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***Trade Practices Act and the Food Sector***

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## 1. Introduction

The food sector in Australia is being impacted by a number of forces that are changing the structure of many primary industries and re-shaping the vertical relationships of supply and demand from farm-gate to checkout. Changed supply and demand relationships have recently caused concern; especially where it appears that buyer power is becoming concentrated at a particular point in the supply chain.

I believe that the Australian Competition and Consumer Commission (“ACCC”), as an economy-wide competition and consumer protection regulator, has an important role to play in helping participants in the food sector to confront these changes. The ACCC administers the *Trade Practices Act 1974* (“TPA”) and the *Prices Surveillance Act 1983* (“PSA”).

To put recent developments in some context, I think it is important to note that by the latter half of the last century many areas of primary production in Australia had become highly regulated, with supply and demand being “managed” by statutory authorities oversighting these industries. More recently, deregulation of these industries has proceeded and statutory marketing authorities have now been exposed to the competitive tests embodied in the TPA.

In a commercial sense, the forces driving change can be seen as longer term and are less easy to pin point, some examples include the lowering of transport costs, the growth of national chains of grocery retailers and the increased importance of branding and marketing of food products by processors.

Recent developments in the food sector can be characterised as either “horizontal” or “vertical” in nature, in terms of how they have impacted on the work of the ACCC.

I will proceed by discussing key ACCC activities relating to rural industries in the next section of this paper. I will then address horizontal issues before proceeding to a consideration of the vertical issues, many of which have been considered in the context of the Parliamentary Inquiry into the Retail Sector. I will then offer some brief concluding comments.

## 2. The ACCC and the Food Sector

Farmers and processors have a strong interest in their inputs being supplied competitively and efficiently and in their output being sold to competing businesses rather than to monopsonies which can exploit them. Customers of primary industries and the everyday consumer also want to be supplied competitively and efficiently. Ensuring the existence of competitive vertical and horizontal relationships is crucial to achieving these goals and the TPA has an important role to play in this regard.

### Enforcement and the Food Sector

Various sections of the TPA regulate horizontal relationships. Section 45 deals with a range of proscribed agreements between businesses, for example price fixing or market sharing agreements. Section 46 essentially provides that a firm with substantial market power shall

not take advantage of that power for one of three proscribed purposes, namely eliminating or damaging a competitor, preventing entry into a market, or deterring or preventing competitive conduct. Section 50 prohibits mergers or acquisitions which have the effect, or likely effect, of substantially lessening competition in a substantial market.

In terms of vertical relationships, section 47 of the TPA prohibits exclusive dealing that has the purpose or effect of substantially lessening competition in a market.<sup>1</sup> Section 48 prohibits suppliers, manufacturers and wholesalers from specifying a minimum price below which goods or services may not be resold or advertised for resale. Section 51AC aims to provide protection for small business against exploitative business conduct.<sup>2</sup>

The ACCC has recently been actively involved in various matters in the food sector under these sections. The merger matters discussed in Part 3 below are all good examples of the manner in which section 50 regulates market structure to prevent the creation of, or an increase in, market power at all levels of the supply chain in the food sector. The ACCC is also keeping a watching brief on continued acquisitions of independent retailers by the major chains.

Recent cases in the area of bread manufacturing and distribution provide a good example of the ACCC's actions in respect of sections 45, 46 and 48. They also demonstrate the manner in which anti-competitive practices in relation to vertical relationships can impact on the competitiveness of horizontal relationships.

In 1997, George Weston Foods Limited, trading as Tip Top Bakeries, was fined \$1.25 million for fixing the price of bread and for attempted resale price maintenance. The ACCC had filed Federal Court proceedings alleging that the company had ceased supplying retailers because the retailers were discounting bread. The company admitted the contraventions. The ACCC alleged that each of the contraventions by Tip Top arose out of pressure exerted on it by Safeway, the Victorian division of Woolworths Ltd.

