

## Explanatory Note

[This Note is not part of the Order. Nothing in this Explanatory Note is legally binding. In the event of a conflict between this Explanatory Note and any provision of the Order, the Order shall prevail.]

### Introduction

1. The Competition Commission (CC) published its final report on the market investigation into the supply of groceries in the UK on 30 April 2008 (the report).<sup>1</sup> The report set out the CC's findings that there are features of the markets for the supply of groceries which adversely affect competition in the UK. One of these features was the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers.
2. To address the adverse effect on competition arising from these grocery chain practices, the CC has decided on a package of remedies to address the adverse effect on competition and the consequential detrimental effects on customers. The Groceries (Supply Chain Practices) Market Investigation Order gives effect to part of these remedies.

### Structure of the Order

3. The Order is divided into five parts:
  - (i) Part 1 contains general provisions, including the commencement date for the Order, to whom the Order applies, definition and interpretation provisions and the power to issue directions.
  - (ii) Part 2 identifies the retailers (Designated Retailers) who will be covered by the Groceries Supply Code of Practice (the Code), establishes a duty on Designated Retailers to incorporate the Code into their agreements with suppliers and provides a duty to provide certain information to suppliers.
  - (iii) Part 3 sets out duties on Designated Retailers to provide information to the OFT.
  - (iv) Part 4 set outs Designated Retailers' compliance obligations with respect to the Code and the Order.
  - (v) Part 5 sets out the dispute resolution procedure for disputes arising in relation to the Code.
4. The Order has three schedules: Schedule 1 contains the provisions of the Code. Schedule 2 contains a list of retailers who will be covered by the Code at the date of its commencement and Schedule 3 specifies the provisions which may be included in a force majeure clause.
5. The CC seeks to avoid placing undue burdens on business. In drafting the Order, we have attempted to balance the need for minimum standards in supply agreements with the need to maintain scope for commercial negotiations, particularly where these negotiations are mutually beneficial to suppliers and retailers. This is consistent with the many different supply arrangements that currently exist between retailers and

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<sup>1</sup>[www.competition-commission.org.uk/rep\\_pub/reports/2008/fulltext/538.pdf](http://www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf).

suppliers, which reflect the very different characteristics of products supplied and of suppliers themselves.

6. This Order comes into force on 4 February 2010. It is not intended that there should be any further transitional period in relation to any of the provisions contained within the Order.

### **Possible consequences of not complying with the Order**

7. Section 167 of the Enterprise Act 2002 (the Act) places a duty on any person to whom this Order applies to comply with it. Subject to the defences in the section, any person who suffers loss or damage due to a breach of this duty may bring an action.
8. Section 167 of the Act also provides that the Office of Fair Trading (OFT) and the CC can seek to enforce this Order by civil proceedings for an injunction or for any other appropriate relief or remedy.

### **Review of this Order**

9. The OFT has a general duty to monitor the operation of the Order under section 162 of the Act. This includes the duty to consider, from time to time, whether the Order should be varied or revoked in the light of a change of circumstances. Article 7 of the Order requires retailers to provide the OFT with information to allow it to monitor and review the operation of the Order.
10. The rest of this Explanatory Note deals in detail with each of the articles in the draft Order.

## **PART 1**

### **Citation, commencement and interpretation**

11. Article 1 has two functions. It gives the Order its name and it sets the dates on which the obligations in the Order come into force. Although not expressly set out in the Order, the CC intends to work with the OFT to ensure that the current Supermarkets Code of Practice,<sup>2</sup> introduced in March 2002 following the CC's investigation of supermarkets in 2000, will be revoked at the same time as the Order comes into effect.
12. Article 2 contains a number of definitions applicable throughout the Order.
13. *Buying team*: the definition of buying team in the Order is likely to be wider than the traditional definition of 'buying team' used by many retailers. In addition to those persons employed by the retailer to manage the relationship between the retailer and its suppliers, the definition is framed to encompass all those employees whose role includes the interpretation and/or application of the provisions of the Code or the Order—it also includes the managers of those employees. The scope of the buying team will differ between retailers depending on how a particular retailer interacts with its suppliers. A retailer who, for example, manages all aspects of a buyer relationship within a concentrated group of employees will have a smaller 'buying team' for the

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<sup>2</sup>This code was introduced in March 2002 following the CC's investigation of supermarkets in 2000 (*Supermarkets: a report on the supply of groceries from multiple stores in the UK*, October 2000, TSO, Cm 4842).

purposes of the Order than a retailer who has different parts of the organization dealing with different aspects of the supplier relationship.

