



Law Council
OF AUSTRALIA

Business Law Section

The Manager
Competition Policy Unit
Small Business, Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: grocerycode@treasury.com.au

12 September 2014

Dear Sir or Madam,

Submission in relation to 'Improving Commercial Relationships in the Food and Grocery Sector' and the draft *Food and Grocery Code of Conduct* (the Grocery Code)

Introduction

The Law Council of Australia is the peak national body representing the legal profession in Australia.

The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (SME Committee) makes this submission in response to the Consultation Paper dated August 2014, released by The Treasury.

The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SME's.

Submissions

In summary, the SME Committee supports Option 3 being the prescribing of a mandatory Grocery Code, whereby large retailers would be legally bound by the Code. The Committee believes that the opt-in Code in Option 2 would not achieve the objective of improving retailer-supplier relationships given its proposed discretionary application to large retailers, as well as the suggested exceptions which would undermine the protections a Code is looking to otherwise afford to suppliers.

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1. Do the concerns outlined above accurately capture the most acute problems facing the food and grocery sector? Are there other behaviours engaged in by retailers that should be considered?

The summary of concerns outlined at pages 4 to 6 of the Consultation Paper accurately capture the most acute problems facing the food and grocery sector. In particular, unilateral and retrospective contract variation is common problem in the industry. Practices have improved in recent times as a result of the scrutiny under which the practices of the major grocery retailers have been under. Only a mandatory grocery Code with legislative enforcement will achieve long-term improvement in the industry.

2. Are there any behaviours of suppliers that should be addressed by the Grocery Code?

In the SME Committee's view, there is a need to consider pricing issues associated with home brands. There is a risk that the major grocery retailers may sell their home brand products at a loss in order to either extract more favourable terms from the suppliers of branded products or to drive branded suppliers out of the market.

3. Do you believe there is a role for Government to intervene in the market to address these concerns?

The SME Committee believes it is appropriate for the Government to intervene in the market to address the concerns identified in the Consultation Paper. The UK Government has seen the need to intervene in the UK grocery market with the introduction of the UK Groceries Supply Code of Conduct (UK Grocery Code) and the UK grocery market is much less concentrated than the Australian grocery market.

4. Does the Grocery Code make it clear who the Code applies to and the scope of relationships in the food and grocery sector that it will cover?

With an opt-in Code it is not clear who the Code will apply to. As the SME Committee understands the proposed Code, retailers must decide whether to opt-in. There no indication which major retailers will, in fact, opt-in to the Code. Furthermore, it appears that a major grocery retailer may elect to opt-out of the Code at any time if it is not happy with the way the Code is impacting on its business activities.

The SME Committee believes that it would be preferable for there to be a prescribed mandatory Code which applies to major grocery retailers which have a particular sales turnover. The SME Committee believes an annual turnover figure of grocery sales of \$500 million would be appropriate as this would result in Coles, Woolworths, Metcash, ALDI and Costco all being covered by the Code.

The Code should not bind suppliers in the sense of creating legal obligations on suppliers. Rather, the purpose of the Code should be to create legal protections for suppliers, not to add to their legal compliance obligations.

The SME Committee is alert to the fate of the Produce and Grocery Industry Code of Conduct (PGICC), which was also a non-prescribed voluntary, industry run code. As stated at Attachment D to the Consultation Paper:

The Produce and Grocery Industry Code of Conduct (PGICC) is a non-prescribed voluntary, industry run code established in 2000 as the Retail Grocery Industry Code of Conduct in response to a Joint Parliamentary Inquiry into the changing retail market environment and its implications for trading. The PGICC takes the form of a voluntary set of guidelines aimed at promoting fair trading practices in the produce and grocery industry. The PGICC covers vertical transactions within the produce and grocery industry supply chain and guides the conduct of businesses within the industry. The PGICC is intended to cover all participants (except consumers) in the Australian produce and grocery industry, including growers, processors, wholesalers, distributors and retailers. It also provided a dispute resolution mechanism through the Produce and Grocery Industry Ombudsman (ombudsman).

The Produce and Grocery Industry Code Administration Committee (PGICAC) administered and monitored the operation of the PGICC. It was chaired by an independent Chairman, and committee members paid the costs of the Chairman and were responsible for promoting the code.

