Hon ANTHONY FELS MLC

MEMBER FOR AGRICULTURAL REGION

Hon. Anthony Fels MLC
Opposition Spokesman for Consumer Affairs
First Floor Sterling House
8 Parliament Place
WEST PERTH WA 6005.

6th July 2005

Mr. Graeme Samuel
Chairman
Australian Competition and Consumer Commission
PO Box 1199,
DICKSON ACT 2602.

Dear Mr Samuel

I write to express my opposition to the proposed acquisition by Woolworths of 19 Action supermarket stores and 3 development sites throughout Australia, currently owned by Foodland Associated Ltd (FAL). If permitted to proceed the consequence of such a merger will be to further concentrate market share within the state and national supermarket industry[1] at the expense of consumers, producers and the independently owned supermarket operators.

I seek your support for the intervention of the Australian Competition and Consumer Commission (ACCC) to the extent necessary to prevent Woolworth's acquisition of the Action supermarket stores and development sites within Australia, including an injunction in the Federal Court if necessary.

It should be noted my opposition to the proposed Metcash and Woolworths takeover of Foodland does not extend to Woolworths acquisition of Foodland's 149 supermarket stores in New Zealand nor to Metcash's acquisition of Foodland's wholesale business and its 58 remaining supermarket stores located in Australia.

Many independent supermarket operators have welcomed the creation of a national wholesaler that combines Metcash's wholesale distribution network in New South Wales, Queensland, Victoria, the ACT and South Australia with Foodland's wholesale distribution network in Western Australia, the Northern Territory and parts of Queensland and New South Wales, on the basis it will position the merged wholesaler

[1] For the purpose of this discussion the supermarket industry is taken to include the retailing of food and packaged groceries on a local, state and national basis, but to exclude both petrol and liquor retailing.

"*to negotiate better buying power, better ranges, better terms (and) quicker access to new lines in the market*[2]".

In outlining what I believe will be the deleterious effects of the proposed merger I intend to consider a number of issues in light of the competition and public benefit tests contained in sections 50 and 90 of the Trade Practises Act (TPA).

COMPETITION TEST

Section 50 of the TPA provides that a corporation must not acquire a business *'if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in the market'*.

In light of the High Court's decision in the Boral case (*ACCC v. Boral Ltd*.) questions 2 and 20 of the ACCC's attachment B for interested parties making a submission regarding this proposed merger are of concern.

In its Boral decision the High Court ruled that only a corporation able to raise prices without losing custom (that is, a monopolist) would be considered to have a substantial degree of market power such that they could lessen competition.

When s. 46 of the TPA was amended in 1986 so as to include the words *'substantial degree'* of power in the market and replace the section title from *'Monopolisation'* to *'Misuse of market power'*, it was clear that Parliament intended to lower the threshold and not maintain it at a level consistent for that of a monopolist. The Explanatory Memorandum to the 1986 amendments of the TPA, which state that *'more than one firm may have a substantial degree of market power in a particular market'*, add further weight to this view.

Question 2 of the ACCC's attachment states ***'the <u>key issue</u> is, if Woolworths acquires the 22 Action stores, whether it would be able to raise its prices for a sustained period of time'.*** For the reasons mentioned above, I wish to emphasise that the words *'substantially lessening competition'* in s. 50 of the TPA ought not be interpreted so as to require a test for monopoly power.

That aside, it should be noted that the Western Australian supermarket industry is already oligopolistic, characterised by two dominant firms, Coles and Woolworths, controlling approximately two thirds of the market. In a White House Task Force Report, published in 1968, it was '*recommended that a combined market share of 70% by four or less companies be presumed to conclusively prove anti-competitive effects, and that companies holding such a share would have the onus of proving that de-concentration would reduce the efficiency of the industry*[3]'. The extent of market

[2] *'Supermarket sale set to spark chain reaction',* The Age, 28th May 2005

[3] *'Fair market or market failure – A review of Australia's retailing sector'*, Report by the Parliament of the Commonwealth of Australia's Joint Select Committee on the Retailing Sector, August 1999, p.51

domination by Coles and Woolworths at a national level, estimated to be 79% of the supermarket industry as of December 2003[4], already exceeds that at which the White House Task Force Report took it as a given there would be anti-competitive effects, and is far greater than other developed nations. In the United States of America, for example, their largest food retailer, Wal-Mart, holds a comparatively low 16% share of the grocery market[5] and as of 2001 their top five supermarkets chains collectively comprised only 34% of the market[6]. In France their three largest supermarket chains held 44% of the market as of 2001[7].