In a matter currently before the Federal Court, the ACCC has alleged that Safeway has breached sections 45, 46, 47 and 48 of the TPA. Regarding section 46, it is alleged that Safeway misused its market power for the purpose of eliminating or substantially damaging independent retailers. It is alleged Safeway refused to accept further supplies of bread from major bread manufacturers who were supplying retailers who were discounting the price of the bread. It is alleged that Safeway recommenced purchasing bread from the manufacturer concerned once the discounter had ceased discounting. Safeway denies the allegations.

## **Authorisations**

Authorisations under Part VII of the TPA allow the ACCC to assist rural industries in addressing issues of buyer power and adjusting to deregulation. Its effect is to grant

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<sup>1</sup> Broadly speaking, exclusive dealing involves one person who trades with another imposing restrictions on the other's freedom to choose with whom, or in what it deals.

<sup>2</sup> The section prohibits a stronger party exploiting its bargaining advantage to impose contractual terms, or engage in conduct, that would be "unconscionable" in the context of the commercial relationship between the parties.

immunity from prosecution under the TPA and prevents the ACCC and third parties from taking successful applicants to court. Essentially the applicant must satisfy the ACCC that the public benefit resulting from the conduct in question outweighs any anti-competitive detriment.

In April 1997, the ACCC granted authorisation to Inghams in South Australia to give effect to and/or enter into its proposed grower agreement and code of practice. Inghams proposed to collectively negotiate a standard five year growing agreement with its contract chicken growers. The ACCC recognised that these arrangements had a number of anti-competitive features, particularly with regard to prices and market entry. In granting authorisation the ACCC was satisfied that the anti-competitive effects of Ingham's proposed arrangements were outweighed by the public benefits. These public benefits included:

- assisting a smooth transition from regulation to deregulation, to ensure lower adjustment costs for the South Australian chicken industry;
- providing chicken growers with countervailing bargaining power;
- a decrease in production costs resulting from the collective negotiation process that should result in lower retail prices.

The ACCC also granted authorisation to the wine grape industry to enable various groups to hold meetings to reach an indicative price for wine grapes. This contrasted with previous arrangements where prices had been fixed. The new arrangements were found to improve information and to assist growers to adjust to an environment in which they had to negotiate their own prices.

### **ACCC Milk Monitoring Role**

At the end of November 1999, the Minister for Financial Services and Regulation, Joe Hockey, wrote to the ACCC informing us of the Government's intention to direct the Commission to undertake formal price monitoring of the prices, costs and profits of businesses dealing with liquid milk product sales.

The monitoring is intended to commence from July 2000 with the imposition of an 11c / litre levy on market milk sales. The levy is to finance the dairy industry restructure package -- a package intended to help dairy farmers adjust to deregulation of the industry at the "farm gate" level. The levy is to be applied on all drinking milk including UHT and flavoured milk. While the levy will be applied to the retailers, the processors will actually collect it. The expectation is that with the drop in farm gate prices, the 11c per litre levy should not lead to an increase in the final retail price. It will be the ACCC's monitoring function to see that the expected reductions in farm gate prices are **not** used to increase margins at the processor and retail level.

The Dairy Industry Adjustment Bill was tabled on 17 February 2000. The Bill indicates that the ACCC will be given a direction under section 27A of the PSA to monitor prices, costs and profits in relation to the sale of leviable milk products. The ACCC is currently developing a methodology for this monitoring exercise and expects to be consulting with industry about this proposed monitoring role.

### **3. Horizontal Issues**

The onset of deregulation in primary industries and the consequent exposure of these industries to the competitive tests embodied in the TPA has required that many of these industries undergo a period of adjustment. The past few years have seen many proposals for horizontal consolidation in various agricultural industries. In the food sector specifically, the ACCC has considered proposed mergers in the grains industry and in the dairy industry. It has also considered mergers involving suppliers of agricultural equipment.