14. *De-list*: de-listing occurs where a retailer ceases to purchase goods from a particular supplier, or significantly reduces its purchases. 'Significant' in this regard is determined by the amount of product that the individual supplier supplies to the retailer, as a decision to de-list will rarely have a significant impact on a retailer's total purchases. Whether a reduction of purchases is 'significant' is likely to vary depending on, among other things, the supplier, the type of goods supplied and the significance to the supplier of the product the retailer ceases to purchase (where the supplier supplies a number of different products). The report does not provide guidance on what will be 'significant' for the purposes of the de-listing provision, and we have not expanded on the definition in the Order, instead leaving this for an arbitrator (or the Ombudsman, when appointed) to decide on a case-by-case basis. However, the CC considers that the primary factor in determining whether a decision to de-list is consistent with the Code will be whether the decision is made for genuine commercial reasons (see discussion in paragraph 59 below).
15. *Groceries*: the definition of Groceries closely follows that in the terms of reference for the Groceries market investigation.
16. *Supplier*: the definition sets out which suppliers will be covered by the Code. It captures all suppliers who supply to retailers, but excludes internal supply, ie supply by bodies within the same group of companies as the retailer. The definition includes only those suppliers who contract directly with retailers (or do so through a direct agency relationship), but does not cover suppliers further down the supply chain, eg suppliers who have a contractual relationship to supply goods to intermediaries, who have a separate relationship with suppliers.
17. Article 3 provides that the CC can give directions for the purposes of securing compliance with the Order.

## **PART 2**

### **Code of Practice**

18. Article 4 specifies those retailers who will be 'Designated Retailers' for the purposes of the Order. The article lists retailers identified in the report as those who would be covered by the Code, and sets out the criteria which the OFT will consider to determine whether additional retailers will be covered by the Code in the future. As currently drafted, the OFT will designate a grocery retailer as a Designated Retailer as soon as it obtains evidence that it meets the £1 billion turnover threshold. The OFT has a discretion as to whether to appoint a business meeting the turnover threshold as a Designated Retailer, based on the nature of the business meeting the turnover threshold, and the purposes of the Order. There is no express provision for the removal of a retailer from the list of designated retailers. Any request for removal from the list of designated retailers (for example, in the event of a Designated Retailer's turnover falling under the £1 billion turnover threshold, or the acquisition of a substantial part of a Designated Retailer that falls under the £1 billion turnover threshold) would be considered by the OFT under its duty to monitor undertakings in section 162 of the Act.
19. Article 5 requires Designated Retailers to incorporate the Code into their agreements with suppliers. A failure to incorporate the Code into supply agreements will be a breach of the Order, actionable by any person affected by the breach pursuant to section 167 of the Act. While there is a requirement not to perform agreements that

do not incorporate the Code, the retailer is still required to accept and pay for goods in relation to existing agreements, and retains the right to make claims in respect of such goods.