The PGICAC has not met since 2011. Its membership was producer, wholesaler and retailer representatives including the National Farmers' Federation, the Victorian Farmers' Federation, the Australian Chamber of Fruit and Vegetable Industries Limited, the National Association of Retail Grocers of Australia, the Australian Retailers Association, the Coles Group and Woolworths Limited.

The Australian Dairy Farmers resigned its membership on 27 January 2009 and the AFGC and the NFF resigned on 3 March 2009. The Horticulture Australia Council was officially closed in May 2010.

As the PGICAC has not met since 2011 and it is not clear if the remaining members still support the code, the PGICC could be considered to be no longer functioning.

(footnotes omitted)

In our view, the proposed Code is likely to go the same way as the PGICC if it is implemented as a voluntary opt in Code. A mandatory Code with legislative backing is required for the grocery industry.

5. Are the definitions for 'retailer' and 'supplier' sufficient to allow the Grocery Code to capture the types of supply chain relationships that present the most problems?

As stated above, the definition of "retailer" should also include a turnover figure so that only large retailers are captured by the Code. There is no legitimate basis for capturing smaller retailers which do not currently possess, and which are unlikely to obtain, a substantial degree of power in a market. The SME Committee understands the UK Grocery Code adopts an annual sales turnover approach.

The definition of “retailer” is appropriate to the extent it will also capture wholesale operators, such as Metcash.

6. Should relationships relating to the supply of alcohol be covered? Why/why not?

The SME Committee sees no reason why the Code should not extend to the supply of alcohol. In 2005, the ACCC commenced legal proceedings against both Woolworths and Liquorland, a Coles subsidiary, for entering into anticompetitive agreements in the liquor industry. This case resulted in the imposition of pecuniary penalties of more than \$10 million. Given this earlier conduct, there is a real risk that other unacceptable commercial conduct is being engaged in by the major grocery retailers in the liquor industry, which not only affect price competition at the retail level but also SME’s at the wholesale level.

7. Is the timing allowed for retailers to transition pre-existing grocery supply agreements to new agreements that conform to the Code appropriate?

As the SME Committee does not support a voluntary Code, this question is not strictly relevant. Having said that, the SME Committee believes that the mandatory Code should apply to all agreements entered into after the Code has commenced operation. There should be no transitional period in relation to new agreements entered into after the Code has commenced.

8. Do you agree with the six fundamental matters listed for inclusion in all Grocery Supply Agreements? Are there other matters that should also be considered?

The SME Committee believes that the six fundamental matters listed for inclusion in all Grocery Supply Agreements are appropriate, namely:

1. *any requirements the retailer has in respect of the delivery of groceries;*
2. *any circumstances in which the retailer may reject the groceries;*
3. *the period within which the retailer must pay the supplier for the groceries and the circumstances in which any payment, or part of a payment, may be withheld or delayed;*
4. *the term of the agreement — if the agreement is intended to operate for a limited time only;*
5. *any quantity and quality requirements relating to the groceries — in clear terms; and*
6. *the circumstances in which it may be terminated — if the agreement provides for termination by one or more parties to it.*

9. Should there be a higher threshold for exempting retrospective variations than unilateral variations in Grocery Supply Agreements?

In the SME Committee’s view, there should be no exemptions in relation to either unilateral or retrospective variations. The retailer should be expected to rely on the usual force majeure clauses in their contracts for circumstances outside of their control.

10. Do you believe that these requirements under the Grocery Code will help address the range of problematic issues that can arise during the relationship between retailers and suppliers?

On a theoretical level, the requirements outlined on pages 13 to 16 of the Consultation Paper will help address the range of problematic issues that can arise during the relationship between retailers and suppliers. However, for these requirements to be effective the exceptions must be removed. As currently drafted, the Code creates a range of rights for suppliers which can be easily modified, altered or removed by the retailer.

In the SME Committee's view, the current range of qualifications and exemptions included in the opt-in Code undermine the ability of the Code to improve retailer-supplier relationships and provide the protections the Code would otherwise afford suppliers. As a result, the Code does not properly address the problematic issues that arise during the relationship between retailers and suppliers.

11. Do you believe that the exceptions accompanying the requirements are necessary to provide sufficient commercial flexibility while maintaining appropriate procedural safeguards?

