

1 August 2018

Food and Grocery Code of Conduct Review
The Treasury
Langton Crescent
PARKES ACT 2600

By email: FGCreview@treasury.gov.au

Dear Sir/Madam

Draft Report into the Independent Review of the Food and Grocery Code of Conduct dated June 2018

Introduction

The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**Committee**) makes this submission in response to the '*Draft Report into the Independent Review of the Food and Grocery Code of Conduct*', dated June 2018 (**Draft Report**).

The Committee has as its primary focus the consideration of legal issues affecting small businesses and medium enterprises in the development of national legal policy in that domain. Its membership is comprised of predominantly legal practitioners who are extensively involved in legal issues affecting small and medium enterprises (**SMEs**).

Previous Submissions

The Committee previously lodged a submission in September 2014 in relation to the '*Improving Commercial Relationships in the Food and Grocery Sector*' report and the draft *Food and Grocery Code of Conduct* (**Grocery Code**).

The Committee was of the view at that time that the Grocery Code should be a mandatory code and we remain of that view.

Accordingly, we repeat our earlier arguments in support of a mandatory code as follows:

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). As The Treasury is well aware, the UK grocery market is much less concentrated than the Australian grocery market.

Furthermore, the ACCC's recent case against Coles for alleged unconscionable conduct in relation to its Active Retail Collaboration (ARC) Program has graphically

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demonstrated the types of conduct which are being engaged in by the major grocery retailers in the market. While the ARC program may ultimately be found not to contravene the unconscionable conduct provisions of the Australian Consumer Law (ACL), in the SME Committee's view the conduct described in the ACCC's Statement of Claim provides a good example of the type of inappropriate commercial conduct occurring in the grocery industry.

As the SME Committee understands the proposed Code, retailers must decide whether to opt-in. Therefore, the coverage is quite unclear as is 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 there should 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. The purpose of the Code is to create legal protections for suppliers, not to add to their legal compliance obligations.

The SME Committee is alert to the fate of 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.

The Committee believes that its concerns about the voluntary Grocery Code have proven to be correct.

Current concerns

The Committee is concerned that the Reviewer has not yet recommended that the Grocery Code be made mandatory, particularly as the Draft Report appears to indicate deficiencies in the voluntary code. The following is a sample of the various findings made by the reviewer in his Draft Report:

- *However, the Review did identify some continuing problematic behaviours that occur at the retailer's buying level during their direct dealings with suppliers. (p.15);*
- *During the Review, suppliers shared their experiences of what can be considered inappropriate buyer behaviour, including instances of harsh bullying tactics and arbitrary decision making with little regard for the potential damage to the supplier's business. (p.15);*
- *The Review received complaints from suppliers concerning the conduct of Metcash, including issues relating to unilateral demands, forensic accounting practices to off-setting amounts owed without the supplier's consent, failure to comply with promotional terms, and requiring payments above reasonable costs to conduct study tours. (p.18);*
- *A retailer's buyer had threatened a supplier with delisting, reducing their ranging and offering poorer shelf space unless the supplier enter into an agreement that offered the retailer higher margins. (p.23);*
- *A supplier had over 70 per cent of their business dedicated to supplying a single retailer and invested to up-scaled production based on the buyer's commitment to increase orders. A sudden change in buying personnel resulted in an extreme cut-back in distribution of the supplier's product. No recognition was given to previous commitments and little regard was given to the detrimental impact on the supplier's business. (p.23);*
- *A supplier had persistent difficulties in receiving written communications from a retailer's buyer during a dispute, raising concerns that this was done intentionally to avoid keeping records of any potential Grocery Code breaches. (p.23);*
- *Retailers not giving suppliers meaningful prior notice to delisting, instead relying on blanket approaches that flag entire categories or product lines for potential delisting. (p.23);*
- *A supplier was given only two weeks' notice prior to a range review, without adequate time to prepare data to respond to the retailer's delisting decisions or pitch new products. (p.24);*