It is my contention that the existing level of competition between Coles and Woolworths is limited and if a competitive supermarket industry is to thrive the independent sector must survive.

Research by Baker and Marshall on the level of geographic competition between Coles and Woolworths in Sydney concluded that the two main firms avoided mutually ruinous behaviour and located in areas out of each other's way[8].

The Australian Consumers Association has conducted research into the extent of competition between Coles and Woolworths and concluded that *'Coles and Woolworths are not particularly competitive on price in their supermarkets. Until the time of the previous version of Franklins supermarkets collapsed Coles and Woolworths always charged substantially more for a typical basket of goods than did Franklins. This was especially true for generic product lines, though also true to an extent with main brand lines. Coles and Woolworths supermarkets that were located close to Franklins' supermarkets, competed much more with Franklins prices. Since the demise of Franklins as a real price competitor the prices of typical baskets of goods in Coles and Woolworths have risen and they do not show any tendency to compete with one another'*[9].

Of the 140 supermarket stores operated by Coles and Woolworths in WA, in only 45% of sites do they directly compete against each other within the same suburb or township[10]. Of the 12 Action stores and development sites located within WA that Woolworths proposes to acquire, 2 sites, Action Maddington and Action Kalgoorlie, will

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[4] Sources: AC Neilsen's Scan Track, published in *Retail World*, December 2003 and National Association of Retail Grocers of Australia website, http://www.narga.com.au/

[5] *'Industry brief: U.S. supermarkets'*, Oligopoly Watch, www.oligopolywatch.com/2003/05/31.html, 31st May 2003

[6] Ibid

[7] Source: AC Neilsen, quoted in the National Association of Retail Grocers of Australia website, http://www.narga.com.au/

[8] *Store Wars: Supermarket Oligopolies and Spatial Competition in Sydney*, by Baker R. and Marshall D.

[9] 'RETAIL SHOPS AND FAIR TRADING LEGISLATION AMENDMENT BILL 2003', Hansard transcript of debate by Hon. D. Barron-Sullivan, 26th November 2003

[10] Refer to store locations listed at www.woolworths.com.au and www.coles.com.au . Of the 92 metropolitan stores operated by Coles and Woolworths, in only 11 locations (Belmont Forum, Floreat Forum, Forrestfield SC, Joondalup SC, Maddington Metro, Midland Gate, Mirrabooka SC, Morley Galleria, Spearwood SC, Warnbro SC and Warwick Grove SC) do Coles and Woolworths directly compete on the same shopping centre site.

'compete' against an existing Woolworths store in the same locality and only 4 will 'compete' directly against a Coles store within the same locality.

In a competitive market place a firms profits, measured as earnings before interest and tax as a percentage of sales (EBIT/sales %) would, over time, be inclined to remain stable. In the case of both Coles and Woolworths however, the trend in their EBIT/sales percentage has been increasing over time in conjunction with their increasing market share.

