TOMPKINS | WAKE

Part Two

The ‘good faith’ principle: What it means and how it can be leveraged.

This T|W Insights is the second in our three-part weekly series on the Grocery Supply Code (Code). In **Part 1**, we provided an overview of the Code. In Part 2 we look at the principle of “good faith”, what it means, and how it can be leveraged in commercial negotiations with regulated grocery retailers (**grocery retailer**).

Under the Code, grocery retailers are required to act in “good faith” in their dealings with suppliers.

What is “good faith”?

Not act in a misleading or deceptive way

- The grocery retailer has acted honestly and not in a way that is arbitrary, capricious, unreasonable, reckless, or with ulterior motive.
- The grocery retailer cannot retaliate against a supplier for past grievances.

Being responsive and communicative

- The grocery retailer has co-operated with suppliers to achieve the purposes of the grocery supply contract, including being responsive and communicative.

Taking into account suppliers’ interests

- The grocery retailer has conducted its trading relationship with the supplier in recognition of the need for—
    i. certainty regarding the risks and costs of trading, particularly in relation to production, delivery, and payment; and
    ii. providing information in a timely way.
- The grocery retailer has respected the confidentiality of information that is disclosed or obtained while dealing with a complaint or dispute with the supplier.

Not act oppressively

- The grocery retailer has conducted negotiations with suppliers without duress and has avoided unreasonable discrimination or distinction between suppliers.

Examples of when a grocery retailer is acting in ‘good faith’

Doesn’t provide false information or mislead by omission.

Gives suppliers sufficient information so they can make an informed commercial decision.

Raises issues with suppliers in a fair and timely manner.

Gives suppliers reasonable timeframes to raise concerns and provide comments.

Gives reasonable consideration to the supplier’s concerns and commercial positions.

Doesn’t use delay tactics to prevent the supplier from exercising its legitimate contractual or legal rights.

Doesn’t choose an option that would materially disadvantage the supplier where an alternative exists, and that alternative gives the grocery retailer the same or similar benefit but does not otherwise disadvantage the supplier.

Ultimately, while the Code is not a 'silver bullet' for suppliers, and hard bargaining will always be needed, there is leverage to be gained under the 'good faith' card.

Some tips for the playbook:

- Grocery retailers are required to give honest answers to suppliers' questions, so suppliers should take time to prepare the right questions to elicit the right responses from the grocery retailer.
  - **Remember:** The grocery retailer may ask the same questions back and suppliers will also be required to give an honest answer. This is because whether the grocery retailer has acted in 'good faith' will also depend on the supplier's conduct.
- The supplier should ensure that all relevant information is provided to the grocery retailer when the price increase notice is given. This is to avoid the grocery retailer saying it needs more information, so the 30 day 'clock' has not yet started. Providing all relevant information up front gives the supplier reasonable grounds to push-back on any requests for further information by the retailer that may be unreasonable.
  - **Remember:** While negotiations on price are required to be conducted in 'good faith', the grocery retailer is not required to accept any price increase request. It is important that direct questions are asked of the grocery retailer to ensure that their decision-making is transparent, and they have followed a 'fair' process for assessing the price increase request.

Good faith: A comparison with unconscionable conduct

While 'good faith' and 'unconscionable conduct' are separate concepts, there is an overlap.

Unconscionable conduct is generally considered to be highly unethical behaviour that goes beyond accepted B2B commercial norms that are relevant to the commercial relationship between a grocery retailer and a supplier. So, the threshold for unconscionable conduct is much higher than the threshold for breach of good faith. However, the extent to which the grocery retailer failed to act in good faith is relevant to whether the retailer has engaged in unconscionable conduct, but merely failing to act in good faith is not enough in itself to constitute unconscionable conduct. Conversely, if a grocery retailer has acted unconscionably, then that conduct would most likely be a breach of good faith under the Code.

The Coles and Woolworths cases

The Australian courts have examined the trading conduct of Coles and Woolworths supermarkets in earlier cases brought by the Australian Competition & Consumer Commission (**ACCC**). These decisions pre-date the Australian Food and Grocery Code.

The question in both cases was whether the supermarket had acted "unconscionably in all the circumstances" in its dealings with suppliers.

Coles: A lesson on what not to do

Coles instigated an Active Retail Collaboration (**ARC**) program which the ACCC claimed was developed to improve Coles' earnings. The ARC introduced continuing rebates payable by suppliers to Coles based on the purported benefits suppliers had gained as a result of the changes Coles had made to its supply chain.

The way Coles conducted the ARC was held to be unconscionable conduct because Coles:

- Calculated rebates based on pre-determined targets so there was no justification to suppliers on how the rebate costs were calculated.

- Threatened commercial consequences for failure to pay the rebates including threats that the supplier's promotional activities would be at risk and refused to purchase new products from the supplier.
- Demanded retrospective payments from suppliers for wastage and required a response within hours where the payment was not the subject of prior agreement while using a purported profit gap claim as leverage.
- Imposed penalties for short deliveries of a supplier's products without notice to, or prior agreement with, the supplier and, refused to repay the penalties imposed on the supplier.

In addition, Coles had misused its bargaining power because the suppliers that were subject to the ARC were:

- Highly dependent on their contractual arrangement with Coles and would have suffered financially if their contracts were cancelled.
- Not provided with adequate and correct information.
- Pressured to agree to the rebates within a short period of time.

Woolworths: Robust commercial dealings do not constitute unconscionable conduct

In the Woolworths case, what appeared to be similar conduct to that in the Coles decision did not constitute unconscionable conduct but was considered robust commercial dealings, despite Woolworths having had a much greater bargaining position relative to its suppliers.

Woolworths developed the "Mind the Gap" scheme to reduce a significant half-year gross profit shortfall. Under that scheme, category managers and buyers contacted suppliers asking for urgent payments ranging from AUD$4,291 to AUD$1.4 million.

Woolworths (being in the fortunate position of having learnt what not to do from Coles) provided evidence that its dealings with suppliers were simply consistent with hard commercial bargaining, which must be viewed in the context of the parties' overall business arrangements, and that each party's relative bargaining position is fluid and not fixed.

The Australian Federal Court agreed with Woolworths.

Our thoughts

The Coles and Woolworth cases show that the threshold for unconscionable conduct is high and whether conduct meets that threshold is entirely fact dependent. Unconscionable conduct is behaviour outside the accepted standards of commercial conduct, and not merely a failure to act in good faith. In assessing this standard, the courts will look at the behaviour of a party as well as the relevant bargaining power of the grocery retailer and the supplier. The courts will also consider other factors set out in the definition of "unconscionable conduct" in the Fair Trading Act 1986.

In our final **Part 3** next week, we will look at the "reasonable in the circumstances" exception under the Code.

Contacts

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