

NAT/680 A fairer agro-food supply chain

OPINION

European Economic and Social Committee

Report from the Commission to the European Parliament and the Council on unfair business-tobusiness trading practices in the food supply chain [COM(2016) 32 final]

Rapporteur: Peter Schmidt

| Consultation | Commission, 04/03/2016 |
|---------------------------|----------------------------------------------------------------|
| Legal basis | Article 43(2) of the Treaty on the Functioning of the European |
| | Union |
| | |
| Section responsible | Agriculture, Rural Development and the Environment |
| Adopted in section | 30/09/2016 |
| Adopted at plenary | 19/10/2016 |
| Plenary session No | 520 |
| Outcome of vote | |
| (for/against/abstentions) | 221/0/5 |
| | |

1. Conclusions and recommendations

- 1.1 The EESC highlights the fact that the weak position of the most vulnerable players in the food supply chain must be addressed by putting an end to unfair trading practices (UTPs) by food retailers (N.B. in this document the word "retailers" refers to the large-scale retail sector) and some transnational companies, which increase risk and uncertainty for all operators along the food supply chain and therefore generate unnecessary costs.
- 1.2 The EESC acknowledges that avoiding UTPs alone would not make it possible to solve the structural market problems in the food supply chain, such as temporary market imbalances, the vulnerable situation of farmers, etc.
- 1.3 The EESC reiterates the concerns and recommendations set out in its previous opinion on "The current state of commercial relations between food suppliers and the large retail sector"¹. In particular, the EESC calls once again on the Commission to adapt European legislation to the specific features of the different parties in the food sector.
- 1.4 The EESC draws attention to the existence of market failures as the situation continues to deteriorate in a system that is insufficiently regulated².
- 1.5 The EESC strongly supports the European Parliament's resolution of 7 June 2016³ highlighting the need for framework legislation at EU level in order to tackle UTPs of food retailers and some transnational companies and to ensure that European farmers and consumers have the opportunity to benefit from fair selling and buying conditions. The EESC believes that due to the nature of UTPs it is both a requirement and a necessity to have EU legislation to prohibit them.
- 1.6 The EESC calls on the Commission and the Member States to take swift action to prevent UTPs by establishing an EU harmonised network of enforcement authorities with this aim, so as to create a level playing field within the single market.
- 1.7 The EESC welcomes the creation of the EU-wide Supply Chain Initiative (SCI) and other national voluntary systems, but only as an addition to effective and robust enforcement mechanisms at Member State level. However, there is a need to ensure that all stakeholders (e.g. farmers and trade unions) can participate and that complaints can be lodged anonymously. It is also necessary to establish dissuasive penalties. In addition, such platforms should be able to react independently. The EESC also proposes the establishment of an Ombudsman with regulatory powers in pre-trial mediation.
- 1.8 The EESC calls for a ban on abusive practices, for example those listed in point 3.3 of this opinion.

^{1 &}lt;u>OJ C 133, 9.5.2013, p.16-21</u>.

^{2 &}lt;u>OJ C 133, 9.5.2013, p.16-21</u>.

³ European Parliament resolution of 7 June 2016 on unfair trading practices in the food supply chain (2015/2065(INI)).

- 1.9 In particular, the EESC recommends that suppliers, such as farmers, be paid a price that is not below the cost of production. The EESC also calls for an effective ban on food retailers selling below cost price.
- 1.10 The EESC recommends that alternative business models that play a role in shortening the supply chain between producers of food and the end consumer be encouraged and supported, e.g. through Member State public procurement policies.
- 1.11 The EESC suggests that the role and position of cooperatives and producer organisations should be strengthened in order to restore the balance of power, because they are a suitable and important type of business enabling farmers as owners to collectively improve their market position including under the conditions of the EU single market and actively rebalance the distribution of bargaining power in the food supply chain.
- 1.12 The EESC urges food chain operators to develop fair trade relations based on long-term and stable contracts and to cooperate with each other, working together to satisfy consumer needs and demands.
- 1.13 The EESC calls for the protection and guaranteed anonymity of whistle-blowers who expose UTPs.
- 1.14 The EESC recommends the introduction of the right to bring class actions.
- 1.15 The EESC proposes to launch a Europe-wide information and awareness-raising campaign on "the value of food". This would be necessary to ensure a long-term change in consumers' behaviour.