20. Article 5 provides that the terms of any supply agreement should not be inconsistent with the terms of the Code. It makes clear that the inclusion of a clause providing for events of force majeure that is not materially different and not more burdensome to suppliers than the terms set out in Schedule 3 to the Order will not be inconsistent with the Code.
21. Article 6 requires Designated Retailers to ensure that their suppliers have a written copy of the supply agreement, as well as any subsequent agreements or contractual arrangements made under or pursuant to that agreement. The article should not be read as implying that a Designated Retailer's terms of supply should always prevail over those of a supplier—it merely provides that the onus is on the Designated Retailer to ensure that a supplier has a written copy of the terms and conditions which govern the relationship between it and the supplier, whether they originate from the supplier or the retailer. Designated Retailers are required to hold written copies of all terms of a supply agreement, as well as any subsequent agreements or arrangements made in accordance with the supply agreement, and to ensure that their suppliers also have a copy of these documents. The article also requires the Designated Retailer to send a cover letter highlighting certain information regarding the terms of supply.
22. Many retailers use electronic communication, including email and shared computer systems, to provide terms and conditions to suppliers. These means of communication fall within the definition of 'in writing', as expressed in the Interpretation Act 1978.<sup>3</sup> Merely including terms and conditions on a retailer's public website for a supplier to view will not be sufficient to meet the requirements set out in Article 6. However, in addition to other forms of written communication, a retailer can satisfy this obligation through the use of a shared-access website, or through a restricted access web page available to the supplier, distinct from the retailer's usual website and created for this purpose. Such electronic communication must:
  - (a) include all terms of the agreement between the retailer and the supplier; and
  - (b) include a facility for changes agreed between the retailer and the supplier to those terms to be recorded on the website and drawn to the attention of the supplier.
23. Documents stored on a computer system will also be sufficient to satisfy a requirement to hold 'written' copies of agreements.
24. 'Supply Agreement' is defined broadly to include any agreement for the supply of groceries for resale by the retailer, including 'spot buy' and 'sale or return' arrangements. The term 'resale' is used to exclude groceries purchased for consumption by the retailer itself, but includes any groceries purchased with the intention of selling them in the retailer's stores. We are aware that there are a broad range of supply arrangements between retailers and suppliers. It is common for an overarching agreement to provide general terms and conditions of sale, and for subsequent orders to be placed pursuant to those terms and conditions. It is also possible for each separate order to be placed pursuant to a separate agreement. The obligations in the GSCOP extend to all types of supply agreements between retailers and

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<sup>3</sup>See the Law Commission's advice in an e-commerce paper of December 2001: [www.lawcom.gov.uk/docs/e-commerce.pdf](http://www.lawcom.gov.uk/docs/e-commerce.pdf).

suppliers, although the obligations in Article 6(6) would be particularly burdensome on retailers who contract with a supplier using frequent, but distinct, supply agreements. The obligations in Article 6(6) are therefore limited in such circumstances.

### **PART 3**

#### **Supply of information to the OFT**

25. Article 7 requires a Designated Retailer to provide certain information to the OFT under certain circumstances. The information to be provided is for the purposes of enabling the OFT to monitor and review the operation of the Order or any provisions of the Order. Any information obtained by the OFT will be subject to the confidentiality obligations in Part 9 of the Act. We have included a reference in Article 7 to section 109(7) of the Act to make clear that the OFT cannot require parties to provide them with privileged information.

### **PART 4**

#### **Compliance obligations**

26. Article 8 sets out information and training requirements for employees of a Designated Retailer. An awareness of the Code and its requirements by all those employees who interact with a retailer's suppliers is an important step in maintaining compliance with the Code. In addition to initial training, Article 8 also requires retailers to provide refresher training on the Code once in each calendar year. The CC does not envisage this retraining being as extensive as initial training, but would be an opportunity to remind employees of the key elements of the Code, as well as updating them on any developments in the previous year.
27. Article 9 establishes the Code Compliance Officer (CCO), whom the CC expects to help facilitate a Designated Retailer's compliance with the Code, primarily by acting as a point of contact for suppliers in relation to issues arising under the Code, but also to encourage the development of best practice for individual retailers in order to improve relationships with their suppliers. A retailer's CCO will be an employee of the retailer, but will remain independent from those employees who are involved with suppliers on a day-to-day basis.
28. The CCO's duties are aimed at ensuring that suppliers have a person to contact within a retailer who is independent from the supplier's day-to-day buying contact. This includes being a point of contact for suppliers in relation to both queries and disputes. The CC expects that this will encourage, among other things, a greater amount of dialogue between retailers and suppliers, the development of consistent supply chain procedures for all of a retailer's suppliers, and the swift resolution of disputes in relation to the Code.
29. Article 10 sets out the reporting requirement for those retailers covered by the Order. The CCO is required to report to the retailer's audit committee on an annual basis, detailing and describing matters relating to the retailer's compliance with the Code and the Order. The report must be signed off by the audit committee (or similar body) of the retailer and delivered to the OFT for review.
30. A summary of the CCO's report must be included in the Designated Retailer's annual report. The CC has limited the publication to a summary, as we expect the CCO report to include a large amount of information which is commercially sensitive to the

retailer. However, the summary should at least provide a general overview of each of the matters that are required to be in the full report, to the extent that it does not reveal any information that is commercially sensitive to the retailer and its suppliers. This should include measures taken by the retailer to address non-compliance or improve compliance with the Code, details of disputes and the result of these disputes and a summary of training undertaken by the retailer's staff.

