grocery supply chain.⁷⁰ Under this option, complaints would be limited to direct suppliers only, of which there are estimated to be 7,000. Assuming that all suppliers are equally likely to make a valid complaint (and that each upheld complaint is equally costly), this might imply a reduction of around 98% in complaints (and enforcement costs) relative to a situation where all suppliers are permitted to complain. However, given the issues regarding concentration within grocery wholesaling, this might mean that the reduction in costs (if assessed on a value basis) would be much smaller.
144. In the absence of any further information, we have assumed that the reduction in the number of complaints could be as high as 50%. This would imply a potential reduction in ongoing costs (i.e. benefits) of **up to £0.6m per year**.
145. A number of retailers suggested that providing non-contracting parties with a right to complain would lead to complaints being vexatious or not based on a full and proper knowledge of the facts. However, the CC did not believe these concerns to be well-founded as the adjudicator would be required to contact the supplier and corroborate the details of the complaints.
146. In their response to the BIS consultation, one retailer raised the potential issue of suppliers' ulterior motives for raising complaints (e.g. 'tactical' commercial reasons) and used the example of the Financial Ombudsman Service, which deems only around 15% of the 1m complaints it receives per year to be worth of being processed. Further, they believe that further measures should be put in place to deter claims without merit.

- risks and assumptions

147. We have not been able to obtain firm figures about the comparative numbers of direct and indirect suppliers. Given that a potential reason for not directly supplying a grocery retailer could be a lack of scale, it could be that indirect suppliers are more likely to be smaller, hence more susceptible to the exercise of buyer power by grocery retailers. However as discussed above, in the absence of any further information, it has been assumed that the reduction in the likely number of complaints could be up to 50%.
148. Under this option, an important potential risk is the impact of costs borne by primary producers and indirect suppliers, for which they would then be unable to seek redress. In

⁷⁰ 311,000 farm holdings; 3,600 fresh food intermediaries and 6,600 food and drink manufacturers in the UK

the most extreme case, these costs could lead to production of certain grocery items becoming unprofitable and such suppliers being forced to exit the market. This could then have an adverse effect on competition for the provision of grocery items to grocery retailers, by reducing the number of potential suppliers, as well as negative distributional effects through the geographic distribution of loss of employment (e.g. in key farming areas) and potentially an increase in carbon emissions associated with UK food supply.

149. The CC noted that increasing concentration in the groceries supply chain has led to many intermediaries themselves having buyer power over primary producers.⁷¹ Even if the GSCOP and adjudicator is successful in preventing retailers from exercising their buyer power, the Code does not cover contracts between primary producers and intermediaries. Therefore, an adverse effect on competition may still exist in the supply chain if the adjudicator limits its scope to direct suppliers. It should be noted however that even if it receives complaints from indirect suppliers, the body will have limited authority to address a problem if it does not directly involve the large grocery retailer.

Decision

150. It has been decided that, in line with the Coalition Programme, the adjudicator should have the power to receive anonymous complaints from anyone in the supply chain, including farmers who may not directly supply the large supermarkets. This means that the costs and benefits identified above will not be incurred.
151. Given the global nature of grocery supply chains, it will be necessary for the Adjudicator to receive complaints from suppliers both at home and overseas. Whilst Government accepts that trade associations, NGOs and other organisations have an important role to play in offering advice and assistance to their stakeholders and members, complaints must also come directly from the business affected.

Administrative burden/policy savings calculation

152. As there is currently no adjudicator associated with the GSCOP, there is no extant associated administrative burden. In terms of the costs outlined above, these are the policy costs incurred through compliance with the GSCOP and any investigations conducted by the new body, rather than administrative burdens.

