

Improving commercial relationships in the food and grocery sector

**SUBMISSION by the OFFICE OF THE
AUSTRALIAN SMALL BUSINESS COMMISSIONER**

SEPTEMBER 2014

We are writing to provide observations on the small business environment that relate to the *Improving commercial relationships in the food and grocery sector* consultation paper.

This submission is based on practical insights from the Office's experience of commercial relationships where small businesses are involved in the food and grocery sector as suppliers.

We address a number of issues and concerns that are raised in the consultation paper that could have an impact on small business suppliers. In our observations, we refer to specific issues that have been raised with our Office by small businesses in the context of being a retail supplier. We believe that a key approach to these issues is to improve the overall business environment by focusing on behaviours and business relationships rather than merely focusing on the terms of supply agreements. This approach includes:

1. encouraging and facilitating small business access to information and professional services; and
2. ensuring access to efficient methods to resolve disputes and preserve business relationships.

The approach recognises that, even where suppliers are able to negotiate a supply agreement, it will not always be possible to negotiate a better outcome than provided by a "take it or leave it" supply agreement. This is due to unequal bargaining positions and the resources that a supplier can apply to negotiating such agreements. It is also common that a supplier in the early stages of the development of a business will not fully appreciate the range and consequences of potential situations where an agreement will need to apply as the business grows.

An approach that seeks to impact the overall business environment also means that (currently) one-sided duties in the draft Code, such as 'acting in good faith', could be expanded to cover both retailers and suppliers in relevant situations.

Framework for governmental activity

Our submission is based on the framework that government has a role in improving the business environment, with two enduring core responsibilities; namely the provision of information and justice. These twin pillars have a critical impact on the profitability of business.

Our Office has the credo that '*no small business should fail through lack of access to information*'. The facilitation of access to information is a core responsibility of government. It is appropriate for government to commit resources to information and other supporting services, especially where the behaviour of businesses participating in a particular sector is regulated. Access to information is a key component of a competitive and equitable marketplace.

The second enduring core responsibility of government when intervening to regulate business is to provide an appropriate system of justice. Previously, provision of justice focused on placing wrongdoers in prisons. Refinements and sophistications over time have developed various means of providing systems of justice, which are not confined to punishment of offences against the Crown but extend to finding justice for those in private

conflicts. Alternative dispute resolution has emerged as an appropriate measure for according justice in business dealings.

A small business focuses on plying its trade or profession. Disputes will arise from time to time, but small businesses will often not have the skills and resources on hand to deal with such incidents that arise in the course of business but are not a part of the *ordinary* course of that business. These types of business disruption are not easily catered for by small business and, depending on the particular dispute, can impact small business disproportionately (particularly where there is unequal bargaining power).

Alongside the pillars of access to information and justice, a deregulation lens should also be applied. The government's red tape reduction programme aims to reduce unnecessary red tape costs on individuals, businesses and community organisations. Our Office encourages small businesses to participate in the deregulation agenda, and to identify regulations that are ripe for reform. Further to this, we encourage regulators to adopt a facilitative approach to the administration of regulation, with a focus on educating to comply, rather than leaping to enforcement of compliance.

Access to information

By accessing appropriate information and resources, small business suppliers are empowered to work smarter, compete more effectively and reduce the costs of operating their business. This relates to suppliers getting the right information, adopting the right business management practices and accessing the right advisors. This is a core focus of our Office.

Some specific actions that relate to a suppliers' access to information in a supply agreement setting include:

Education and publicity programmes – Education and publicity programmes around the developments in the food and grocery sector, including the development and introduction of the Code, could benefit suppliers and significantly improve the business environment.

Professional advice and colour coding – Our Office encourages business operators to get professional advice before signing contracts, such as supply agreements. Professional advice brings attention to obligations that a supplier may be unaware of, saving them time and money. We encourage businesses to get their advisors to use highlighters to colour code the rights and obligations of each party. In the same way that advisors can draw attention to contractual rights and obligations using the simple tool of highlighters, supply agreements can adopt a colour code to assist businesses. This ensures that suppliers are clear in terms of the rights and obligations of each party and can more easily understand the document.

Plain English supply agreements – We recommend the use of plain English in supply agreements to improve understanding by the parties. This is particularly important since a layperson's understanding of a technical term can differ significantly from its technical legal meaning. This extends to making sure that the entire supply agreement is in a single document without additional amendments and other documents that must be read into an agreement to understand its full operation.

Access to justice

The cost of a dispute for a supplier is not just the financial cost of the lost business and the cost of pursuing resolution (such as legal costs), but also the opportunity cost and emotional stress involved. The opportunity cost includes what the supplier would otherwise have achieved for the business using their time and effort. For suppliers, resolving a dispute takes someone out of the business. Added to this cost is the emotional stress that disputes have on suppliers.

A particular difficulty of a retailer/supplier dispute is that they do not generally arise in the ordinary course of operating a business. They tend to arise periodically and in unusual circumstances. Accordingly, suppliers may not identify an emerging dispute until a late stage and they will not necessarily have developed the skills to resolve the dispute. Through the early identification of emerging disputes, financial and time costs can be reduced, and business relationships can be preserved.

