



ALDI Stores
(A Limited Partnership)
ABN 90 196 565 019

1 Sargents Road, Minchinbury, NSW 2770 AUSTRALIA

Locked Bag 56
St Marys Delivery Centre
NSW 2760

Telephone: (02) 9675 9000
Facsimile: (02) 9675 9399

Buying Department
Facsimile: (02) 9675 9299
(02) 9675 9288

19 September 2014

Manager
Competition Policy Unit
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: grocerycode@treasury.gov.au

Dear Sir/Madam

ALDI Stores ('ALDI') welcomes the opportunity to provide its views on the *Food and Grocery Code Consultation Paper* ('Consultation Paper') and the accompanying *Competition and Consumer (Industry Codes - Food and Grocery) Regulation 2014* ('the Code').

This submission addresses those matters raised in the Consultation Paper which would have the more significant impact on ALDI's operations and current dealings with its suppliers.

At a general level, we acknowledge the circumstances that have led to the development of the Code, as well as the Code of Conduct ('AFGC Code') agreed between the Australian Food and Grocery Council ('AFGC') and Coles and Woolworths in late 2013. In short, we understand that the Code seeks to respond to concerns in relation to specific behaviours of the two major supermarket chains ('MSCs') who have significant market power, and provides a mechanism for them to opt in and be bound by the obligations within it.

In considering the Code, ALDI notes that it does not have the same market power as the MSCs, and it does not engage in the types of behaviours that have been raised in relation to the MSCs as outlined in the Consultation Paper. ALDI already has clear and fair agreements and good relationships with suppliers, and efficient and simple processes to resolve any issues that emerge from time to time with suppliers.

We also observe that the Code is based on the AFGC Code, the drafting of which did not involve ALDI. Accordingly, many of the provisions in the Code suit the business model of the MSCs but are inapplicable or inconsistent with ALDI's business model as a limited line, low cost retailer.

Overall, ALDI has a significant concern that the Code would add complexity to our current effective and transparent procedures and processes with suppliers. This would increase administrative and compliance costs on ALDI and its suppliers which is in contrast to ALDI's business model to simplify and standardise its operations to keep operating costs low in order to ensure everyday low prices for consumers.

ALDI is still considering whether it would be prepared to opt in to the Code. This submission sets out a number of specific reservations and concerns that would need to be addressed before it could consider this.

1. Industry Context and ALDI's Relationships with Suppliers

Our understanding is that the AFGC Code and the Code, have been precipitated by widespread criticism of certain behaviours by the MSCs vis a vis their suppliers. It has been suggested that these behaviours include:

- requiring payments from suppliers to have products stocked or for better positioning of products;
- requiring funding from suppliers of costs of promotions, marketing and markdowns;
- delisting products for non-commercial reasons; and
- threatening to disrupt a supplier's business or terminate their supply agreement.

ALDI does not engage in these behaviours.

We are known for our excellent relationships with our suppliers and the benchmark industry supplier survey (Nielsen Retail Barometer, quoted in 'The Sydney Morning Herald', Adele Ferguson, 8 November 2013) consistently rates ALDI as retailer of the year (64% in 2013, compared to 21% for Coles and 7% for Woolworths), as well as the highest net rating for quality of relationship (73% in 2013, compared to 57% for Coles and 9% for Woolworths).

2. ALDI's Unique Business Model

ALDI's efficient and globally-tested business model is to limit operating costs to ensure the lowest possible prices for its range of almost entirely exclusive own brand products. This business model is distinctly different to the business model of the MSCs. Relevantly when considering the Code, these differences include:

