Australian Competition and Consumer Commission

Promoting Competition and Fair Trading

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Competition and the nation's supermarket trolley:
A perspective of the Australian Competition and Consumer Commission

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Introduction

In this country, at this time, our tables are piled high with riches. It is a fact that Australia's food and grocery sector produces, distributes and retails drink and foodstuffs with an admirable technical efficiency.

Because the Commission's interest is in the operation of economically efficient markets, I want to make some brief introductory comments about how efficient markets produce measurable benefits, and about the role of the Commission.

The Commission's job is to ensure compliance with, and enforce the nation's competition and consumer laws. By doing so, our objective is to enhance the operation of efficient and competitive markets. In this we are scrupulously even-handed. We apply the Act to all - no matter how powerful they may be - for the benefit of all

Of course, there is a more profound purpose here – the Act itself is underpinned by the notion that competition and markets provide the basis for high rates of growth, an enhanced productivity performance and employment growth. This is, I note, a prediction validated by the Australian experience.

By enforcing the law the Commission works to benefit both consumers and businesses. Consumers have an interest in being supplied competitively, efficiently and honestly.

But as well as benefitting consumers, competition and consumer law works to the advantage of the business community.

Firms have an interest in being supplied competitively and efficiently, and have an interest in selling to buyers who have to compete for output. Competition and consumer protection law provides an assurance to men and women in business that they will have the opportunity to compete fairly for all possible business, and that they will be able to keep the rewards of success.[1]

When compared to other OECD countries, Australia has done very well. For example, during the nineties Australia's annual rate of growth, at constant prices, averaged 3.6 per cent. This compares to 3.2 per cent in the United States and 1.9 per cent in Germany and France.

As well, Australia has benefitted from a marked increase in productivity.

Unlike the 1960s and 1970s, our productivity performance during the nineties was not part of a world-wide productivity boom. Over the past ten years, Australia made gains of three per cent per annum and was one of only three countries to experience strong growth in productivity.

Having sung of the economic virtues that generally result from competition, I now want to speak on subjects that have a direct bearing on the food and grocery sector.

Prominent amongst these are:

- the grocery industry code of conduct
- mergers and acquisitions
- the operation of section 46

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1 Shenefield, J.H. and Stelzer, I.M.: *The Antitrust Laws: A Primer* (The AEI press, Washington D.C., 1998)

- the inquiry of the Senate Economics Committee into the effectiveness of the Act in protecting small business, and;
- labelling.

As well, I will outline for you the Commission's strategies on enforcement and compliance.

Code of conduct

The current review of the Retail Grocery Industry Code of Conduct provides a good opportunity to examine the effectiveness of existing arrangements.

Of course, the background to the development and implementation of the code is familiar to you – and very familiar to us.

The Commission has been involved in considering about forty codes in various industry sectors. We have had informal consultations, and have been involved in working parties reviewing codes of practice. As part of the Commission's authorisation process, we have formally examined codes for potentially anti-competitive elements. Examples of codes include the Franchise Code, which is a mandatory code, and voluntary codes like the Supermarket Scanning Code, the Cinema Code and the Commercial Television Industry Code of Practice.

Our general view is that effective voluntary codes - that is, industry self regulation or co-regulation - generate benefits for industry, the consumer, for the government, and for the Commission as a regulator.

We are not alone in our thinking here. The Office of Fair Trading in the United Kingdom has since 2001 introduced a new scheme to approve codes of conduct. The result is a lighter, but effective regulatory touch, which still produces benefits for consumers.

Of course, the key word here is effective.

Codes that fail to meet objectives have little value to either industry or consumers. They are, in fact, likely to be counterproductive. An ineffective code makes for increased compliance costs and results in little offsetting benefit.

Moreover, if ineffective codes are perceived to be the rule rather than an intolerable exception, it is conceivable that pressure would develop for the introduction of mandatory codes.

The Commission considers that the mediation provisions of the Retail Grocery Industry Code appear to be delivering results. We continue to work closely with the ombudsman in various areas of complaints and continue to examine how some of the processes under the code can be improved. In particular, transparency in dealings between growers and wholesalers has been identified by us as an area warranting further attention.

That said, there are issues involved in dealings between some raw material suppliers and processors, although these tend to vary with the product involved. In many cases, these issues will tend to be addressed in collective negotiations.

Questions have also been raised about the level of transparency of pricing and terms between grocery suppliers and wholesalers and retailers. Many of you are aware that the Commission last year released details of a comprehensive voluntary survey. This survey demonstrated that the major retail chains did not always receive the most favourable terms of supply. In this report, and on this issue, we also identified industry claims that ‘like treatment for like performance’ has greater relevance than ‘like treatment for like customers’.