Table 1 - Woolworths & Coles EBIT to sales (%) for their supermarket divisions - Australia[11]

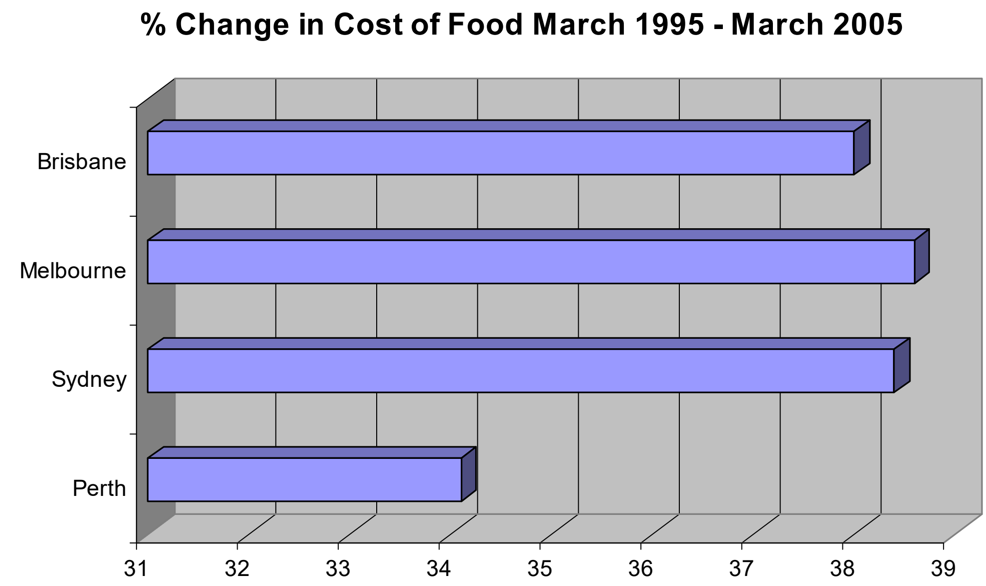
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 (1/2)
Woolworths	3.27	3.40	3.62	3.34	3.39	3.53	3.61	3.76	3.97	4.18
Coles	2.9	3.3	3.3	3.3	3.3	3.5	3.6	3.6	3.7	3.7

In the event of Woolworths proposed acquisition of Action stores proceeding, it is no more likely to result in increased competition and lower prices for consumers, than has been the experience in other states which have long had the dubious honour of having a higher level of supermarket industry concentration than WA.

The Australian Bureau of Statistics (ABS) Food Data Time Series for the ten-year period March 1995 to March 2005 show that for ***Perth***, Sydney, Melbourne and Brisbane the respective increases in the cost of food in each capital city amounted to ***34.1%***, 38.4%, 38.6% and 38.0% respectively. The evidence suggests that in Perth's supermarket sector, in which the two dominant chains have held a lower market share than in other Australian capital cities, consumers have benefited from increased competition by way of lower prices.

Graph 1 -

[11] '*Annual Reports*', Woolworths 1996 to 2005, http://www.woolworthslimited.com.au/shareholdercentre/financialinformation and Coles Myer, 1997 to 2005, http://corporate.colesmyer.com/



Source: ABS Food Data Time Series, March 1995 to March 2005[12]

When compared to Melbourne, for example, Perth's food prices increased by 4.5% less over the decade to March 2005 in spite of generally higher fuel and freight costs.

Question 20 asks whether *'Woolworths, if it acquired the 22 Action stores (would) be prevented from raising its prices for a sustained period of time by threat of, for example, new supermarkets opening . . . ?'*

The market power of Coles and Woolworths already bestows upon them preferment from shopping centre developers.

In 1999 the CEO of Australia's largest owner of supermarket centres, Country Wide Retail Trust (CRT), confirmed to the Federal Parliament's Joint Select Committee on the Retail Sector that "*without an anchor tenant committed to a long-term lease, any proposed major retail development will flounder*[13]". Of the 60 supermarket centres then owned by CRT all were leased to a major chain, with Coles and Woolworths accounting for 58 sites or 97% of tenancies.

Mr. Neville Gale of Advantage Supermarkets (WA) stated to the Joint Select Committee on the Retail Sector that "*the gaining of sites is the major impediment to the growth*" of the independent sector[14].