2. Introduction

- 2.1 The agro-food supply chain connects important and diverse sectors of the European economy that are essential for economic, social and environmental welfare as well as for the health of Europeans. However, in recent years there has been a shift in bargaining power in the supply chain, mostly to the advantage of the retail sector and some transnational companies and to the detriment of suppliers, in particular primary producers.
- 2.2 A small number of companies now dominate the marketing and sale of food. For example, many grocery markets in a strongly increasing number of Member States are majority controlled by between three and five retailers, with a collective market share of between 65 and 90% among modern retailers^{4,5}.
- 2.3 The concentration of bargaining power has led to the abuse of positions of dominance causing weaker operators to become increasingly vulnerable to Unfair Trading Practices (UTPs). This transfers economic risk from the market up the supply chain and has a particularly negative impact on consumers and some operators, e.g. farmers, workers and SMEs.

⁴ Friends of the Earth, 2015. *Eating from the Farm*.

⁵ Consumers International, 2012. The relationship between supermarkets and suppliers: What are the implications for consumers?

2.4 The EESC already discussed UTPs in its opinion on "The current state of commercial relations between food suppliers and the large retail sector" in February 2013⁶. Since then the situation of UTPs has little improved. On the contrary, the power of the large retail sector has even increased, and this might lead to abuse vis-à-vis some operators, e.g. farmers, workers and SMEs.

3. Unfair Trading Practices and their impact

- 3.1 UTPs can broadly be defined as practices that significantly deviate from good commercial conduct and are contrary to good faith and fair dealing⁷.
- 3.2 UTPs can occur at any stage in the supply chain between a variety of operators. However, they are more prevalent at later stages of the supply chain where there is a greater concentration of power amongst retailers and some transnational companies. Where UTPs are found at earlier stages of the supply chain they are often the result of a transfer of risk originating from UTPs at later stages.
- 3.3 Examples of such practices include, but are absolutely not limited to:
 - unfair transfer of commercial risk;
 - unclear or unspecified contractual terms;
 - unilateral and retroactive changes to contracts, including price;
 - lower product quality or consumer information without communication, consultation or agreement to the buyers;
 - contributions to promotional or marketing costs;
 - delayed payments;
 - listing or loyalty fees;
 - charges for shelf-positioning;
 - claims for wasted or unsold products;
 - use of product cosmetic specifications to reject consignments of food or reduce the price paid;
 - pressure to cut prices;
 - charges for fictitious services;
 - last minute order cancellations and forecast volume deductions;
 - threats of delistings;
 - flat-rate charges that companies levy on suppliers as a requirement for inclusion in a list of suppliers ("pay to stay").
- 3.4 UTPs have wide-ranging effects on operators, consumers and the environment. However, such practices are profitable by their very nature and therefore attract short-terms gains for those who apply them, to the detriment of other stakeholders in the supply chain. In the long run, food

^{6 &}lt;u>OJ C 133, 9.5.2013, p.16-21</u>.

⁷ European Commission, 2014. <u>Tackling unfair trading practices in the business-to-business food supply chain</u> COM(2014) 472 final.

chain operators must have sustainable supply relationships and work to prevent supply chain disruption in order to compete and continue to meet ever-changing consumer demands.