#### **Dairy Mergers**

Following deregulation, the dairy industry has been the subject of scrutiny by the ACCC, with proposals being raised for consolidation of dairy processors. In 1998 the ACCC considered the proposed acquisition of Pauls Limited by National Foods. Both National Foods and Pauls were Australian owned food processing companies which specialised in manufacturing and distributing fresh milk and a range of other dairy products.

The ACCC was of the view that the initial proposal presented to it was likely to lead to a substantial lessening of competition in both the market for fresh milk in the State of Victoria and the national market for yoghurts and dairy desserts. The ACCC's concentration thresholds were crossed, in that the parties would have had a combined market share of more than 85% in the market for fresh milk in Victoria, and over 50% in the market for yoghurts and dairy desserts nationally.

Accordingly, National Foods revised its proposal for the takeover of Pauls to address the ACCC's concerns, by offering a section 87B undertaking to provide for the divestiture of some assets. After some consideration of these modifications, the ACCC accepted that its competition concerns would be satisfied if National Foods was, firstly to divest certain Victorian milk processing assets which constituted a significant proportion of Pauls' market milk processing capacity in Victoria, and secondly to relinquish the Danone Licence to produce yoghurts and dairy desserts.

In the event, the National Foods / Pauls merger proposal did not proceed as Pauls was finally acquired by Parmalat Australia.<sup>3</sup> While Parmalat also produced and distributed fresh milk in Victoria, the ACCC did not have any competition concerns with this proposal as Parmalat had such a small share of the fresh milk market in Victoria. This did not raise competition issues in any other Australian market.

More recently, a great deal of interest has surrounded the New South Wales-based dairy co-operative, Dairy Farmers, and its proposal to restructure as a company under the Corporations Law. Concurrent with this proposal to demutualise, both Bonlac Foods and Parmalat have been considering take over proposals for Dairy Farmers. The Parmalat merger proposal would require the members of Dairy Farmers to abandon their plan to demutualise and list on

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<sup>3</sup> Parmalat Australia is a wholly owned subsidiary of Parmalat Finanziaria S.p.A, a large-scale Italian-based international food processing company with significant dairy manufacturing and distribution operations in Europe, Canada, the United States and South America.

the stock exchange. Dairy Farmers is also currently in the process of considering the feasibility of a merger between itself and Bonlac Foods.

At this stage it is unclear what will finally emerge from all of this, but the ACCC will examine any merger proposals closely if and when they are put to us.

### **Sugar Refining and Flour Milling Mergers**

In 1997, the ACCC considered a merger proposal in the refined sugar industry. CSR and Mackay Refined Sugars Pty Ltd approached the ACCC with a proposal to enter into a joint venture which would combine their refining, distribution and marketing operations in Australia and New Zealand. The parties stated that their rationale was to address certain structural problems which existed in the refined sugar industry, such as the high fixed cost structure of the industry, significant economies of scale and highly corrupted international markets. When it had previously considered such a proposal in 1993 the ACCC had not seen refined sugar imports as an effective competitive constraint on Australian refiners. The ACCC accepted that important changes had occurred since 1993 which would increase the effectiveness of imports as a competitive constraint. These changes included removal of the \$55/tonne sugar tariff, reduction in freight rates and increases in world and regional refining capacity. The ACCC still expressed concerns about the competitive effects of certain aspects of this joint venture, particularly in Western Australia. In response, the parties offered the ACCC section 87B undertakings, pursuant to which they agreed to make their import facilities in Western Australia available to any person wishing to import sugar into Western Australia.

In relation to flour and starch acquisitions in 1996 the ACCC did not intervene in the acquisition by George Weston Foods of the starch business of Bunge Industrial. The ACCC's market inquiries in this matter found that a high degree of competition would still exist because of the presence of Manildra and Starch Australia, and because of the possibility of importing starch.