Wider impacts

153. In terms of indirect impacts, there is potential for the costs imposed as a result of the introduction of the Groceries Code Adjudicator to be passed on to consumers in the form of higher retail prices. Indeed, the response from one retailer indicated that, if the creation of the adjudicator added materially to operating costs, that price rises would be 'inevitable'.
154. This is likely to impact most heavily on low-income consumers, for whom food makes up a higher proportion of total expenditure. For example, Defra calculates that between August 2007 and October 2009 food prices rose by 16%, which impacted proportionately more on low-income households⁷² (with spending on food and non-alcoholic drink rising from 15.2% in 2007 to 16.8% in 2009, compared to 10.5% to 11.7% for all households).⁷³ This effect could be mitigated by substitution towards cheaper products, but this is difficult to estimate without more detailed data.
155. Secondary issues relating to UK grocery sector, such as the sustainability of the food supply chain, security of supply as it relates to food and carbon footprint of the supply chain, have been raised by stakeholders but have not been subjected to detailed analysis here, as this will not be the primary focus of the adjudicator. Nevertheless, the actions of such a

⁷¹ CC Report, paragraph 11.292

⁷² Defined as those in the lowest 20% of the income distribution

⁷³ UK Food Security Assessment: Detailed Analysis, Defra (2010)

body could have an indirect impact on these issues, though it is not possible at this stage to predict what these impacts might be and their relative size.

Summary and preferred option 5

156. In their report, the CC recommended that the Government establish a GSCOP Ombudsman, with the powers to impose penalties for breaches of the Code, after retailers failed to voluntarily establish such a body. The UK Government supports the need for such a body. The previous Government accepted the need for a body to monitor and enforce the GSCOP and have the power to receive anonymous complaints. It launched a public consultation as soon as the GSCOP came into force. The Coalition Government Programme, published on 18 May, commits the Government to introduce, as a first step, an Ombudsman, in the Office of Fair Trading, to enforce the Grocery Supply Code of Practice and curb abuses of power which undermine our farmers and act against the long-term interest of consumers.⁷⁴
157. This impact assessment focuses on several aspects of the establishment of such a body, notably:
- Whether establishment requires the creation of a new body
 - Whether such a body should have the power to levy penalties on retailers that breach the GSCOP
 - Whether such a body should limit consideration of code-related complaints to direct suppliers only
158. In relation to the first of these it has been concluded that, in line with the Coalition Programme, the body should be based within the OFT, but will remain independent. In relation to the second, the Government expects that the deterrent with the greatest impact on behaviour change is that of reputation. However, powers will be provided in the primary legislation for the Government to introduce financial penalties should future experience indicate that reputation alone is not sufficient. On the last of these issues, Government has decided that the body should have the power to receive anonymous complaints from anyone in the supply chain, including farmers who may not directly supply the large supermarkets, in line with the Coalition Programme.
159. The table below presents a summary of the costs and benefits associated with each policy option. The Government's preferred approach is Option 1 and potentially Option 3 at a later date.

Summary table of costs & benefits associated with each option

	Costs (£m)		Benefits (£m)	
	Transition	Ongoing	Transition	Ongoing
Option 1: Base case	0	1.2	Unquant.	Unquant.
Option 2: Creation of a new body	3-4	0	0	0
Option 3: Power to levy penalties	0	6	0	1.2
Option 4: Limiting the scope of complainants	0	Unquant.	0	0.3

⁷⁴ http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

Specific Impact Tests

Competition Assessment

Would the proposals directly limit the number or range of suppliers?

None of the proposed options would directly limit the number of grocery retailers or suppliers.

Would the proposals indirectly limit the number or range of suppliers?

None of the proposed options would indirectly limit the number or range of grocery retailers as the GSCOP only applies to the ten largest retailers with annual grocery sales of more than £1 billion. They may, however, affect grocery suppliers. By ensuring that the GSCOP is monitored and enforced, thereby preventing the transfer of excessive risk and unexpected costs to suppliers, it is less likely that they could be forced out of business, for example due to reduced profit margins or retrospective price adjustments. It is even possible that new entrants could enter the market if the returns were sufficiently high.

If the power to levy penalties is ultimately enacted, this could further increase retailer compliance, potentially leading to market entry and/or enhancement of supplier investment and profitability.

Would the proposal limit the ability of suppliers to compete?

None of the proposals should limit the ability of grocery retailers to compete with each other as they are all subject to the same Code and regulations. They should, however, allow grocery suppliers to compete on a level playing field, regardless of their size relative to the retailers they supply. As suppliers that are based outside of the UK are also covered by the Code, there is no additional incentive for grocery retailers to contract with foreign grocery suppliers (hence no increase in the likely probability of foreign suppliers supplanting domestic suppliers).

The level of competition in the upstream groceries supply chain may possibly increase as a result of the adjudicator receiving complaints from indirect (as well as direct) suppliers, by providing certainty around supply agreements and allowing them to avoid any losses which they might have otherwise incurred.