3.5 Impact of UTPs on suppliers

- 3.5.1 The various types of the impact of UTPs on the operators that suffer from them are diverse and far-reaching and can lead to reduced income for suppliers, either through price deductions or because of the increased costs incurred as a result of these practices. UTPs have been estimated to cost suppliers EUR 30-40 billion⁸. In addition to the continued price pressures applied to suppliers, such practices create uncertainty, thus stagnating innovation and investment in the supply chain, and they can put competent, responsible suppliers out of business.
- 3.5.2 The pressure exerted on farmers and food processors, and the consequent downward pressure on prices, also leads to reduced wages both in the agricultural sector and for employees in the food manufacturing industry. In the case of more permanent labour, the race to the bottom for lower prices also leads to reduced wages in order for suppliers to make their margins.
- 3.5.3 SMEs are often the most vulnerable to UTPs, e.g. in the global banana trade, where the small scale farmers' produce is used to "top up" larger plantation volumes, these suppliers are at risk of being the first to be cut out of a sale if an order is cancelled without due notice⁹.
- 3.5.4 There are some areas of food production and manufacturing where contractual freedom no longer exists. In Germany recent developments show that retail prices have unilaterally been reduced without negotiations with suppliers. In the UK, milk is often a "loss-leader" in the grocery sector and British dairy farmers have faced being paid ever-lower prices for their milk, in some cases below the cost of production. In Spain, for the processing industry, paying below cost is legal, which is seriously eroding price formation along the chain.
- 3.5.5 The fresh produce sector is particularly susceptible to UTPs due to the high perishability of the produce it supplies to the European market. Farmers have a limited time in which to sell their produce to ensure adequate shelf-life for the end client and ultimate consumer, and this is often abused by commercial buyers for retailers and middlemen by imposing unnegotiable price deductions on receipt of goods.
- 3.5.6 Several investigations have established certain operators having clear buyer power that leads to abuses through unfair trading practices¹⁰. These abusive practices can arise at any stage in the supply chain, and they are also evident in relations between farmers and the food industry, as companies from this sector also have "buyer power" due to the relative concentration of power¹¹.

⁸ Europe Economics. Estimated costs of Unfair Trading Practices in the EU Food Supply Chain.

⁹ Make Fruit Fair, 2015. Banana Value Chains in Europe and the Consequences of Unfair Trading Practices. http://www.makefruitfair.org/wp-content/uploads/2015/11/banana_value_chain_research_FINAL_WEB.pdf.

¹⁰ Weekly Report, Berlin 13/2011 page 4 et seq.

¹¹ <u>OJ C 133, 9.5.2013, p.16-21</u>.

- 3.5.7 The increase in sales of "own-brand" (white labels or retailer-owned brands) products by retailers allows them to change suppliers frequently if they find a cheaper producer either during or after contractual relations have begun. However, "own-brand" products are not unfair in themselves and can assist SMEs entering the market and offer consumers a variety of choice.
- 3.5.8 The expansion of some retail activities through vertical integration into procurement and processing can lead to retailers undercutting prices. This is an example of an increase of bargaining power through the continuous concentration of power.
- 3.5.9 In case of selling below the cost of production, and the use of basic agricultural products, such as milk, cheese, fruit and vegetables as "loss leaders" (i.e. below the purchasing cost) by large-scale retailers and some transnational companies, are a threat to the long-term sustainability of European agricultural production.

3.6 **Impact of UTPs on consumers**

- 3.6.1 UTPs have a significant negative effect on European consumers. Larger operators often absorb the costs presented by UTPs, but smaller businesses are placed under increased pressure and are unable to invest and innovate, excluding them from high-value markets¹². This results in reduced consumer choice and availability and ultimately increased consumer prices.
- 3.6.2 The lack of transparency on labels is to the detriment of consumers, who are unable to make informed purchasing choices despite having, on several occasions, expressed the desire to favour healthy, environment-friendly and quality agri-food products that are linked to their local area. This opacity has a negative impact on consumer confidence levels, further exacerbating the crisis affecting the agricultural sector.
- 3.6.3 Price pressures force processors of food to produce as cheaply as possible which can affect the quality of food available for consumers. To reduce costs, in some cases companies use cheaper raw materials, which affect the quality and value of foodstuffs for example, the use of trans fats in many products replacing healthier oils and fats from Europe.

3.7 Impact of UTPs on the environment

3.7.1 The impact of UTPs on the environment needs to be recognised. UTPs encourage overproduction as a means for suppliers to insure themselves against uncertainty. This overproduction can lead to food being wasted, causing an unnecessary depletion of resources, including land, water, agrichemical and fuel^{13,14}.

¹² Fair Trade Advocacy Office, 2014. Who's got the power? Tackling imbalances in agricultural supply chains. Page 4.

¹³ EP IMCO, 2016. Report on unfair trading practices in the food supply chain (2015/2065(INI)).

¹⁴ Feedback, 2015. Food Waste In Kenya: uncovering food waste in the horticultural export supply chain.