No, we believe that these proposed exceptions to an opt-in Code would undermine the ability of the Code to improve retailer-supplier relationships and provide the protections the Code would otherwise afford suppliers. The claim that there is a need for commercial flexibility should not prevent the Code achieving its objective of improving retailer-supplier relationships and in practice the allowance of exceptions, whether by inclusion in the initial contract or by agreement between the parties, enables a retailer with market power to intimidate suppliers into accepting such exceptions on a 'take it or leave it' basis.

12. Will the exemptions significantly reduce the effectiveness of the Code in addressing critical supply chain concerns?

Yes, these exemptions will significantly reduce the effectiveness of the Code in addressing critical supply chain concerns.

13. Will the inclusion of a duty to act in good faith improve commercial relationships in the sector?

Yes, the SME Committee believes the introduction of a duty of good faith will improve commercial relationships in the sector. We have recently seen a similar debate in relation to proposed changes to the Franchising Code of Conduct. The Franchise Code Reviewer and the Government both agreed that the introduction of a good faith obligation into the franchise relationship would be a positive development. The SME Committee also believes that the introduction of a good faith obligation in relation to grocery supply agreements would also be commercially very useful.

14. Should this obligation only apply to retailers, or do suppliers also engage in behaviours lacking in good faith that warrant them being covered by this obligation as well? Which option is most appropriate?

The SME Committee understands that the Code is a response to anecdotal evidence of widespread negative commercial behaviours by major grocery retailers towards their suppliers. The SME Committee also understands that there are allegations that such negative commercial behaviours have been made possible by the substantial degree of market power which the major grocery retailers possess. In these circumstances, it seems that the purpose of the Code is to provide protections for suppliers, and not to provide unnecessary protections for the major retailers.

15. Would compliance with the duty of good faith lead to increased or decreased compliance costs?

We do not believe that compliance with the duty of good faith would lead to increased compliance costs, and if so, that additional cost is justified.

16. Do you agree with the threshold conditions in the Code that suppliers must meet in order to trigger the retailers' obligation to take part in mediation or arbitration? What impact could this have on the accessibility of the dispute resolution mechanisms in the Code?

The requirement that retailers may refuse to attend dispute resolution if their code compliance manager determines that the supplier's complaint is vexatious, trivial, misconceived or lacking in substance is unreasonable. In fact, the SME Committee is not aware of an effective dispute resolution system which has such a one-sided discretion.

17. Would the dispute resolution mechanisms under the Code 'provide effective, fair and equitable dispute resolution processes'?

No, as currently structured the dispute resolution mechanisms are defective. The mechanisms place too much discretion in the hands of the major retailers not to attend mediation or arbitration.

18. How should each party allocate costs of dispute resolution?

The costs of dispute resolution should be borne entirely by the major grocery retailers. The only exception should be where a complaint has gone to arbitration and the supplier is found by the arbitrator to have made a vexatious complaint. In these circumstances alone, the arbitrator should be able to make a costs order against the supplier.

19. Is the range of remedies available for breaches of the Grocery Code appropriate?

The SME Committee supports a mandatory Code. As such, it believes that a similar regime of remedies should be available for a breach of the Code as is currently available under the Franchising Code of Conduct. Having said this, the pecuniary penalties available for a contravention of the Code must be substantially higher than those currently available under the Franchising Code. Only in this way, will such pecuniary penalties have any actual deterrent effect.

20. Should penalties be included in this opt-in Code that can be enforced by a court?

The SME Committee supports a mandatory Code and not an opt in Code. Also as stated above, the Committee supports the introduction of pecuniary penalties for breach of the Code that can be enforced by a court.

21. Should the ACCC be empowered to issue infringement notices for contraventions of this opt-in Code under the CCA?

The SME Committee does not believe that a penalty regime for an opt-in Code is appropriate as a matter of legal principle. Should a mandatory Code be introduced, the SME Committee believes the ACCC should be empowered to issue enforcement notices.

22. Does the proposed Grocery Code clearly set out the issues in the food and grocery sector that it seeks to address? Does it include clear requirements and obligations to address these issues?

The Code clearly sets out the issues in the food and grocery industry that it seeks to address. However, it then “muddies the water” by introducing a range of exceptions, qualifications and discretions which have the combined effect of potentially undermining the ability of the Code to address questionable commercial practices in the industry.