Now, the Commission understands that the membership of the Food and Grocery Council makes a diverse group, and that members have different views on the desirability and effectiveness of a code.

It is clear, however, that if a voluntary code is to work, then industry members must commit themselves to making it work. Clearly, code sponsors must be able to demonstrate that members are prepared to observe provisions.

A code will only be effective if it addresses issues that are important to participants. Key considerations include the definition of the objectives of a code and resulting benefits, the development of relevant and appropriate rules and the calculation of the cost of code administration.

The Buck Review provides the industry and individual firms the chance to make critical and constructive comment on how a voluntary code should work best. Because the review is an opportunity for you to shape the future operation of your industry, it is an opportunity that should not be ignored.

Mergers and acquisitions

Mergers and acquisitions in the retail and wholesale grocery markets is a subject that has, often enough, consumed the Commission's attention and grabbed public attention.

The example closest to you would be the sale in 2001 of the **Franklins** chain.

At the time, the Commission accepted that the Franklins business was in rapid decline, and that the withdrawal of key stakeholder support was imminent. Our primary concern that an collapse of the chain would see the bulk of stores go to the major supermarket chains, and fewer stores available for independents and new entrants.

That is, by not acting, by refusing to countenance a merger, the result would have been increased concentration and reduced competition.

The Commission agreed to the sale of 200 stores to independent retailers, and a maximum of 67 stores being sold to **Woolworths**. Independents were offered around two-thirds of the total sales value of the Franklins stores.

Approval of the agreement was conditional on the parties to the acquisition providing the Commission with enforceable undertakings to transfer stores that were designated to independents to those independent chains. In addition, to address concerns about local competition, the Commission required the divestiture of some Woolworths stores.

In the food and grocery industry, concerns about the state of competition – both current and prospective – have often been framed by concerns about creeping acquisitions.

It has been said, often enough, that there needs to be action taken against the phenomenon of creeping acquisition.
The relevant law in this area is enshrined in s.50 of the Act. As an enforcement agency the Commission is required to enforce the law as it exists, and, where appropriate, bring cases before the Federal Court for judgement.

Section 50 generally prohibits mergers or acquisitions that would substantially lessen competition.

In considering mergers or acquisitions, the Commission is required to make an assessment along the following lines. First, we define the relevant market. Then we assess whether or not the market is substantial. Finally, we determine if the acquisition is likely to substantially lessen competition.

Some of the factors relevant to evaluating the competitive impact of a merger or acquisition include:

- The height of barriers to entry
- The level of concentration
- The level of import competition
- The degree of countervailing power, and
- The dynamic characteristics of the market including growth, innovation and product differentiation.

Thus, to ensure dependability and fairness in process, the Commission's approach is to examine closely the circumstances of each case and to apply well-known and defined criteria.

This process, I believe, generates coherent and consistent results. Moreover, this approach better protects the dynamic operation of the market and the gains generate by competition than a policy that fixes levels of market share.

The Commission recognises that detriment to independent operators could result from creeping acquisitions. There is the potential for a loss of sales volume at the wholesale level to give rise to a loss of economies of scale. This, in turn, could generate cost pressures on the entire independent grocer sector. The Commission acknowledges this potential. But the difficulty remains that each individual acquisition must be considered against the test specified in section 50. That is, will the acquisition of a single supermarket result in a substantial lessening of competition?

But I also note that the focus on 'creeping acquisitions' has the potential to generate unintended and perhaps harmful consequences. This potentially could arise when incumbents seek to sell properties in a market made thinner by a prohibition on creeping acquisitions. Creeping acquisitions provide an exit path for those wishing to sell their business. Organic growth by Coles and Woolworths does not provide that exit. Stopping creeping acquisition may remove an exit path, but will not address increases in market shares through organic growth.

The context is a market for food and groceries undergoing dynamic change. Recent alliances between the majors and petroleum companies have injected a new market dynamic. It brings behaviour in non-food markets into the equation in a way not previously envisioned and the Commission is examining developments closely.

Certainly, it is true that Woolworths and Coles are major players in the Australian market. They operate over 1,300 supermarkets. And on a national basis they account for a majority of market share.

However, aggregate market share may not fully indicate the state of competition in a market.

We need to consider the stability, not just of the aggregate share of Woolworths and Coles, but of individual market shares. Whilst aggregate share might be static or only slowly increasing, component shares can vary in a way that reflects the degree of competition between the two major chains. Certainly, in Australia during recent times, Woolworths has increased sales and share at a greater rate than Coles – a matter of quiet satisfaction to Woolworths, I'm sure. Moreover, independents have shown a preparedness to expand operations.