4. Summary of the Commission report on unfair business-to-business trading practices in the food supply chain

- 4.1 The Commission has produced a report¹⁵ assessing the existence and effectiveness of national frameworks established to enforce measures to counter UTPs, and also the role played by the EU-wide voluntary Supply Chain Initiative (SCI) and its national voluntary platforms.
- 4.2 The 2016 Commission report highlights the fact that a large majority of Member States have already introduced regulatory measures and public enforcement systems to deal with UTPs. Some Member States have gone further than others, yet many are still unable to address the "climate of fear" experienced by victims of UTPs. Since different approaches could address UTPs effectively, the Commission has concluded that, at this stage, specific EU legislation would bring no added value.
- 4.3 The Supply Chain Initiative (SCI)¹⁶ is a joint initiative of eight EU associations. They represent the food and drink industry, branded goods manufacturers, the retail sector, SMEs, and agricultural traders. The SCI was launched in the framework of the "High Level Forum for a better functioning of the food supply chain"¹⁷ with the aim of helping stakeholders address UTPs.
- 4.4 The report concludes that the SCI has created awareness about UTPs and is potentially a faster, cheaper alternative to judicial proceedings. It could also help resolve cross-border issues. The Commission also highlights areas for potential improvement of the SCI, such as enhancing the impartiality of the governance structure and enabling individual confidential complaints.

5. General Comments

- 5.1 The EESC's position on the EC report is in line with the European Parliament's resolution on UTPs in the food supply chain, adopted on 7 June 2016 with strong cross-party support¹⁸. The Parliament highlights the need for framework legislation at EU level and calls on the Commission to put forward proposals to tackle UTPs in the food supply chain, so as to ensure fair earnings for farmers and a wide choice for consumers. The Parliament also highlights the fact that the SCI and other national and EU voluntary systems should be promoted not as an alternative but "as an addition to effective and robust enforcement mechanisms at Member State level, ensuring that complaints can be lodged anonymously and establishing dissuasive penalties, together with EU-level coordination"¹⁹.
 - 5.2 The Commission considers that the Supply Chain Initiative is still too recent to assess its success. However, the EESC notes that the SCI has not been effective in reducing UTPs and abuses of buying power for the following reasons:

¹⁵ COM(2016) 32 final.

^{16 &}lt;u>http://www.supplychaininitiative.eu/de/homepage</u>.

¹⁷ http://ec.europa.eu/growth/sectors/food/competitiveness/supply-chain-forum/index_en.htm.

¹⁸ European Parliament resolution of 7 June 2016 on unfair trading practices in the food supply chain (2015/2065(INI))

¹⁹ European Parliament resolution (2015/2065(INI)), ibid.

- 5.2.1 The leadership of the retail industry in the SCI is a major deterrent for any farmer to engage effectively with the platform given the mistrust between these stakeholders. The SCI therefore does not provide suppliers with the anonymity they require to overcome the "climate of fear". Furthermore, the SCI cannot proactively investigate supply chains and so relies on operators to make complaints, thus placing the burden of proof upon the victims of UTPs.
- 5.2.2 The Commission suggests that the SCI allows for the self-regulation of UTPs. However, the lack of financial sanctions means that purchasers are not deterred from using otherwise profitable UTPs. For example, Tesco PLC was recently found to be conducting unfair trading practices when dealing with its suppliers despite being a member of the SCI. Whilst Tesco has been non-financially penalised by British legislation (The Groceries Code Adjudicator), it has not received any sanctioning from the SCI. The SCI's only deterrent is the ability to remove the membership of an offending business, which it is yet to utilise with regard to Tesco PLC. This is a clear example of how the SCI does not prevent UTPs.
- 5.2.3 The EESC also notes the absence of farmers and trade unions in the SCI's membership. Whilst some organisations have never joined the initiative or its national counterparts, the Finnish Central Union of Agricultural Producers and Forest Owners (MTK), a founding member of the national platform implementing the SCI in Finland, quit the initiative arguing that it did not work as it increased risk for farmers due to a lack of anonymity.