- *Suppliers being pressured to cycle promotional activities at the same dollar value every year without any regard given to the potential costs or benefits to the supplier. (p.24);*
- *Late cancellations of orders that the supplier had already procured and paid for from overseas. (p.24);*
- *In relation to price rises: (p.24);*
 - *retailers refusing to accept a price rise for a supplier's product (to cover increased input costs such as raw materials, wages, electricity etc.), but then subsequently increasing the retail price to secure additional margin for themselves;*
 - *retailers requiring suppliers to list cost increases with reference to commercially sensitive information, such as ingredients within their product. Suppliers are concerned with disclosing their recipes and intellectual property, particularly if the retailer has a competing home brand product; and*
 - *suppliers who withhold supply in response to a price rise dispute experiencing retribution from the retailers by having other product lines delisted and receiving significantly reduced orders;*
- *Overwhelmingly, the Review heard there is a lack of trust in relation to retailers' ability to resolve complaints. Stakeholder feedback stated that many suppliers are reluctant to pursue dispute resolution through the CCM, due to a fear of retribution and lack of trust in the process. (p.30);*
- *Stakeholders perceived the CCMs as biased towards the retailer and lacking the degree of independence, separation and authority necessary to adequately deal with their complaints. The assignment of the CCM to a signatory's legal team did not ease these concerns – which conveyed notions of legal compliance above the equitable resolution of disputes. Further, the CCM was not considered sufficiently senior in the signatory's management to mitigate the risk of retribution. (p.30);*
- *The Review observed a real concern amongst suppliers that major supermarkets held their own branded products to a different standard, that they were more lenient with their sales and margin targets. (p.43);*
- *During the consultations, suppliers alleged that retailers placed large segments of a category on notice for a possible delisting during their range review process. They would then issue a final delisting notice to affected suppliers in a compressed timeframe. (p.44);*
- *Suppliers and others also queried the effectiveness of prescribing a Grocery Code that enables the parties to opt-out of key protections through written agreement. (p.46); and*
- *The Review received consistent complaints from suppliers in relation to the retailers' process for negotiating an increase in the price of goods. (p. 48).*

The Committee considers that the above concerns noted in the Draft Report and arguable contraventions of the Grocery Code by supermarkets demonstrates the need for the Grocery Code become a mandatory code.

Furthermore, it is the Committee's view that the recommendation by the Reviewer to create a new role of independent Code Adjudicator to replace the Code Compliance Manager indicates that the dispute resolution process under the voluntary Code has been ineffective. It is apparent that the Code Compliance Manager role was intended to be a key centre-piece of the new voluntary Code. Therefore, to recommend the removal of the Code Compliance Manager and their replacement by a new Code Adjudicator is an indication that this crucial aspect of the voluntary Grocery Code has not worked.

It seems to the Committee that by recommending the creation of a Code Adjudicator role, the Reviewer is effectively proposing a hybrid Code which is part voluntary and part mandatory. The Committee does not support this approach and does not believe that such a model represents best practice regulation.

Responses to Draft Recommendations

Draft Recommendation 1: The Government should introduce a separate targeted mandatory code to apply to major participants that refuse to become signatories to the voluntary Grocery Code

As stated above, the Committee believes that the Grocery Code should be a mandatory code.

The Committee does not agree that the Australian Government should introduce a separate targeted mandatory Code to apply to participants that refuse to become signatories, for example Metcash.

It is clearly far from best practice regulation to contemplate a split system whereby some participants in an industry are subject to a voluntary code, whilst others are subject to a mandatory code.

In our view, the fact that Metcash and Costco have not become signatories to the voluntary code leaves the Australian Government with little option but to make the Grocery Code mandatory.

Draft Recommendation 2: The Grocery Code should be amended so that wholesalers are subject to the same Grocery Code obligations as retailers (including the general conduct provisions in Part 3), except for customer facing provisions that are only relevant to retailers.

The Committee agrees with the recommendation, subject to its view that the Grocery Code should be made a mandatory code.

Draft Recommendation 3: That the current coverage of products under the Grocery Code remains unchanged

The Committee sees no reason why the Grocery Code should not be extended to include the supply of alcohol. In 2005, the Australian Competition and Consumer Commission (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 may be engaged in by major grocery retailers in the liquor industry.