The second matter concerned the acquisition by Bunge Cereal Foods of Defiance Mills in early 1997. The ACCC did not have any competition concerns in this matter, as it found that the acquisition was unlikely to lead to a substantial lessening of competition in either the relevant flour or bread markets. The ACCC reached this conclusion because it found that there was little overlap in the flour operations and no overlap in the baking operations of Bunge and Defiance. Particularly in the relevant market for the manufacture and supply of pre-mixes, the ACCC found that barriers to entry were fairly low. Further, capital costs appeared to be low and costs were unlikely to be sunk. There was also evidence of new entry into the market by flour millers in the two previous years.

In November 1998, the ACCC announced that it did not intend to oppose the purchase of the Australian milling and baking assets of Bunge International Limited by Goodman Fielder Limited, subject to Goodman Fielder agreeing to enter into enforceable undertakings to divest certain milling assets, to ensure competition was maintained in the relevant flour milling markets.

### **Agricultural Equipment**

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Horizontal consolidation has also been an issue which the ACCC has considered in regard to agricultural supplies. In May 1999, a proposed global acquisition was announced by New Holland of Case Corporation with implications for the national market for the supply of agricultural equipment. Following market inquiries being undertaken by the ACCC with farmers, equipment dealers and suppliers, the ACCC came to the conclusion that the proposed acquisition was unlikely to substantially lessen competition. The ACCC considered that this was due particularly to the presence of several vigorous and effective competitors in the Australian agricultural and construction equipment markets.

Concerns were expressed in this matter that the proposal may substantially lessen competition in rural and regional Australia by reducing access to dealer distribution channels for smaller competing suppliers. The predominant concern in this respect was that the acquisition would provide the merged firm with the ability and incentive to force dealers into exclusive dealing arrangements. In recognition of these concerns, the ACCC announced its intention to monitor exclusive arrangements between suppliers and dealers in this industry following the completion of the merger.

Given the current environment, the ACCC is expecting further proposals for mergers in the agricultural and food sectors, and we will consider these carefully as and when they are presented to us.

#### **4. Vertical Issues**

A combination of factors has seen vertical issues emerge as a major concern for participants in the food sector in recent years, particularly at the “farm gate”. These vertical issues appear to be driven by: structural change and deregulation, on-going consolidation upstream and perceived buyer power, particularly on the part of retailers.

##### **De-regulation**

Deregulation of many of the grower industries in Australia has changed the nature of the relationship between primary producers, processors and retailers quite significantly. Open competition is replacing market controls as government business enterprises and statutory marketing authorities are becoming subject to competition laws. Primary producers are having to undertake the task of negotiating their own selling price and other terms of trade with processors (or retailers) instead of observing a set market price. With the abandonment of quotas, producers are also now required to determine the amount of output to produce according to market forces, while at the same time ensuring that their conduct in trying to meet these challenges does not breach the TPA.

##### **Consolidation in Up-Stream Markets**

At the same time, primary producers in many industries are facing increasing consolidation in upstream markets. For instance in the dairy industry, which was traditionally characterised by small regional or state-based processors, we have seen the growth of multi-state processors such as Dairy Farmers, National Foods and Parmalat / Pauls. De-regulating markets have facilitated this development, as has a desire by processors’ key customers (eg.

supermarkets, service stations, fast food chains, etc) to deal with as few suppliers as possible. Consolidated processors provide retailers with lower transaction costs, more significant volume discounts, improved brand recognition and promotions, improved service and product support, uniformity in store layout and stock, and greater control / accountability regarding supply chains and product quality. In these circumstances, processors and distributors see advantages to establishing a presence in multiple State markets such that they can provide national coverage to these retailers. One way in which they have sought to achieve this is by way of acquisition.

The late 1980's also saw considerable consolidation at the retail level. In mid-1985 Coles acquired Myer and Woolworths and Safeway merged their operations. In 1986-87 Coles Myer purchased John Weeks Holdings Pty Ltd which operated the Bi-Lo chain, as well as acquiring most of the Shoey's chain<sup>4</sup>. In the early 1990s Davids undertook a program of acquisitions of regional and state based independent retailers to build itself up as a "fourth force", a unified wholesaler that could provide retail and financial support to independent retailers to help them compete with the chains.