6. Current enforcement mechanisms for preventing UTPs in Europe

- 6.1 Twenty Member States have legislative provisions and regulatory initiatives, but their success is still moderate²⁰. Fifteen of these Member States have introduced measurements in the last five years, demonstrating the significant prevalence of UTPs in the supply chain. However there is great disparity between the different levels of regulation, and many national enforcers are unable to issue financial sanctions or accept anonymous complaints.
- 6.2 The UK's Groceries Supply Code of Practice²¹ (GSCOP) is regarded as one of the most progressive legislative measures for preventing UTPs²². Prior to the establishment of this code, a voluntary code of practice existed but was found to be ineffective at preventing UTPs due to its lack of regulation. GSCOP is regulated by the Groceries Code Adjudicator (GCA) who has the legal power to receive anonymous complaints regarding UTPs, launch investigations exofficio, publicise malpractice conducted by these businesses, and fine retailers up to 1% of their annual turnover for breaches of GCSOP. However, despite its achievements, the GCA can only regulate the relationship between retailers and their direct suppliers (largely based in the UK). This issue presents "moral hazards" in which both retailers and their direct suppliers transfer risk to indirect suppliers by UTPs.

²⁰ COM(2016) 32 final.

²¹ UK GOV. 2016: <u>www.gov.uk/government/publications/groceries-supply-code-of-practice</u>.

²² The code was established as result of an investigation conducted by the UK Competition Commission that found retailers to have a disproportionate amount of power in the supply chain leading to the transfer of risk up the supply chain.

- 6.3 Similar investigations to that of the UK's competition commission have been conducted in Spain²³, Finland²⁴, France²⁵, Italy²⁶ and Germany each showing a high prevalence of UTPs in the food supply chain.
- 6.4 Many of Europe's operators trade in multiple Member States giving these businesses the chance to "forum shop", thereby undermining Member State-level legislation. The unharmonised legislative landscape across the EU has created an uneven playing field within the single market. In addition, where legislation only regulates between direct suppliers and retailers, the use of middlemen organisations by retailers to purchase food reduces the effectiveness of such legislation, as is the case in the UK. This further builds the case for European-wide legislation.
- 6.5 Overseas suppliers generally supply EU retailers indirectly via importers and other intermediaries. As such, there is little awareness of the existence of such authorities²⁷ and those that are aware lack access to most enforcement authorities in order to seek remediation regarding UTPs.

7. Call for a European network of national enforcers to prevent UTPs

- 7.1 In recognition of the comments raised above, the EESC calls for the establishment of a European network of enforcement authorities to prevent UTPs. The nature of UTPs both requires and warrants EU legislation to prohibit them, so as to protect all food suppliers, wherever they are located, including in third countries. In order for this to be effective, enforcement authorities within the network must have the following functions:
 - Free access to all players and stakeholders in the EU food supply chain, regardless of geographical location.
 - Measures to effectively protect the anonymity and confidentiality of stakeholders who wish to submit complaints about UTPs.
 - Ability to investigate businesses ex officio with regard to abuses of buying power.
 - Ability to issue financial and non-financial penalties to offending businesses.
 - EU-level coordination between Member States' enforcers.
 - Potential for international coordination with non-EU enforcement bodies to prevent UTPs that occur both inside and outside the single market.
- 7.2 It should be the objective of all Member States to establish national enforcement bodies to deal with complaints relating to UTPs. These bodies should be designed with the above functions as a minimum standard.

²³ Comisión Nacional de los Mercados y la Competencia, Informe sobre las relaciones entre fabricantes y distribuidores en el sector alimentario, 2011.

²⁴ Finnish Competition Authority (FCA), "FCA study shows that daily consumer goods trade uses its buying power in several ways that are questionable for competition", 2012

²⁵ Autorité de la Concurrence, Avis n° 12-A-01 du 11 janvier 2012 relatif à la situation concurrentielle dans le secteur de la distribution alimentaire à Paris.

²⁶ Autorità Garante della Concorrenza e del Mercato, "Indagine conoscitiva sul settore della Grande Distribuzione Organizzata", 2013

²⁷ Feedback, 2015 ibid.

- 7.3 Legislative measures for preventing UTPs can and should be cost-effective.
- 7.4 The European Parliament's resolution also calls on to the Commission to ensure effective enforcement mechanisms, such as the development and coordination of a "network of mutually recognised national authorities at EU level"²⁸.
- 7.5 The British Institute of International and Comparative Law (BIICL) has recommended that the EU should adopt a directive to establish common objectives amongst Member State enforcement authorities to prevent UTPs and include rules for European-coordination of these bodies²⁹.