## **PART 5**

### **Dispute resolution**

31. Part 5 of the Order sets out the dispute resolution procedure under the terms of the GSCOP. The procedure seeks to encourage retailers and suppliers to engage in a dialogue prior to undertaking formal dispute resolution, without unduly delaying a swift resolution of complaints. We expect arbitration to cover both disputes as to the application of the GSCOP, as well as whether the GSCOP applies to a particular dispute.
32. It is important for both retailers and suppliers to be aware when a dispute has arisen, as this will influence the timing of the various steps in the dispute resolution procedure. Article 10 is drafted so that the CCO and the supplier have an opportunity to discuss supply chain issues without a formal dispute arising. However, the article requires the retailer to establish at an early stage whether the supplier wishes to invoke the formal dispute resolution procedure. We expect that, if a retailer has sufficient procedures in place to encourage dialogue between the supplier and the retailer's buying team and/or CCO regarding supply chain issues, this should reduce the need for the dispute to be escalated to the formal dispute resolution procedure set out in the article.
33. As set out in Article 11, the onus will generally be on the retailer's CCO to establish whether a supplier wishes to elevate a complaint regarding a retailer to a formal dispute under the GSCOP. A supplier may refer the dispute to arbitration if it cannot be resolved within 21 days from the date on which the dispute arises. However, we expect that in a number of cases the parties will wish to continue to attempt to resolve disputes between themselves beyond the 21 day period. Therefore, while the right to arbitration will become available after 21 days, the dispute will not automatically be referred to arbitration at that time, nor will the right to refer the dispute to arbitration extinguish if it is not exercised immediately.
34. Article 11 provides that the Ombudsman should be the default arbitrator for any dispute. If the Ombudsman has not been established, or if the Ombudsman has a conflict of interest in relation to a particular dispute, the arbitration will be administered by a single arbitrator appointed in accordance with the Rules of the Chartered Institute of Arbitrators. It will be the responsibility of the parties to the dispute (rather than the OFT) to arrange for the appointment of the arbitrator.
35. The rules which will govern the arbitration, and the rights of appeal, are set out in paragraphs 11(6) and 11(8) respectively. All costs of the arbitrator will be borne by the retailer, unless the arbitrator decides that the supplier's claim is vexatious or wholly without merit. All other costs of the arbitration will be assigned at the arbitrator's discretion.
36. While the dispute resolution procedure specifies that only a supplier may invoke the arbitration requirement, Article 11(9) allows a retailer to include a clause in a Supply Agreement giving a retailer the right to invoke arbitration, in a similar manner to that set out in Article 11(4).

## Schedule 1

### The Groceries Supply Code of Practice

37. Schedule 1 contains the Code, which must be incorporated into Designated Retailers' supply agreements, as required by Article 5 of the Order. The Code consists of six parts, relating to different aspects of the retailer/supplier relationship.
38. Part 1 of the Code contains a number of definitions, many of which mirror those in the Order. The definitions have been repeated in the Code in order to allow it to be read and understood without needing to revert back to the Order.
39. *Reasonable notice*: given the different situations within the Order as to when reasonable notice must be given, and the myriad different relationships between retailers and their suppliers, the CC has not defined a specific period in which notice will be considered reasonable. The CC has set out a series of factors that will assist with the assessment of when notice is reasonable, none of which factors will be necessarily determinative in any particular case.
40. *Required*: many of the practices covered by the Code are beneficial to both suppliers and retailers (eg promotions, marketing, and the modification of supply chain procedures) and outright prohibitions on particular conduct would unnecessarily limit the scope of commercial negotiations between retailers and suppliers. The Code seeks to ensure that suppliers are not under duress to acquiesce to requests made by retailers in respect of certain practices. Thus a retailer may legitimately make a request of a supplier, but it must not apply any more than ordinary commercial pressures to the supplier. The definition of *Required* places the onus on the retailer to demonstrate that, where it makes a request of a supplier, that supplier is free of any duress from the retailer when it acquiesces to that request.
41. Part 2 contains an overarching fair dealing principle, which will add a useful context within which the GSCOP should be interpreted. The fair dealing provision emphasizes the need for certainty on the part of suppliers regarding the risks and costs of trading, particularly in relation to key elements of the supply chain: production (including volume and sizes of products), delivery and payment (including prices and payment terms).
42. Part 3 of the Code contains principles relating to variations to the terms of supply or to supply agreements. Paragraph 3 prohibits retrospective changes to terms of supply, once they have been agreed by the parties.
43. A discussion of when a variation of a supply agreement will be retrospective is set out in the report in the footnote to paragraph 9.46 of the report:

In our view, where a retailer and a supplier have concluded an agreement for the supply of goods, any subsequent unexpected unilateral change of the contractual terms governing the provision of those particular goods is generally not appropriate when the supplier has itself already sunk significant costs in order to meet the objectives set out in the agreement. Even when the renegotiation occurs prior to delivery of the goods and acceptance of them by the retailer, it is likely that a supplier will have taken irrevocable steps as a result of the contract.
44. Paragraph 3(2) allows for adjustment to terms of supply to have retrospective effect where the supply agreement clearly and unambiguously allows for such changes, and the basis for how such adjustments can be made. This encourages retailers and

suppliers to consider how risk will be allocated at the time supply agreements are entered into.

45. The types of practice that are intended to be prohibited by paragraph 3 are described in Appendix 9(8), paragraphs 27 to 42 of the report. Some examples are also provided in the Annex to this Explanatory Note.
46. Paragraph 4 obliges a retailer to provide written notice to a supplier when changes are made to its supply chain procedures, or compensate a supplier for any costs incurred by the supplier due to a failure to provide such notice.
47. Part 4 of the Code sets out minimum standards in relation to prices and payment. Paragraph 5 requires retailers to pay for goods received from suppliers within a reasonable time after the date of the supplier's invoice. We note in this context that the EU Late Payments Directive considers, in the absence of a fixed payment period in a contract, that a payment will be considered late if it is not made within 30 days of the receipt of the invoice requesting payment.<sup>4</sup>
48. Paragraph 6 prohibits a retailer from requiring a supplier to make any payment towards a retailer's marketing costs unless such a contribution has been agreed in the supply agreement.
49. Paragraph 7 prohibits completely a supply agreement containing a provision which makes a supplier liable for shrinkage from a retailer's premises. Shrinkage broadly covers any loss of goods after they have been delivered to the retailer. The report<sup>5</sup> states that shrinkage is an area where the CC felt that even an upfront allocation of risk may be excessive. Hence, the paragraph prohibits any express provision in a supply agreement providing that the supplier must pay any compensation to a retailer for shrinkage losses (whether upfront or retrospective).
50. Paragraph 8 prohibits retailers from requiring a supplier to make any payment for wastage. In respect of some types of goods it would be reasonable for suppliers and retailers to share the cost of wastage. Paragraph 8 provides for a retailer and a supplier to agree upfront how wastage will be allocated under the Supply Agreement.
51. Paragraph 9 prohibits a retailer requiring payments in order to secure the stocking or listing of a supplier's product. An exception exists when such payments are made in relation to promotions. In order to encourage retailers to stock new and innovative products, an exception also exists for payments to secure stocking or listing of new products. However, such payments must reflect the risk run by that retailer in stocking, displaying or listing new products.
52. Paragraph 10 requires retailers to compensate suppliers for erroneous forecasts. Forecasts are important to both retailers and suppliers, and are particularly beneficial in allowing suppliers to plan their production to meet retailer's expected needs. Paragraph 10 requires retailers to ensure that any forecasts are sufficiently transparent so as to allow suppliers to make their own assessment as to the veracity of any forecast made (to the extent that suppliers have not been involved in the forecasting process). A retailer will be liable for any cost incurred by the supplier as a result of any forecasting error attributable to that retailer unless the supply agreement expressly provides otherwise, or the retailer has prepared the forecasts in good faith, with due care, and following consultation with the supplier.