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[12] *'Retail Trade, Australia, Food Data Time Series'*, Australian Bureau of Statistics, Sept. 1972 to March 2005
[13] *'Fair market or market failure – A review of Australia's retailing sector'*, Report by the Parliament of the Commonwealth of Australia's Joint Select Committee on the Retailing Sector, August 1999, p. 75
[14] Ibid, p. 77

Compounding the existing barriers to market entry of supplier discounts and limited access to development sites, Coles and Woolworths have been harvesting increased supermarket sales by way of offering discounted petrol.

Commenting upon this strategy *The Age*[15] stated *'Coles Myer is leasing more than 590 Shell sites . . . (subsidising petrol at) 4.5 cents a litre . . . they are losing $27,000 a month per site . . . more than $180 million a year, . . . (however) . . . the petrol offer is adding 1-2% to the company's food and liquor sales'.*

Since Woolworths diversification into the petrol market in the late 1990's it has acquired and developed a total of 438 petrol sites, including 109 Woolworths/Caltex Alliance sites[16]. '*Supermarket sales are driven by the bonus of a reduction on the price of petrol . . . the increase in revenue is about 10% where gross revenue is between $500,000 to $1,500,000 per week*[17]'.

The Australian Consumers Association has commented upon the deleterious aspects of this strategy being pursued by both corporations stating '*If the sustained deep discounting of petrol prices by Coles/Shell and Woolworths/Caltex is allowed to run for a reasonable time it seems likely that there will no longer be significant competition from independents nor even from other major suppliers – unless they can form similar arrangements to provide a cross-subsidy to support the petrol sales. Indeed there is a major impediment to that eventuality, since there are only 2 retailers capable of providing the market mass to make this arrangement work and they are already partnered. Thus the alliances in an effective duopoly to damage competition in another – motor fuel. The longer-term outcome could therefore be a domination of petrol retailing, in parallel with supermarket retailing by just two operators. This could well result in an inflation of nominal petrol prices so making the 4c/L discount meaningless, while continuing to appear attractive.* ***These operators would be in a position to effectively challenge any new entrant into either supermarket or petrol retailing by adjusting prices and discounts to thwart the new entrant's capacity to compete effectively****. Reinforcing barriers to entry in this fashion is unlikely to benefit consumers'*[18].

The dominance of Coles and Woolworths is built on a foundation of limited competition between the duopolists, acquisitions, predatory pricing, restricting competitors access to new sites, increasing EBIT as a percentage of sales and more recently the cross subsidising of petrol to drive retail sales.

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[15] '*The Coles Myer conundrum*', *The Age*, 5th July 2004

[16] *'Woolworths First Half Sales Results for 2005'*, http://www.woolworthslimited.com.au/ p. 2

[17] *'The dangers of the three industry ownership strategy being followed by Coles/Woolworths'*, Research paper by the Independents Action Group, 2003, p. 3

[18] 'RETAIL SHOPS AND FAIR TRADING LEGISLATION AMENDMENT BILL 2003', Hansard transcript of debate by Hon. D. Barron-Sullivan, 26th November 2003

The most authoritative estimate of Coles and Woolworths respective shares of the WA supermarket industry was provided by AC Neilsen[19] in April 2005 and was estimated at 33.1% and 29.7% respectively.

Table 2 - SHARE OF SUPERMARKET INDUSTRY IN WESTERN AUSTRALIA

SOURCE & DATE OF WA MKT. SHARE ESTIMATES	**COLES (CML)**	**WOOLWORTHS (WOW)**	**INDEPENDENTS**	**ACTION** (Metcash post-merger) (14 stores/2 sites to WOW*)
Woolworths - 2005[20]	26.2%	23.40%	NA	NA
Retail World - 2002	33.30%	28.10%	NA	NA
Scan Track, AC Neilsen - April 2005	33.10%	29.70%	24.1%	13.0%
Office estimate of post-merger market shares - 2005[21]	**33.10%**	**36.20%**	**24.1%**	**6.50%[22]** (4.5-6.5% to WOW*)

Woolworths has a history of stating their market share to be whatever most pleases their audience's ear. During the earlier part of hearings before the Federal Parliament's Joint Select Committee on the Retailing Sector Woolworths referred to their market share in terms of their share of a persons stomach and thereby defining their market share as a mere 20 per cent. Before the same hearings, some four weeks later, '*Chief Executive Roger Corbett was reassuring his shareholders that, according to AC Nielsen packaged grocery scan data, Woolworths market share had risen from 35.1% to 35.6% in the past twelve months*[23]'. Accordingly, Woolworths estimate of its market share, listed in Table 2, ought to be discounted.