8. Current industry good practice to prevent unfair trading practices

- 8.1 Fixed pricing or minimum guaranteed pricing contracts based on fair negotiations between buyers and suppliers offer the latter a greater degree of security than when selling produce on the open market. However, whilst these types of contract guarantee set prices for suppliers, this practice would be enhanced if volumes of produce were fixed or had minimum guarantees. Currently, volumes can be retrospectively amended and produce can be rejected by buyers when market demand changes, sometimes at the last minute leading to unforeseen costs for remarketing, repackaging or disposing of food.
- 8.2 Some suppliers to the EU have begun to employ third party agents to inspect produce on arrival at destination so as to prevent spurious product rejection claims from importers. Such claims are made when forecasted supply and demand has changed, thus increasing the risk for buyers at the latter stages of the supply chain. There is seasonality with this issue, since when supply is high and therefore prices are low, suppliers are at greater risk of receiving claims compared to when supply is scarce. Whilst the use of third party agents certainly reduces the frequency of such rejection claims for exporters, such services are an additional cost for suppliers, thus further limiting their capacity for investment and innovation in their business. Furthermore, smaller suppliers are generally unable to afford such assistance and so do not benefit from this practice.

9. Alternative food supply chains

- 9.1 There are many examples of alternative supply chains where fairer trading practices exist and a fairer balance of distribution or reallocation occurs. There are some promising approaches in the cooperative area, but these are increasingly threatened by the growing power of business groups and multinationals.
- 9.2 To increase fairness in the EU's food supply chain, a combination is required of steps to address the power hold of large businesses in the supply chain preventing UTPs, and to strengthen countervailing power by encouraging the development of cooperatives and alternative channels for food distribution.

²⁸ European Parliament resolution (2015/2065(INI)), ibid.

²⁹ Link http://www.biicl.org/documents/872_biicl_enforcement_mechanisms_report_-_final_w_exec_sum.pdf?showdocument=1.

- 9.3 Cooperatives and farmer associations in Europe and overseas have allowed suppliers to aggregate production volumes in order to increase selling power, enter mainstream markets, and negotiate better prices. Such business models allow small suppliers greater control of the production and marketing of their products and offer an alternative to large-scale growing operations. The European Parliament has called on the Commission to encourage business models in order to increase their bargaining power and position in the food supply chain³⁰. In addition, there is a need for stronger sector and region orientated promotion of cooperation between producers and cooperatives³¹.
- 9.4 Community-supported agriculture (CSA) schemes and other farmer-consumer cooperatives allow consumers to contribute directly to the production of the food that they eat. Recent figures suggest there are currently 2,776 of these CSA schemes operating in Europe, feeding 472,055 consumers³². Larger models of product "box schemes" also benefit from short supply chains to deliver produce directly either to consumer households or to centralised collection points.
- 9.5 The direct sale of agri-food products by farmers, for example at *farmers' markets*, have a dual advantage: for producers abusive practices are absent and they can benefit from a greater degree of autonomy and increased revenue, while consumers may have access to fresh, genuine and sustainable products, the origin of which is certain. In one study³³, it was found that farmers received much higher incomes for their produce using these supply chains rather than traditional markets. Such initiatives should be further supported by public funding, such as from the CAP's second pillar payments, as they generate growth and jobs, as well as responding to consumers' needs.
- 9.6 Member States should develop ways to improve the situation of farmers and local food businesses through direct contracts with public authorities when implementing new directives on public procurement, going beyond the logic of the maximum discount.
- 9.7 Furthermore, a Europe-wide information and awareness-raising campaign on the value of food should be launched. Greater awareness among consumers about the importance of food production and increased appreciation of food are proving to be increasingly necessary and might contribute to fairer trading practices.

Brussels, 19 October 2016

Georges DASSIS The president of the European Economic and Social Committee

³⁰ European Parliament resolution (2015/2065(INI)), ibid.

^{31 &}lt;u>OJ C 303, 19.8.2016, p. 64–72</u>.

³² European CSA Research Group, 2015. Overview of Community Support Agriculture in Europe. <u>http://urgenci.net/wp-content/uploads/2016/05/Overview-of-Community-Supported-Agriculture-in-Europe.pdf</u>.

³³ http://www.foeeurope.org/sites/default/files/agriculture/2015/eating_from_the_farm.pdf.