Section 46

I want now to turn to the operation of section 46.

Section 46 applies to the misuse of market power. Businesses that have a substantive degree of market power are prohibited from taking advantage of that power for the purposes of eliminating or substantially damaging a competitor, preventing entry into markets or deterring a person from engaging in competitive conduct.

Broadly, the objective of s.46 is to protect the competitive process by preventing firms with substantial market power from engaging in illegitimate, unilateral, anti-competitive conduct. As such, small businesses are assured a measure of protection from the predatory actions of powerful competitors.

Of course, it is an inevitable part of competition that some firms will be damaged, and others prosper. Some will close because they cannot compete effectively.

This is an important feature of a vigorous, competitive market and an important part of achieving the most efficient use of the nation's resources.

I do not pretend that it is an easy task to achieve a perfect balance between prohibiting anti-competitive conduct and ensuring robust competition that, on occasion, will necessarily work to the detriment of individual firms.

The perfect balance requires that the law be in perfect shape and perfectly enforced.

Most recently, the misuse of market power elements of the Act have been considered in the High Court case *regarding Boral*, and the case involving **Australian Safeway Stores Pty Ltd** which the Commission has sought special leave to appeal.

The findings of the High Court in *Boral* have implications for the future, effective operation of s.46. And I want canvass some of the issues in the context of Commission's submission to the Senate Economics Committee Inquiry into the effectiveness of the Act in protecting small business.

Briefly though, in proceedings brought by the Commission in the Federal Court, we alleged that Safeway had a policy of removing a particular baker's products from sale when similar products were sold on special at nearby independent stores.

We alleged that Safeway's conduct variously involved anti-competitive agreements, misuse of market power, exclusive dealing and resale price maintenance and contravened ss.45, 46, 47 and 48.

We further alleged that when Safeway discovered that its retail competitors were selling bread at what it regarded as an unacceptably low price, it put pressure on the baker supplying these retailers by refusing to accept further supplies from the baker until the retailer stopped selling the cheap bread.

The allegations raised highly complex issues of trade practices law. In December 2001 the Federal Court determined that Safeway had not breached the Act – a decision that was appealed by the Commission.

Recently the Full Federal Court held that, in some instances, Safeway engaged in price fixing and an abuse of market power.

Specifically, the majority of the court found that on four of nine instances pleaded against Safeway the company had misused its market power as a wholesale purchaser of bread for an anticompetitive purpose.

The court held that Safeway had not engaged in misuse of market power in respect of the other five instances pleaded by the Commission.

After careful consideration of these specific decisions, the Commission sought leave to appeal.

In our submission to the Senate Economics Committee, we noted that case law has provided increasing clarity to the operation of s.46. However, several recent judicial decisions, particularly the *Boral* appeal in the High Court, have raised issues as to the application and operation of s.46.

It appears that s.46, as presently drafted and as interpreted by the courts, does not appropriately implement the stated policy intentions of Parliament. There is not sufficient time to cite the fine detail of our arguments here, so I will just stand one example up for inspection.

It is possible that, in supporting a restrictive interpretation of the requirement for a corporation to hold a 'substantial degree of power in the market', the *Boral* decision of the High Court may result in a narrower application of s.46.

In 1986, s.46 was amended. The heading of the section was changed from monopolisation to misuse of market power. Significantly, the application threshold was intended to be lowered from substantial control to 'a substantial degree of power in a market'.

The majority judgements in Boral indicate that the threshold test for the purposes of s.46 have been effectively restored to monopoly or near monopoly, contrary to Parliament's intention in 1986.

The Commission takes the view that it is desirable to provide guidance to the courts and certainty to market participants. The policy intention behind s.46 should be given effect by amending s.46 to clarify the following principles:

- the threshold of 'a substantial degree of power in a market' is lower than the former threshold of substantial control
- the substantial market power threshold does not require a corporation to have an *absolute* freedom from constraint – it is sufficient if the corporation is not constrained to a *significant* extent by competitors or suppliers
- more than one corporation can have a substantial degree of power in a market, and
- evidence of a corporation's behaviour in the market is relevant to a determination of substantial market power.

It is desirable that such changes be made as soon as practicable.

As well as misuse of market power, the Commission has suggested what we consider other desirable modifications to s.46. The main changes include:

- the clarification of the 'take advantage' element of the provision
- in cases of predatory pricing, an amendment that a finding of recoupment be not required to establish contravention, and
- clarification of whether or not s.46 applies to any use of market power with a proscribed purpose, irrespective of where the conduct occurs.