- we focus almost exclusively on an exclusive own brand product range, with less than 5% of our product lines being supplier-branded products so we can reduce the cost of everyday groceries through reduced marketing overheads;
- ALDI's core product range is around 1,350 products (typically one product per category) which contrasts with around 25,000 for a full-line supermarket operated by the MSCs;
- our prices do not fluctuate wildly in comparison to the 'high-low' pricing models generally adopted by the MSCs, but instead remain consistently low in the form of everyday low prices;
- ALDI has a much flatter buying structure than the MSCs, reflecting our simpler and streamlined model – every supplier deals directly with one of our Buying Directors. Above our relatively small team of Buying Directors, ALDI has a number of Group Buying Directors and a Managing Director – Buying. This contrasts with the MSCs which we understand have buying departments with many hundreds of staff, with multiple levels of buying staff dealing with suppliers. Unlike the MSCs where junior buying staff tend to be the first point of contact for suppliers, ALDI's Buying Directors are generally the only point of contact for suppliers on all issues ranging from the products to resolving issues in line with the ALDI Management System, being ALDI's dispute resolution process. In that sense, ALDI's Buying Directors would constitute "Senior Buyers" for the purposes of the Code; and
- we have existing, successful mechanisms to deal with any supplier issues in the rare circumstances that these arise.

The uniqueness of ALDI's business model is directly relevant to whether the Code is applicable to ALDI. The terms of the Code closely follow the AFGC Code which was a product of consultations between the AFGC and Coles and Woolworths. As a result, the Code more closely reflects the business model of the MSCs, rather than ALDI, as the Code assumes:

- retailers have more market power than the suppliers, but many large suppliers have more market power than ALDI. ALDI currently only operates in New South Wales/ACT, Queensland and Victoria and is estimated to account for around 10% of the grocery market on the Eastern Seaboard¹;
- retailers' product lines are predominantly comprised of supplier-branded products, whereas ALDI is first and foremost an own brand retailer with less than 5% of its products being supplier-branded; and

¹ Roy Morgan Research, 'Supermarket Currency' report, December 2013, media release, 12 February 2014.

- retailers have large, multi-tiered, buying teams which are not easily accessible to suppliers, in contrast to ALDI which has a flat structure where its Buying Directors have authority to resolve supplier issues.

For these reasons, ALDI approaches the Code consultation process with the preliminary view that there appears to be no ‘problem’ relating to ALDI that is in need of a ‘solution’, and that the Code represents a poor fit with the way in which ALDI conducts its business.

3. Code Provisions Which Should Not Apply to ALDI

There are a number of provisions in the Code which do not apply to ALDI given its unique business model, in particular, the product ranging, shelf space allocation and dispute resolution provisions.

(a) Product Ranging/Shelf Space Allocation Principles

The requirements of the Code for a retailer to provide brand product ranging and shelf space allocation principles seems to be aimed at addressing the concern that MSCs misuse their market power by discriminating in favour of their own brand products and may require suppliers to make payments to secure better positioning or an increase in allocation of shelf space. In contrast to the MSCs, 95% of ALDI's products are own brand and it does not require any such payments of any of its suppliers. For these reasons, ALDI does not have or need product ranging or shelf space allocation principles.

Whilst we understand that the MSCs generally conduct range reviews at least twice a year, ALDI only conducts annual tenders, unless a longer term contract is in place, of each of its products predominantly to ensure continued quality and competitive pricing. This is carried out on a product by product basis and not by category in most cases.

For the reasons outlined above, product ranging and shelf space allocation policies are unnecessary and not applicable to ALDI. If ALDI were to adopt such policies, it would not deliver any benefit to ALDI or suppliers and instead would result in unnecessary administrative burden and costs on ALDI.

Accordingly, ALDI believes clause 24 of the Code should only apply to retailers with 50% or more of products that are not own brand products, when it may be relevant to have such policies.

(b) Dispute Resolution Procedures

ALDI already has an effective and efficient informal dispute resolution process in place through the ALDI Management System. The ALDI Management System is used by ALDI globally and outlines ALDI's organisation and management structure and the process for addressing any complaints or disputes.