In its Merger Guidelines the ACCC states "*a firm or firms will not normally be able to exercise market power in the absence of a significant market share*"[24]. The Commission regards a significant market share as constituting a "*combined market share of the four (or fewer) largest firms of 75 per cent or more and the merged firm will supply at least 15 per cent of the relevant market*"[25].

In a post-FAL WA supermarket industry the three largest supermarket operators, Woolworths, Coles and Metcash, will exercise a combined market share of at least 75.8% and enable the existing supermarket duopoly to exercise even greater

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[19] *'Scan Track'*, AC Neilsen, 17th April 2005

[20] *'WA suppliers fear ranging cuts with Woolworths Action move'*, Retail World, June-July 2005, p. 5

[21] Based upon Action's average store turnover, the 14 Action stores (3.9%) and 2 development sites (0.6%) in WA are estimated to account for at least 4.5% of the WA supermarket industry.

[22] The June -July 2005 edition of *Retail World* (p. 5) quotes a national supplier who believes the 40% of Action stores in WA Woolworths is proposing to acquire *'account for 50-60% of the Action turnover in WA'* or a minimum of 6.5% of the WA supermarket industry.

[23] *'Fair market or market failure – A review of Australia's retailing sector'*, Report by the Parliament of the Commonwealth of Australia's Joint Select Committee on the Retailing Sector, August 1999, p. 42

[24] *'ACCC Merger Guidelines'*, June 1999, p. 43

[25] Ibid, p. 44

market power than is presently the case. Its effects will be anti-competitive, prices for food in Perth are likely to trend upwards to the national level and consumer choice will be further restricted.

PUBLIC BENEFIT TEST

Section 90 of the TPA requires the ACCC to take into consideration any public benefits that may derive from a proposed merger, particularly where '*that benefit would outweigh the detriment to the public constituted by any lessening of the competition'*.

The TPA does not comprehensively specify what constitutes a public benefit although the Australian Competition Tribunal has determined that it should include *'. . . anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements . . . the achievement of the economic goals of efficiency and progress'.*

Under s. 88(9) of the TPA the ACCC may authorise the proposed Woolworths/Action merger, notwithstanding that does not meet the requirements of s. 50, if, under sections 88(9) and 90, it considers the merger would result in benefits to the public.

I have argued that the effect of the proposed merger will be anti-competitive. I hope to demonstrate that as a result of a loss of consumer choice, increased supplier price discrimination against independent supermarket operators and loss of business to local suppliers, the proposed merger would result in substantial loss of benefit to the public.

The Council of Small Business Organisations of Australia (COSBOA) believes experience has shown the '*concentration of ownership of retail outlets (e.g., food) leads to a reduction in the amount of product sourced locally, as the bigger retailers move to centralise suppliers to maximise economies of scale*[26]'. Consequently, consumers suffer a reduction in the product choices available to them. WA cereal and nuts producer, Olympic Fine Foods, for example, presently sells 38 products to Foodland supermarkets whereas with Woolworths they sell only seven products[27]. The proposed Woolworths acquisition of 16 Action stores is likely to cost Olympic Fine Foods about $800,000 in lost sales.

[26] *'Fair market or market failure – A review of Australia's retailing sector'*, Report by the Parliament of the Commonwealth of Australia's Joint Select Committee on the Retailing Sector, August 1999, p.32
[27] '*Local firms fear being left off shelf*', The West Australian, 31st May 2005, p. 6

Similarly the Gingin Abattoir, which presently exports 100% of its goat meat, but would like "*to be able to access the domestic market*[28]", believes they had a chance to break into the domestic market via Action and this opportunity will be lost if the proposed merger proceeds.