Effective alternative dispute resolution, that operates with speed, at low cost, informally and collaboratively, will generally be of greater benefit to a supplier – principally because it facilitates parties continuing their commercial relationships. Also, the potential cost of legal proceedings in many retailer/supplier disputes, could outweigh the amount in dispute. Drawn out legal proceedings with the possibility of appeal may also mean that parties do not deal with each other commercially while the action proceeds and the breaking of this business relationship may persist beyond.

The success rate of mediation of small business disputes is extremely high. Mediation of such disputes conducted or organised by the State Small Business Commissioners consistently exceeds a success rate of 80%.

Our Office recently launched an online dispute resolution portal – *Dispute Support*. The online portal was developed in collaboration with states and territories, and consolidates dispute resolution information, resources and services available for small businesses across Australia. *Dispute Support* provides easy, tailored access to the most appropriate low cost service available to small business operators to resolve disputes, while also providing information on dispute resolution processes and strategies for avoiding and managing disputes.

By ensuring that suppliers have easy access to justice through alternative dispute resolution one of the potentially most costly parts of operating a business is relieved. For disputes that ultimately require determination by the regulator of this Code, being the Australian Consumer and Competition Commission (ACCC), streamlined processes for lower-value disputes would be beneficial.

We commend the approach in the consultation paper where supply agreements include an alternative dispute resolution clause that provides a clear and inexpensive route for the determination of supply agreement disputes. However, it is important that any costs associated with initiating and then pursuing the process are kept as low as possible. This is particularly important since many disputes are able to be resolved in the pre-mediation phase and it is critical that this initial phase is able to be commenced as easily and cheaply as possible to encourage early resolution of disputes.

In this context, we note that subclause 32(1) of the draft Code requires that mediation or arbitration must be conducted in accordance with the rules of the Institute of Arbitrators and

Mediators Australia (IAMA), and subclause 32(2) provides that, in the absence of the parties agreeing, IAMA appoints the mediator or arbitrator. IAMA's rules include the requirement that where IAMA nominates a mediator, a fee of \$330 is payable, or such other sum as prescribed by IAMA from time to time (see rule A2 of Schedule A to IAMA's Mediation Rules). A threshold impost of \$330 is likely to be considered unreasonable by small business and appears contrary to the intention to provide for low cost alternative dispute resolution.

We also commend Code for various clauses that support the smooth-functioning of mediation, like subclause 32(3)(a):

The retailer is taken to take part in the mediation or arbitration if the retailer is represented at the mediation or arbitration by a person who has authority to enter into an agreement to settle the dispute on behalf of the retailer.

In addition, we would argue that before matters proceed to further investigation by the proposed regulator or otherwise, an alternative dispute resolution certificate should be required (as a condition of progressing the matter). The certificate, which could be provided by officials such as small business commissioners or ombudsmen, would constitute advice that alternative dispute resolution had been attempted but had not resolved the dispute. Alternatively, the certificate may advise that a party refused to participate in or withdrew from alternative dispute resolution. In this latter situation, the recalcitrant party's behaviour could be taken into account, say, when considering awards of costs. Failure to engage appropriately in such processes could also form the basis for further reporting by ombudsmen and small business commissioners.

Specific issues

Through our engagement with small businesses, there are a number of aspects of the draft Code that we believe may be altered to make the Code more effective.

Good faith – The proposed Code requires only that the retailer act in good faith, with no mention of suppliers also acting in the same manner. Of course, it is only the parties to the Code who can be held to this requirement on an ongoing basis. However, once a supplier seeks to access the Code, it may be possible to require that the supplier then operate with good faith when using the Code. This would ensure that the business environment is improved through a clear requirement for both parties to act in good faith.

In addition, the Code may be explicit that the notion of good faith extends to retailers not penalising suppliers who seek to access rights under the Code. This is critical to encourage small business to use the Code.

Alcoholic beverages – The definition of “groceries” under the Code does not extend to alcoholic beverages, despite such products often being integrated into the retail business. Given the operation of supermarkets in this way, it would make sense to include these sorts of product within the Code.

Penalties – We note that there are no penalties for failure to follow the Code. Although we see greater value in facilitative and educative approaches, rather than the heavy-handed imposition of a financial penalty, penalties may still operate alongside these other approaches to support the overall improvement of the business environment. We note that a similar approach has been adopted in the recent Franchising Code of Conduct.

Code coverage – There is a question as to whether the Code should be “opt-in” and which retailers that it should apply to. In order for the proposed Code to be implemented fairly and equitably, there is an argument that all (major) retailers should be bound by the Code. The current Code is written to be a voluntary prescribed Code, with only those retailers who opt-in being bound. Small business suppliers may have agreements with multiple large retailers and it would make sense for there to be consistency for these businesses. Having said that, we note that the Code was prepared by some retailers and consideration would need to be given to how it would apply in broader circumstances.

Conclusions

In short, two significant ways to improve commercial relationships in the food and grocery sector in Australia for retailers and suppliers is through accessing:

1. the right information and skills; and
2. efficient dispute resolution services.

There are key roles for government to play in these areas. However, there is also a responsibility on small businesses (and retailers) to adopt good management practices, access skills that they do not possess (such as through the use of professional advisors) and operate in good faith to minimise and manage their agreements.

The Code has the potential to progress these areas and we commend the retailers for it. We believe that it will operate to improve the overall business environment to benefit those dealing with the major retailers as well as those in competition with them.