While there is a degree of concentration in the liquor industry in the supply of beer, wine and spirits, there are also many thousands of small liquor suppliers, including many small craft brewers and small, family owned and operated wineries.

The Committee also believes some consideration should be given to extending the coverage of the Grocery Code to include other relationships between supermarkets and their suppliers, particularly the relationships between supermarkets and landlords. Committee members are aware of examples of egregious conduct by supermarkets towards owners of small shopping centres, particularly in regional areas.

Draft Recommendation 4: *Introduce a new primary provision of fair dealings to replace the current obligation to act in good faith (clause 28). The new provision should contain indicators of fair dealings that are easy to understand and apply to the particular circumstances of the parties.*

The ACCC should be tasked with enhancing its guidance materials to include detailed examples of how the Grocery Code provisions may be interpreted and applied in practice.

The Committee does not agree to replacing the existing good faith standard with a new fair dealing standard. The good faith standard is the standard which applies under the Franchising Code of Conduct and other relevant Codes. The Committee believes that the good faith standard is operating effectively in the franchising industry. Furthermore, to introduce a new fair dealing standard would be to complicate the application of the Grocery Code.

The Committee agrees that the ACCC should be tasked with providing enhanced guidance materials about the Grocery Code and the interpretation and application of its provisions. We believe that the ACCC could increase its educational activity in relation to the Grocery Code, to ensure that suppliers are aware of the Code or its central provisions.

Furthermore, the Draft Report could be improved by including a comprehensive analysis of the extent to which SMEs are aware of the existence of the Grocery Code or its provisions.

Draft Recommendation 5: *The Code Compliance Manager should be replaced with an independent Code Adjudicator, which would be governed by specific new provisions added to the Grocery Code that set criteria including independence from the signatory, confidentiality requirements, ability to make binding decisions and annual reporting and surveying requirements.*

The Committee's view regarding Draft Recommendation 5 is noted above on page 5 as per its comments relating to the new role of independent Code Adjudicator to replace the Code Compliance Manager.

Draft Recommendation 6: *The role of the ACCC should be expanded to:*

- ***have oversight responsibility of the Code Adjudicators, including regular meeting to discuss issues under the Grocery Code; and***
- ***review the Code Adjudicator's annual reports and seek confidential submissions from suppliers as part of ACCC's core compliance activities for the Grocery Code.***

The Committee's response to this recommendation should be seen in the light of its earlier comments about making the Grocery Code mandatory.

In the event that the Australian Government decides (1) not to make the Code mandatory, and (2) to create the role of independent Code Adjudicator, we agree that the ACCC

should have an oversight in relation to the Code Adjudicator role, at least in the short term.

The longer-term issue is whether the ACCC should retain its role in relation to the enforcement of Codes generally, or whether the Government needs to consider the creation of a specialist Code regulator.

The Committee does not believe that the ACCC's level of enforcement activity with respect to existing mandatory codes has been sufficient to ensure compliance.

As stated in the Committee's recent submission to the Parliamentary Joint Committee on Corporations and Financial Services into *The operation and effectiveness of the Franchising Code of Conduct*, the ACCC's level of activity in investigating and taking enforcement action in relation to breaches of the Franchising Code of Conduct, and other mandatory codes, remains low.

The following information (which has been taken from the ACCC's website) shows the level of ACCC enforcement action in relation to the Franchising Code of Conduct over the last eight years:

Year	Enforcement actions
2010	5
2011	0
2012	0
2013	0
2014	2
2015	2
2016	1
2017	5
Total	15

Source: <https://www.accc.gov.au/business/industry-codes/franchising-code-of-conduct/franchising-code/franchising-investigations>

In other words, the ACCC has taken 15 enforcement actions in the franchising sector over the last eight years.

In addition, many of the ACCC enforcement actions have been against small franchisors, with limited market presence and little brand recognition.

Accordingly, the Committee questions the level of general deterrence which the ACCC has been able to achieve through a handful of enforcement actions against largely unknown franchise systems.