Under the ALDI Management System complaints/dispute procedure, suppliers can raise any issues they may have, for example a decision by ALDI to de-list a product, with the relevant ALDI Buying Director who has authority to resolve that dispute. If the matter is not resolved to the supplier's satisfaction, the Supplier can request the matter is escalated, ultimately to the Managing Director – Buying. At a practical level, we find almost all supplier concerns are dealt with promptly, often on the same day or the following day from when they were initially raised with the ALDI Buying Director.

The dispute resolution process proposed in Part 5 of the Code is unnecessary, less efficient, more complicated, and more difficult to establish and implement than the process currently used by ALDI. In particular, the Code process would:

- remove Suppliers' direct access to the commercial decision makers at ALDI (i.e. Buying Directors) to quickly and effectively resolve any issues;
- significantly impact ALDI's ability to quickly resolve issues/complaints/disputes with suppliers, particularly if it relates to ‘special buys’ products (i.e. once off weekly catalogue specials) where urgent resolution would be required, whereas it could take up to 40 business days before the dispute reaches mediation/arbitration under clause 31 of the Code;
- be a costlier system for suppliers to follow; and
- be a costlier system for ALDI in terms of employing a Code Compliance Manager, to prove every time if a supplier's complaint is vexatious, trivial, misconceived or lacking in substance, and to follow each step of the dispute resolution process under the Code.

4. Compliance Costs and Administrative Burdens

ALDI operates a lean and efficient organisational structure, which seeks to minimise unnecessary administrative processes and keep ALDI's costs low, in order to maintain lower prices for its consumers.

There are a range of provisions under the Code that will impose significant additional administrative compliance requirements on ALDI which will increase our operating costs, and could impact ALDI's low cost model. In ALDI's view, the projected costs of compliance with the Code as outlined in the Consultation Paper are not accurate and underestimate the realistic cost of implementing new policies and procedures and ongoing compliance.

Relevant compliance burdens and cost issues include:

- appointing a Code Compliance Manager (clause 28);
- amending ALDI's existing agreements with its suppliers to comply with the Code;
- updating ALDI's procedures and training to reflect the requirements of the Code;
- reporting on compliance every six months which is twice the frequency of reporting required under the UK Mandatory Code. Retailers should not be required to report on compliance with the Code more frequently than annually, given the administrative burden of the reporting and compliance obligations and additional costs;
- establishing additional and unnecessary policies, e.g. product ranging and shelf allocation policies (clause 24) as set out in section 2, above; and
- establishing the formal dispute resolution process in Part 5 as set out in section 2, above.

5. Lack of Balance and Coverage

(a) Coverage of Suppliers

As presently drafted, the Code assumes all retailers have the bargaining power over suppliers, and only imposes obligations on retailers. The Code does not recognise the significant market power of major suppliers which may be exerted against smaller retailers in the Australian market such as ALDI.

There are provisions which should be included or extended in the Code to apply equally to both suppliers and retailers to ensure the Code is more balanced, including requiring that:

- suppliers give reasonable notice if they intend to cease supplying a product;
- suppliers comply with laws regarding a retailer's intellectual property and confidential information (clauses 21 and 22);
- suppliers act lawfully and in good faith (clause 25);
- suppliers are prevented from making claims or complaints which are vexatious, trivial, preconceived or lacking in substance (Part 5); and
- suppliers co-operate and act in good faith in resolving disputes (Part 5).

Suppliers could be required to opt in to be bound and obtain the benefit of the Code or at a minimum the Code should recognise that the mutual obligations outlined above should be included in the Grocery Supply Agreement.

(b) Alcohol products

The aim of the Code is to establish a minimum standard of conduct between retailers and suppliers in respect of a broad range of products sold by grocery retailers. MSCs have a substantial market position in alcohol retailing, which can impact both suppliers and smaller retail competitors such as ALDI. Given alcohol products also form part of the product offering of such smaller retailers and are sometimes supplied by the same suppliers of other grocery products, then it seems sensible for there to be one code which covers all such grocery products, including alcohol products.