You will find the reasoning that supports these brief conclusions in our submission to the small business inquiry.

Labelling

The Commission has been closely involved in reviews of food standards, including the labelling of foodstuffs.

You probably are aware that the Commission wrote to the Council last year seeking assistance in informing members that labelling was an important issue and that when food labels were being re-designed in anticipation of new laws, some thought needed to be given to fair trading laws and the message consumers would take from new labels.

Common labelling traps for manufacturers and sellers are:

- **False country of origin claims** – such as 'Australian' when a product is made from a blend of Australian and imported produce (for example, the *Viva Olive Oils* case);
- **Inaccurate pictorials or descriptors** – such as 'low GI', 'all real fruit' or 'grilled' (for example, the *McDonalds'* patty case)
- **Inaccurate or incomplete claims about a product's virtues** - such as that it 'improves your health' or "reduces the risk of heart disease (for example, the *Meadow Lea Gold'n Canola* case), and
- **Absolute claims such as 'totally fat free' or '100 per cent GM free' or '100 per cent freshly squeezed orange juice'** – when concentrates have been included or sugar added (such as in the *Outback Juice* matter).

An often overlooked fact related to these sorts of labelling problems is that they are self made problems. Manufacturers choose to call their products 'all Australian' or '100 per cent GM free' with the object of attracting consumers and gaining a marketing advantage. No one compels them to make such claims.

A claim that is false will clearly breach the Act.

But you should also remember that a claim that is true can still be misleading and therefore also breach the Act. I do not want to express a final Commission view here, but it seems to me that representations such as 'ninety five per cent fat free' may be literally true, but may convey to consumers an impression that the food in question is lower in fat than comparable products.

Can you imagine anyone selling a full strength beer on the basis of what some may regard as an accurate representation 'ninety five per cent alcohol free'?

So how do you manage the risks? At least part of the answer - particularly for advertisers and sellers - lies in good compliance systems.

The new 'key ingredients' regime should see more complete information made available to consumers. However, the Commission will continue to be vigilant in relation to food labels. We will be particularly swift to act where we see:

- health risk or detriment associated with representations
- systemic consumer complaints, and /or
- an unfair competitive advantage being gained by traders that play loose with the truth.

Competitors are also free to bring court proceedings if they believe the have suffered from misleading conduct in breach of the Act. In fact, a significant number of the 'fair trading' type complaints received by the Commission comes from companies that believe they have been roughly handled.

Future directions for the Commission

I want to conclude my remarks today by outlining what the approach of the Commission in the future to enforcement, compliance and publicity.

The Commission has obligations under the Trade Practices Act to investigate allegations of unlawful behaviour. In doing so we are indifferent to the size of the party or the volume of protestations.

If a large business treats small business unfairly, in an unconscionable manner, then the Act will be enforced. If a business treats consumers unfairly and in a misleading and deceptive manner, the full force of the Act will be applied. If a business colludes with

another business, then the full force of the Act must and will be brought down upon the offending businesses.

It's important we utilise our resources to achieve wide-reaching results in the areas of enforcement and compliance.

The approach of the Commission reflects this thinking. Enforcement strategies are either curative or preventative, and range in intensity from contested hearings in the courts, through hearings by consent, formal section 87B undertakings, administrative settlement, informal resolution to education programs.

This differential approach means that we most efficiently apply resources to areas of greatest enforcement need, and most effectively ensure compliance.

One of the important roles of the Commission is to inform the public of the activities of the Commission itself.

This was the clear intention of Parliament, which in s.28 of the Act provided that the Commission make available to persons in trade, consumers and the public, information about the operation of the Act and matters concerning the rights and interests of consumers.

In providing such information, the Commission accounts for its actions to the Australian public. As is proper, the community has a right to be informed of, and to assess and judge the work and decisions of the Commission.

I will continue to use the media as a forum for informing the public of their rights and responsibilities under the Act.

Of course, publicity attending an adverse judgment of say, pricing fixing or unconscionable conduct, can lower a firm's standing and reduce sales. A good reputation is highly prized by businesses. Those planning unlawful anti-competitive behaviour therefore put at risk a valuable asset.

As a result, the Commission should not and will not be cavalier in its treatment of individuals or corporations about whom we allege wrongdoing – not in public, and not in private.

Conclusion

I've outlined to you some of the work of the Commission in, I hope, areas of direct interest to you. I've emphasised the positive economic and social benefits that result from vigorous competition. And I have explained some of the Commission's reasoning in suggesting that, on s.46, it is desirable to provide guidance to the courts and certainty to market participants.