The National Association of Retail Grocers of Australia (NARGA) have argued that "*the competitiveness of the independent grocery retailers is inextricably linked to the ability of independent wholesalers to secure comparable prices to those secured by the two major supermarket chains. . . .* ***the better the prices received by the independent wholesalers, the better the prices they can offer to their independent retailer customers, the better the prices those retailers can offer consumers*** *and the more competitive tension there is between the two major supermarket chains and the independent sector*[29]".

This should come as no surprise to the ACCC for in its *Report to the Senate by the ACCC on prices paid to suppliers by retailers in the Australian grocery industry* the ACCC recognised that the potential for supplier price discrimination in favour of the major retail chains would increase with increasing concentration of market share being held by major retail chains. The **ACCC stated "*the grocery market is highly concentrated . . . (and) . . . could become more so if price discrimination in supplying grocery products caused non-chain retailers to incur higher costs e.g. the lower price given to the major chains is 'subsidised' by higher prices charged to other buyers*[30].**"

The ACCC's Report stated that the major chains were favoured on price in a majority of instances during the period of its inquiry (1999-2000 & 2000-2001).

Graph 2 – Incidence of price discrimination in the Australian grocery industry

(reproduced from the ACCC's *Report to the Senate on prices paid to suppliers by retailers in the Australian grocery industry)*

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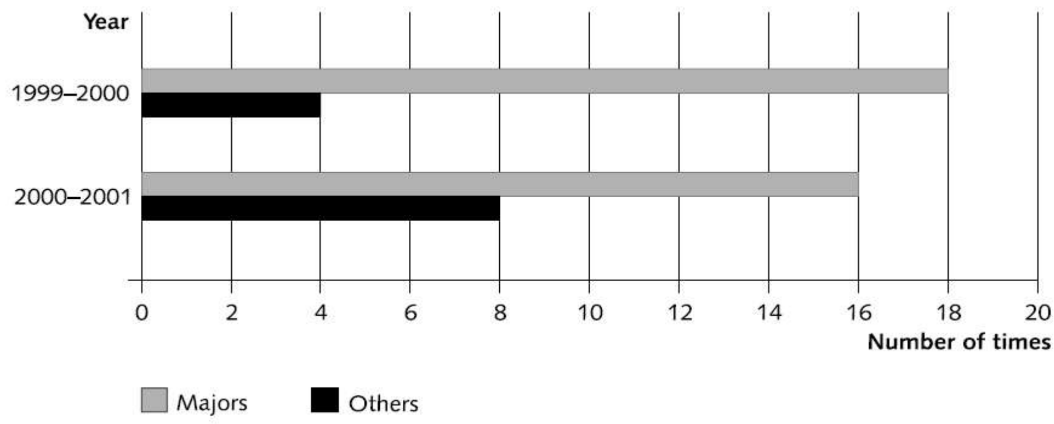
[28] The proprietor of the Gingin Abattoir, Mrs Stephanie Tugo (ph. 02 9499 7639), has stated they could supply about 5% to 10% of their volume to the domestic market but such a volume will be far too small for one of the larger supermarket operators.

[29] *'Supplementary Submission No.1 by the NARGA to the Dawson Committee review of thew Trade Practices Act'*, October 2002, p. 7

[30] *'Report to the Senate by the ACCC on prices paid to suppliers by retailers in the Australian grocery industry'*, September 2002, p. 49

Chart 5.3.1 The number of times the major retail chains (Woolworths, Coles and Franklins) received the best price compared to other wholesale buyers 1999–2000 and 2000–01.



The abuse of the market power against producers and independents has also been a concern expressed by both the Government and Opposition in WA. Minister for Agriculture, Hon. Kim Chance MLC (ALP), has publicly stated "*there's clearly not enough competition in the market*[31]" and his opposition counterpart, Hon. Paul Omodei MLA (Liberal), has echoed this view stating "*in the end the producer becomes the price taker*[32]".