23. Does the Code cover the key issues that it should cover in order to achieve its aims of regulating standards of business conduct, ensuring transparency and certainty in commercial transactions and building trust and cooperation in the sector?

The Code does not achieve its aims of regulating standards of business conduct if it is an opt-in Code, because it has a wide range of exceptions and a defective dispute resolution mechanism. The Code also does not provide either transparency, given suppliers can “opt-out” of the protections provided in the Code, or certainty because the major grocery retailers have effective discretion to determine what is a valid supplier complaint.

24. Are there any unintended consequences that may arise from the operation of the proposed Grocery Code?

The SME Committee believes that there is nothing to prevent the major grocery retailers from deciding to deal primarily with those suppliers who have “chosen” to opt-out of various protections otherwise provided for them under the Code, rather than those suppliers who choose to maintain their rights. There is also a risk that major grocery retailers may pressure suppliers to opt-out of the protections provided under the Code.

25. Please provide any views on the effectiveness or otherwise of current industry codes and existing laws in addressing concerns identified in Part A of this paper.

In the SME Committee's view, the PGICC has been a failure. As stated in the Consultation Paper, the PGIC Administration Committee has not met since 2011 and a number of members have resigned.

The unconscionable conduct provisions of the ACL may prove to be effective in addressing the concerns identified in Part A of the Consultation Paper. However, this issue will not be conclusively determined until the resolution of the ACCC's current litigation against Coles in relation to its Active Retailer Collaboration program, mentioned above. Having said that, it appears that the resolution of that particular case may be a number of years away.

26. If the proposed Grocery Code were to be prescribed, what should be the future of the PGICC, the Australian Wine Industry Code of Conduct and the Horticulture Code? Please provide reasons for your views.

If the Code is prescribed, the PGICC should be reviewed to determine whether it has any residual role. The SME Committee understands that the PGICC was intended to apply to a broader group of industry participants than the Code, for example, growers and distributors.

Having said that, in the SME Committee's view, the PGICC should be disbanded, as it would serve no worthwhile function, given the existence of a prescribed Grocery Code and the Horticulture Code of Conduct.

27. What are the costs and benefits associated with maintaining the status quo?

There are considerable costs associated with maintaining the status quo. If monopsony buying power is being exercised by the major grocery retailers this will have costs in terms of allocative, productive and dynamic efficiency. The exercise of such monopsony power may be resulting in suppliers engaging in less product innovation, for fear of having such innovations appropriated by the major grocery retailers.

Furthermore, there is a risk that if the major grocery retailers are able to sell their home brand products at below cost this will have the effect of damaging or eliminating existing branded suppliers. In the longer run, we may see the major grocery retailers gaining a substantial degree of market power in various product markets, through their home brand products, and then being able to recoup these losses through the charging of monopoly rents.

28. Would the benefits of prescribing a code on an opt-in basis outweigh the costs? Why do you consider this to be the case?

The SME Committee does not believe there are substantial or long lasting benefits in prescribing a code on an opt-in basis, for the reasons outlined above.

29. Are the compliance cost estimates associated with Option 2, and the underlying assumptions that have been used to estimate them (as outlined in Attachment E) accurate?

The SME Committee found the compliance cost estimates outlined in Attachment E quite confusing. It seemed that the estimates do not include the costs of actually dealing with supplier complaints. Rather it focuses on such issues as setting up the systems, providing training and so on. However, there is no provision for the costs of actually considering or handling supplier complaints or disputes.

We think that once the actual costs of considering and responding to disputes is taken into consideration, the total compliance cost estimates may rise.

30. Would the benefits of prescribing a mandatory code outweigh the costs, or vice versa? Why do you consider this to be the case?

The SME Committee believes that the benefits of prescribing a mandatory Code far outweigh the costs. We have seen the failure of an earlier voluntary Code in the grocery industry in terms of achieving any meaningful change.

Furthermore, given that the major grocery retailers have been constantly claiming that they are dealing with their suppliers in a fair and ethical manner, the introduction of a mandatory Code should have little substantive impact on the way they are currently doing business with their suppliers.

Further discussion

The SME Committee would be happy to discuss any aspect of this submission.

Please contact Coralie Kenny, the Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'John Keeves', with a long horizontal line extending to the right.

John Keeves
Chairman, Business Law Section