The Committee also understands that in recent times the ACCC has issued approximately ten section 51ADD random compliance check notices a year. This is a very low number of compliance checks given there are approximately 1100 franchise systems in Australia.

Draft Recommendation 7: *The ACCC should change its approach to conducting annual compliance checks on signatories and should only rely on its section 51ADD information gathering powers after certain conditions are met, including that matter has been raised with the Code Adjudicator and deemed not to have been resolved satisfactorily.*

The Committee is concerned that the list of “*Problematic behaviours*” listed on pages 23 and 24 of the Draft Report does not appear to have come to the attention of the ACCC. This raises significant concerns about a gap in terms of the ACCC receiving important information about potential breaches of the Grocery Code.

Accordingly, the Committee does not support a recommendation which would effectively fetter the ACCC’s conduct of investigations into alleged breaches of the Grocery Code, in circumstances where there are already doubts about the effectiveness of investigation of the Grocery Code to date.

Draft Recommendation 8: *The protection and notification requirements for the delisting of a product should be extended to a significant limiting of distribution resulting from range reviews.*

The Committee agrees with this recommendation.

Draft Recommendation 9: *It should be clarified that the term ‘Grocery Supply Agreement’ applies to all agreements between a supplier and signatory, including freight and promotional agreements, which relate to the supply of groceries.*

The Committee agrees with this recommendation.

Draft Recommendation 10: *Clause 10 of the Grocery Code should be amended to so that there is a ban on variations to Grocery Supply Agreements that have retrospective effect.*

The Committee agrees with this recommendation.

Draft Recommendation 11: *Clause 14 should be amended to protect a supplier’s right to negotiate a lower wastage charge (if they have reduced their actual wastage) without it jeopardising other terms and conditions in their agreement.*

The Committee agrees with this recommendation.

Draft Recommendation 12: *To amend clause 21 relating to fresh produce standards and quality specifications to make it clear that the requirements apply to all fresh produce, including fruit, vegetables, meat, seafood and dairy etc.*

The Committee agrees with this recommendation.

Draft Recommendation 13: *A new provision relating to price rise processes should be introduced to:*

1. prevent a retailer from requiring a supplier to disclose commercially sensitive information where the retailer has a competing own-brand product; and

2. require that retailers take no longer than 30 days to consider a price rise request made by a supplier, unless circumstances exist that justify a reasonable extension that is agreed to by the supplier.

The Committee agrees with this recommendation.

Draft Recommendation 14: *There should be a review of the Grocery Code within three to five years of implementation of any changes as a result of this Review.*

The Committee agrees with this recommendation.

Civil Pecuniary Penalties

The Committee notes the comments made at pages 41 and 42 of the Reviewer's Draft Report concerning civil pecuniary penalties. We do not agree with the reasons stated in these sections of the Draft Report for retaining low civil pecuniary penalties for breaches of prescribed industry codes, such as the need to provide a light touch regulatory framework.

The purpose of any civil pecuniary penalty regime in a prescribed industry code has to be to achieve genuine specific and general deterrence in the relevant industry. We do not believe that maximum civil pecuniary penalties of \$63,000 are likely to achieve either specific or general deterrence in relation to entities with annual revenues of between \$1 billion and \$42 billion.

Concluding remarks

Members of the Committee found many of the views and conclusions reached in the Reviewer's Draft Report somewhat puzzling. It appeared to the Committee that while many of the problems with the application and enforcement of the voluntary Grocery Code were identified, the Draft Report then stopped short of making the obvious recommendation that the Grocery Code be made mandatory.

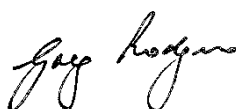
We believe that three years was a sufficient period of time to trial a voluntary Grocery Code. However, in our view that experiment has failed and it is now appropriate for the Government to introduce a mandatory Grocery Code.

Further discussion

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

Please contact Meghan Warren, the Chair of the SME Committee, on 0439 467 800 or mwarren@burkes-law.com if you require further information or clarification.

Yours faithfully



Greg Rodgers
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