Consolidation in these up-stream markets has meant that primary producers and processors have to negotiate their terms of trade with fewer customers who constitute a larger proportion of their sales. This situation raises the issue of "buyer power".

### **Buyer Power**

Buyer power is exercised when a firm or group of firms obtains from suppliers more favourable terms than those available to other buyers or would otherwise be expected under normal competitive conditions. A retailer may be defined to have buyer power if, in relation to suppliers, it can credibly threaten to impose a long term opportunity cost (ie. harm or withheld benefit) which, were the threat carried out, would be significantly disproportionate to any resulting long term opportunity cost to itself. Buyer power describes situations where in the long run, suppliers are induced to lower their prices despite there being no decrease in their unit costs.<sup>5</sup>

In the food sector, if the concentrated market position of the retail chains provides them with buyer power, this will allow them to obtain more favourable terms than their independent competitors, which in turn provides the chains with a competitive advantage in downstream markets and the opportunity to exploit seller power. Of course, whether a firm has

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<sup>4</sup> It should be noted that these acquisitions proceeded in circumstances where the merger provisions of the TPA prohibited only acquisitions that resulted in the creation or strengthening of a dominant position. In 1993, the provisions were amended to prohibit acquisitions that had the effect or likely effect of substantially lessening competition in a market. One of the reasons for the change of test was the concern that some of the retail chain acquisitions that had occurred in the 1980's were able to proceed without challenge under the dominance test.

<sup>5</sup> However, it should be noted that if prices are pushed below what may provide suppliers with a normal rate of return, this may cause the exit of some suppliers which is unlikely to be in anyone's interest. It may also press suppliers to find new ways of doing business and enhance dynamic efficiency. Further, buyer power may have the effect of eliminating from the supply chain the excess profits that may have arisen pre-deregulation.



substantial market power in any case is dependent on the particular circumstances of the relevant market in which they operate.

In our submission to the Joint Select Committee on the Retailing Sector, the ACCC identified some of the types of buyer power related issues that are being faced in the food sector. In summary, some of these issues included the following:

- The chains' bargaining power with manufacturers may have implications for the terms and conditions on which the competing independent retailers are supplied.
- The buyer power of the chains may be exercised in a way that distorts the prices obtained by manufacturers with consequent distortions on investment and product innovation at the manufacturing level.
- Retailers may be able to use their power to require such things as "use by" dates that suit their shelf life turnover, or to require manufacturers to number their packaged products with a uniform system of bar code.
- An oligopolistic market structure at the wholesale / retail level of the grocery industry imposes backward pressure on the agricultural and manufacturing sector, which depends on the chains for the majority of its sales. This causes profits to be squeezed at the producer level and, to the extent that it drives otherwise viable and competitive players out of business, results in a misallocation of resources.

### **The Retail Inquiry**

In December 1998, the Federal Parliament appointed a Joint Select Committee on the Retailing Sector to inquire into and report on, amongst other things, the degree of industry concentration in the retailing sector in Australia, with particular reference to the impact of that industry concentration on the ability of small independent retailers to compete fairly in the sector. The Committee agreed that it would give a wide interpretation to its terms of reference and would include in its terms of reference an examination of the purchasing practices of the major retailers, especially those relating to purchases from primary producers. This raised a number of vertical, as well as horizontal, issues.

The Inquiry generated a large amount of interest, receiving mixed views about the competitiveness of the sector from the major chains, independent retailers, wholesalers, primary producers, consumers and other interested organisations. As an enforcement body rather than a research or policy development body, the ACCC based its submission to the Inquiry on its competition law enforcement experience. We considered that we could best contribute to the Inquiry by outlining a background to the grocery retail sector and its supply chain relationship, discussing the issue of market power in retailing, the competition issues that may stem from market power, and what the ACCC can do under the TPA in respect of these issues. We also outlined the manner in which overseas jurisdictions deal with issues of concentration and market power in the retail sector.