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<sup>4</sup>Directive 2000/35/EC.

<sup>5</sup>See paragraphs 9.48, 11.316 and 11.317 of the report.



53. Paragraph 11 limits the extent to which a retailer can require a supplier to obtain good, services or property from any third party where the retailer acquires a benefit from the third party arrangement. A retailer must only tie a supplier to a third party where the supplier's alternative fails to meet reasonably objective quality standards laid down by the retailer, or where the alternative source charges more than the third party for the goods, service or property.
54. Part 5 of the Code sets out minimum standards in relation to promotions. Paragraph 12 prohibits a retailer requiring payments from the supplier in order for the supplier to secure better positioning or an increase in the allocation of shelf space. As with paragraph 8, an exception exists when such payments are made in relation to promotions.
55. Paragraph 13 provides that a retailer will not require a supplier predominantly to fund the costs of a promotion. The ordinary meaning of the word predominantly suggests an amount greater than half of the costs of a promotion. Where some payment is required by the retailer paragraph 13(2) requires the retailer to give reasonable notice, in writing, to the supplier holding the promotion.
56. Paragraph 14 requires the retailer to take precautions during promotional periods to ensure that it orders only so much of the relevant products at promotional prices so as to cover the expected sales during the promotional period. In particular, the retailer must ensure that the basis on which any order is made in relation to promotional products is transparent. If a retailer does not take such precautions, paragraph 14(1) requires the retailer to compensate the supplier for any product purchased from the supplier at the promotional price, but sold by the retailer at a higher non-promotional price.
57. Part 6 sets out other duties on retailers. Paragraph 15 provides that suppliers may be held responsible for the cost of customer complaints which are attributable to their negligence or default, while ensuring that payment for customer complaints does not become a 'profit centre' for retailers. It sets out instances when a retailer may require a supplier to make a payment in relation to a consumer complaint, and sets out procedures a retailer must follow in these instances. Paragraph 15 does not, however, limit a retailer's claim for any contractual damages for losses due to faulty goods supplied by the supplier. Paragraph 15 allows a retailer to charge a supplier in relation to consumer complaints when:
  - (a) the retailer and the supplier have agreed on an average figure for payments in relation to resolving customer complaints, and this average figure does not exceed the expected costs to the retailer of resolving the complaints; or
  - (b) if the retailer has not adopted the procedure in (a) above, the retailer is satisfied that the customer complaint is justifiable and attributable to the negligence or default of the supplier. In some instances the retailer must also provide evidence of this to the supplier.
58. If the retailer wishes to adopt the practice set out in (b) above, the extent of the costs recoverable, and the procedures the retailer must go through to verify the complaint, differ depending on how the complaint can be resolved:
  - (a) If a complaint can be resolved in store by a refund or exchange, the payment required from the supplier should not be greater than the retail price of the product charged by the retailer.

- (b) If a complaint cannot be resolved in store through a refund or exchange, the payment required from the supplier can be all those costs reasonably related to that retailer's costs arising from the complaint. However, there are further steps involved in establishing fault in these circumstances, as the retailer must provide the supplier with a full report regarding the complaint, including evidence that the consumer complaint is justifiable and attributable to negligence or default on the part of the supplier. The greater standard of evidence reflects the greater cost that is likely to be incurred by a supplier in such instances.
59. Paragraph 16 imposes duties on retailers seeking to de-list a supplier. The definition of de-list is discussed in paragraph 14 of this Explanatory Note. However, the key factor in determining whether a decision to de-list is justifiable under the Code is whether it is for 'genuine commercial reasons'. Particular examples where de-listing will not be for genuine commercial reasons are where a retailer de-lists a supplier as a consequence of the supplier exercising its rights under the Code or its supply agreement with the retailer, or the failure by a retailer to fulfil its obligations under the Code.
60. The procedure for de-listing a supplier is set out in paragraph 16(2). Prior to de-listing a supplier, a retailer must provide reasonable notice to the supplier of the decision to de-list. The amount of notice will vary depending on the case—notice periods should have regard to the investment and costs that have been made by the supplier in order to meet the requirements of the supply agreement, and should include sufficient time for the supplier to exercise its rights to have the decision reviewed internally by the supplier. These rights include attending an interview with the retailer's CCO to discuss the decision to de-list, and having the decision reviewed by a senior buyer of the retailer.
61. Paragraph 17 allows a supplier to require a retailer's senior buyer to review any decision taken by a retailer in relation to issues to which the Code relates. The retailer must ensure that a supplier is aware of contact details for its senior buyer(s).