Accordingly, ALDI believes the definition of "groceries" in the Code should specifically include alcohol products.

6. Other Important Amendments/Clarifications

(a) Variation of Grocery Supply Agreements

ALDI has a core set of terms and conditions in place with each of its Suppliers and from time to time, ALDI may need to amend those terms to reflect, for example, changes in operating requirements. ALDI currently has an effective system in place for varying those terms and conditions by giving suppliers notice of any proposed variations. In order for ALDI to continue with such practices, it would need to rely on the exception to varying Grocery Supply Agreements contained in clause 10(2) of the Code. We are concerned that provision does not provide sufficient flexibility to vary our Grocery Supply Agreements. In particular, clause 10(2) appears to require a retailer to set out in a Grocery Supply Agreement each specific change of circumstance that would allow for such a variation to be made, which ALDI believes would be impractical.

Similar to the UK Code, ALDI suggests the Code be modified to provide that a retailer has a right to vary a Grocery Supply Agreement where reasonable notice has been provided to the supplier.

(b) Set Off

ALDI's general set off right is included in its agreements with suppliers and works effectively with suppliers to allow adjustments of invoices and payments in a simple and non-bureaucratic manner.

ALDI may be able to amend its agreements with suppliers to set out a non-exhaustive list of circumstances in which the set off may apply, but it would not be able to set out all the possible circumstances or specify the amount of the set off in its Grocery Supply Agreement as would be required under clause 16 of the Code.

If ALDI were to opt in to the Code, it would expect that it could continue to exercise its set off right in accordance with its agreement with suppliers without having to specify all possible circumstances in which it could apply or specifying particular set off amounts. Accordingly, ALDI proposes an amendment to clauses 16(2) and 16(3) to allow a set-off to be made if permitted by a Grocery Supply Agreement without the extensive detail currently contemplated.

(c) Fresh Produce

ALDI may need to return fresh produce to suppliers from time to time if the produce does not meet its produce standards and quality specifications but also if the produce has been delivered late. However, the terms on which ALDI may reject fresh produce are clearly set out in its current agreements with suppliers.

ALDI would only return unsold products, including fresh produce, to suppliers at the suppliers' expense, if permitted under its agreement with suppliers. If products meet ALDI's requirements under its agreements with suppliers, and can no longer be sold, ALDI has a program in place to donate those products to charities through OzHarvest and Foodbank.

If ALDI were to opt in to the Code, it would expect that, if necessary, it could return fresh produce to suppliers for the reasons outlined in its agreements with suppliers, including for late delivery.

Clause 18(3) should be amended to allow for rejection of fresh produce for any reason set out in the Grocery Supply Agreement. In order to ensure it is clear to retailers and suppliers, "fresh produce" should be defined in the Code.

(d) [Intellectual Property Rights]

ALDI recognises and does not infringe the intellectual property rights of its suppliers. We have procedures in place to ensure that we do not infringe intellectual property rights held by a supplier in connection with supplier-branded products when ALDI is developing its own brand products, and the brand names, packaging designs and advertising in relation to such products.

There are already requirements at law, both under statute and at common law, to recognise the intellectual property rights of a party. If a supplier considers that a retailer has breached its intellectual property, then it could take legal action to protect that intellectual property.

ALDI is concerned that the obligation to "respect" the intellectual property rights of suppliers in clause 21(1) of the Code is vague and may require ALDI to go above and beyond the requirements of the law in recognising the intellectual

property rights of suppliers, particularly when combined with the effect of the proposed dispute resolution procedures which would easily allow suppliers to make such allegations.

In order to address this concern, the reference to "respecting" the intellectual property rights of suppliers should be removed from clause 21(1). Instead, that clause could include an acknowledgement that retailers and suppliers must recognise and not infringe the intellectual property rights of the other party as required under statute and common law.]

Please do not hesitate to follow up with us further if you would like to discuss any issue we have raised.

Yours sincerely

Oliver Bongardt
Managing Director Buying