A number of complaints to the Committee were concerned with issues relating to vertical relationships, particularly buyer power. For instance some primary producers, while

acknowledging the benefits of dealing with the chains, complained that product is often returned to growers or orders cancelled as a result of what appears to be over-ordering and that significant added costs are often imposed via enhanced labelling and packaging requirements. Others alleged that the superior buying power of the chains meant that they received more favourable trading terms than the independents, effectively tilting the playing field in the chains' favour.

The Committee's Report was published in August 1999 and contained ten recommendations some of which dealt with issues relating to vertical relationships. More specifically, the Committee recommended that a mandatory Code of Conduct be drafted to regulate the conduct associated with vertical relationships throughout the supply chain. The Committee recommended the inclusion of specific provisions addressing issues such as: the principle of like terms for like customers (enforced by the ACCC through information gathering powers); transparency in 'vulnerable' supply markets, product labelling and packaging requirements; and contractual uncertainty (in particular the passing of ownership of produce and the circumstances under which produce can be returned).

The Committee also recommended the establishment of an independent Retail Industry Ombudsman through which small business can bring complaints or queries relating to the retailing sector for speedy resolution. Where complaints received by the Ombudsman raise issues that fall within the jurisdiction of another established body such as the ACCC, it was considered that those complaints should be referred to such bodies for further investigation.<sup>6</sup>

The Government responded to the recommendations in December 1999, stating that it would support the development of a voluntary code of conduct ("Retail Grocery Industry Code") by an industry funded code committee. The Government considered that businesses within the retail grocery sector are best placed to assess the nature of the difficulties being experienced in the sector and to resolve them. A mandatory code would only be considered if voluntary self-regulation failed and if the market failure or social policy objectives addressed in the code are serious enough to warrant enforcement of the code at law. The Government also supported an Ombudsman scheme as a desirable alternative to costly and lengthy litigation for small and large business.

From the ACCC's perspective, such a response seems appropriate. The Commission has long argued that industry codes of conduct can provide improved outcomes at the industry level, provided that they are properly framed, administered and enforced. Alternative dispute resolution schemes, like the Retail Industry Ombudsman, should be included in industry codes, and that is what is being proposed in this case. The ACCC is happy to be consulted in regard to the drafting of the Code during the code development process, as suggested in the

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<sup>6</sup> Other key recommendations impacting on the role of the ACCC included the following: the ACCC be able to take representative action under Part IV (competition provisions) of the TPA, the \$1 million transactional limitation under s 51AC (unconscionable conduct) be raised to \$3 million; s50(6) (merger provisions) be amended to refer specifically to regional markets and mandatory notification of retail grocery store acquisitions by publicly listed corporations.

Government's response, should such consultation be seen as appropriate by the code committee.

## **5. Conclusions**

Rural and regional Australia stands to gain from competition policy for many reasons. Strong competition will ensure that the rural sector has access to competitively priced inputs and better service, and will enable it to better compete on an international scale. If savings made through efficiency gains are passed on to consumers in the form of lower prices, then primary producers should also see increased sales.

Assistance in the achievement of these goals for rural and regional Australia through the enforcement of the TPA is a priority for the ACCC. As the discussion above indicates, the ACCC has recently been involved in many merger and authorisation matters relating specifically to the rural sector. Examples of other enforcement actions where the ACCC has secured positive outcomes for the rural community (as consumers of products and services) include the nationwide freight express cartel in the TNT / Mayne Nickless / Ansett Freight Express case, the ready mixed concrete price fixing case in Brisbane, the Gold Coast and Toowoomba, and poultry price fixing by chicken processors in South Australia.

The ACCC is committed to continuing its vigorous enforcement of the TPA in these areas for the benefit of rural and regional consumers and producers.