## Examples: retrospective variations to supply agreements

**Example 1:** A supplier of produce meets with a retailer to discuss and agree forecast volumes for the upcoming season. The forecast clearly states that the volumes agreed are indicative only, and will be subject to orders actually made by the retailer.

A forecast is a planning tool beneficial to both retailers and suppliers. Where there is a clear and unambiguous provision in the supply agreement that a forecast is subject to revision and does not create obligations on the other party, subsequent amendment of a forecast will not be a retrospective variation of a supply agreement. In this example the risk of the forecast overstating the amount of produce required by the retailer has been assumed by the supplier, provided that the forecast does not breach the erroneous forecast provisions in the Code.

**Example 2:** To encourage a supplier to commence supplying a new product line, a retailer commits to purchasing a minimum volume of that product for each of the first three years in which it is supplied. Half way through the first year of the supply agreement, the retailer amends the minimum volume requirement.

This example can be contrasted with that relating to forecasts. By agreeing to a minimum annual purchase, the retailer is making an express commitment for the forthcoming year, designed to encourage a supplier to undertake significant investment to achieve the agreed volume. Any change to this volume will be a retrospective variation of a supply agreement. However, given the level of uncertainty that is inherent in establishing sales for a new product line, it seems likely the retailer and supplier should turn their minds to how variation in the minimum volume required might be adjusted. Any provision in the supply agreement for adjustment should be clear and unambiguous.

**Example 3:** A retailer agrees to purchase a certain volume of produce from a supplier and places an order to this effect. Prior to delivery of the order, the retailer decides that it wishes to run a promotion on the produce to be delivered, and requires the supplier to fund some of this promotion. Following delivery, the retailer fails to sell a significant proportion of the produce due to a sudden change in consumer demand. The retailer therefore discounts the amount paid to the supplier to recoup lost profit from the lack of sales.

In this example, there has been a clear agreement for the supply of goods, and the subsequent change to the contractual terms, both in relation to the promotion and the discounting of the price paid, will be retrospective changes to the supply agreement.

**Example 4:** A supplier of seasonal produce is unable to deliver goods to the specifications set out in the supply agreement, due to unforeseen weather conditions. The retailer and the supplier agreed that the retailer will accept the goods that do not meet specifications, but at a lower price than previously agreed.

Such an arrangement will not be a retrospective variation to a supply agreement. In this case, there has been a breach of the supply agreement by the supplier, and the retailer has agreed to take action to mitigate any loss that will arise from that breach.

**Example 5:** A retailer and supplier reach an agreement for the supply of a product that is made primarily from a particular input. A price has been agreed for all volumes ordered by the retailer during the period of the contract. Three months into the agreement, the price of the input decreases by 30 per cent. The retailer wishes to decrease the retail price for the

product to reflect the decrease in the cost of production. The retailer consequently wishes to reflect the decrease in retail price in the purchase price paid to the supplier.

Under the terms of the Code the price cannot be changed for goods where the price has already been agreed. In many circumstances, a supply agreement will be an overarching agreement, with price and quantity agreed as orders are placed. In such situations, any change in input price can be reflected in the next order. However, the Code prohibits changes to the price paid by retailers for goods already ordered, or where the price has been set for a certain period.

The retailer will be able to vary the price paid to the supplier for goods already ordered if the supply agreement clearly and unambiguously provides that the price at which goods will be supplied will vary depending on input price, and provides for a formula setting out how the new price will be calculated (eg goods supplied on a cost plus basis). Such a clause will fall under the exception set out in paragraph 2(3) of the Code.