That the exercise of market power by Coles and Woolworths has not always been benign is further evidenced by the recent decision of the Federal Court to impose a $4.7 million penalty upon Coles for breaches of the Trade Practices Act relating to attempts to restrict hotels and bottle shops in NSW supplying packaged takeaway liquor to customers. In a similar case, Woolworths have offered a $4.75 million settlement and payment of $250,000 towards the ACCC's legal costs.

According to Metcash[33] the 19 Action stores that Woolworths proposes to acquire "*represent 12% of the total revenue we would have achieved had we acquired 100% of FAL Australia*". For the 2004 financial year total revenue for the Australian division of FAL amounted to $2,638.8 million[34], some 12% of which would amount to approximately $317 million. Approximately $234 million in sales can be attributed to the WA portion, which suggests WA producers and manufactures could lose tens of millions of dollars in sales if Woolworths re-sourced product.

The proprietor of the Gingin Meat Works, Mr Ned Borello, whose plant supplies the domestic market, (with 80% of their business being with Action supermarkets),

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[31] *The West Australian*, 30th May 2005, p. 6
[32] Ibid.
[33] *'Metcash wins Foodland support for acquisition of FAL Australia'*, announcement to the ASX, 25th May 2005
[34] *'FAL 2004 Results Presentation'*, http://www.fal.com , pages 11 & 13

believes they will "*have to lay off 34 employees*" as Woolworths will continue to source all of its requirements for meat from an abattoir in Bunbury that it owns[35].

The Perth Pork Centre[36] believes the sale of Action stores to Woolworths will adversely affect its business and those of local farmers to whom it pays $2.60/kilo for pork compared with $2.08/kilo that Woolworths pays its pork producers.

Similarly, the Organic Growers Association have criticised Woolworths '*for not supporting the local organics industry by importing produce from the Eastern States and holding produce in freezers for too long, which affected quality and shelf-life*[37]'.

As to the welfare of employees of Action, the Shop Assistants Union[38] have advised that Action/FAL provide their employees with Journey Insurance to cover them for injury in the event of an accident occurring whilst travelling to and from work, a benefit that Woolworths does not provide to its employees.

In conclusion, the process of economic agglomeration in the retail sector has resulted in '*the demise of hundreds of small grocery stores, butchers, bakers . . . as a result of the continuous expansion of major supermarket chains . . .*'[39]. Independent proprietors are being transformed into the employees of corporate giants, and free markets are giving way to corporate command economies.

The deleterious effects of concentrated corporate power, such as that which now exists in Australia's retail sector, should never be excused as the result of the free interplay of market forces, for in a free market corporations would not exist.

It is incumbent upon the ACCC to reject Woolworths proposed acquisition of Action stores throughout Australia as inimical to the interests of consumers and the public, who will be best served by the restoration of a competitive supermarket industry.

yours faithfully

Hon. Anthony Fels MLC
Member for Agricultural Region
Shadow Spokesman for Consumer Affairs

[35] The Gingin Meat Works can be contacted on 08 9575 2166.
[36] Contact the General Manager of the Perth Pork Centre, Mr. Ron Penn, on 08 9573 1300.
[37] '*If it's organic – its local'*, The West Australian, 28th June 2005, p. 9
[38] Contact the WA State Secretary, Mr. Joe Bullock, on 08 9221 4321.
[39] *'Fair market or market failure – A review of Australia's retailing sector'*, Report by the Parliament of the Commonwealth of Australia's Joint Select Committee on the Retailing Sector, August 1999, p. vii

<u>Wednesday, 31 August 2005</u>
I rang girl at ACCC. 02 6243 1226.
She will get Tim Grimwade, Paul Palisi, Collette Downie or David Jones to call me back.
I wanted confirmation they have received my submission, and also what response, etc they have to it.