Would the proposal reduce suppliers' incentives to compete vigorously?

On the contrary, grocery suppliers would have greater incentive to compete assuming that the adjudicator ensures that they know, with certainty, the costs and risks of their operations.

Small Firm Impact Test

The GSCOP regulates the practices of larger grocery retailers with annual sales of more than £1 billion. Therefore, none of the proposed measures will have an impact in SME-sized grocery retailers – they will. However, the legislation may have a positive impact on small grocery suppliers (e.g. farmers and primary producers) by preventing their customers - large retailers and/or large suppliers - from transferring excessive risk and unexpected costs to them. A larger number of small firms that are indirect suppliers may also benefit from the adjudicator as it will accept complaints from them too (large suppliers will also have access to the Adjudicator). Furthermore, given the reputational damage that a retailer would suffer if the Adjudicator found it to be in breach of the GSCOP, there is a strong incentive to treat small and medium suppliers fairly.

Sustainable Development

By ensuring that primary producers and other grocery suppliers do not have their profit margins reduced by the exercise of buyer power, those enterprises will have greater financial resources to invest in innovative products and technology that reduces the environmental impact of production.

Race, Disability and Gender Equality Test

After initial screening as to the potential impact of this policy on race, disability and gender equality it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact.

Rural Proofing

To the extent that the adjudicator improves the operation and competitiveness of primary producers and rural enterprises that supply groceries, each option would have a beneficial effect in rural areas as a significant number of suppliers (e.g. farmers) are concentrated here.

Other Specific Impact Tests

Greenhouse gas assessment, wider environmental issues, health and well-being, human rights, justice system) have been considered and after screening, it has been confirmed that there is no significant impact.

Annexes

Annex 1: Post Implementation Review (PIR) Plan

<p>Basis of the review:</p> <p>A Post Implementation Review has been committed in the impact assessment and would be undertaken in 2015, to assess the effectiveness of the legislation taken forward to implement the Groceries Code Adjudicator. This will be used to inform the review of the sunset clause, which will determine whether to proceed, remove or improve the legislation to establish and enforce the GSCOP.</p>
<p>Review objective:</p> <p>The review would be intended to verify the assessment of the estimated costs and benefits associated with implementation of the preferred option (Option 5). If there are significant discrepancies between the estimated and actual figures, efforts will be made to understand the reasons for this and act if necessary. The review will also help determine whether the Department needs to take any further action, legislative or non-legislative.</p>
<p>Review approach and rationale:</p> <p>The review would make use of the regular reporting by the OFT (and eventually, when it is fully established, the adjudicator) on the level of compliance with GSCOP. This should take into account stakeholder views – including both retailers and suppliers – and include both quantitative (e.g. number of complaints/disputes, including those successfully resolved) and qualitative (e.g. expert opinion) data.</p>
<p>Baseline: The baseline position is the situation that prevails under the current UK regulatory regime (i.e. now that the GSCOP is in place), or the ‘do nothing’ scenario highlighted in the impact assessment. The impact of the preferred option will then be measured relative to this baseline. It should be possible to distinguish between the impact of the GSCOP and the impact of the adjudicator by using the evidence from the Competition Commission’s market investigation, which was undertaken prior to the introduction of the GSCOP.</p>
<p>Success criteria:</p> <p>Success will be judged against the potential breaches of GSCOP by the relevant retailers – if compliance is high, there should be a low level of complaints/disputes for the adjudicator to deal with. However, a high level of complaints alone is likely to be insufficient to declare the policy a failure, as the nature of those complaints and whether they are considered meritorious or not will be taken into account.</p> <p>Over the longer term, the policy will be judged against the levels of investment and innovation in the groceries supply chain (likely to be measured through supplier questionnaires). If the remedy is successful, these measures should not be adversely impacted following the introduction of the adjudicator.</p>
<p>Monitoring information arrangements:</p> <p>Ongoing monitoring is part of the adjudicator’s role and it is expected that it will publish annual reports on compliance, which may impose burdens on the retailers subject to GSCOP. It would be expected to report on a regular basis regarding the nature of complaints and disputes that it has investigated.</p>
<p>Reasons for not planning a PIR:</p> <p>N/A</p>

