Australian
Competition &
Consumer
Commission

Assessing shopper docket petrol discounts and acquisitions in the petrol and grocery sectors.

February 2004

Executive Summary

The Australian Competition and Consumer Commission (the ACCC) has been required recently to make a number of specific decisions in relation to the petroleum and grocery industries. The ACCC has decided to allow petrol discounting schemes and related arrangements to continue. The ACCC has also decided not to oppose the acquisition of a number of independent supermarket stores by a national grocery chain. The aims of this report are to explain the ACCC's reasons for these decisions and outline the industry context in which those decisions have been made.

These decisions concern, among other things, "shopper docket" schemes tying petrol discounts with grocery purchases. The main shopper docket schemes under review relate to discounts offered by a subsidiary of Coles Myer Ltd (Coles) resulting from an alliance between Coles and The Shell Company of Australia Ltd (Shell) and by Woolworths Limited (Woolworths) and one of its subsidiaries, Australian Independent Retailers Pty Ltd (AIR).

The other related arrangement includes an acquisition of shares by Caltex Australia Ltd (Caltex) in AIR, which is the company honouring the discounts. This arrangement is referred to as the "short term arrangement".

The ACCC also considered the acquisition of a number of independent supermarkets by Coles. As at June 2003, Coles had advised the ACCC of its intention to acquire 20 independent grocery outlets.

Industry context

The petroleum industry has undergone a period of considerable change in response to the forces of supply and demand over the last three decades. A reflection of this change is the significant decline in the number of service stations by around 60 per cent since 1970. Over this time, the independent sector has developed as a competitive force in many locations.

Similarly, the Australian grocery industry has experienced a high degree of consolidation over the last several decades. The largest players in the industry are now Woolworths and Coles, the companies seeking to expand their arena of competition into petroleum retailing.

The expansion of Woolworths and Coles into petroleum retailing and the offering of petrol discounts by grocery retailers should be seen in the broader context of changes that have occurred at all levels in the petroleum industry in response to market forces. It is also an attempt by retailers to increase petrol and grocery sales through satisfying changing consumer lifestyles and particularly a growing preference for convenient, quick one-stop shopping. This has resulted in a convergence between petroleum and grocery retailing.

The experience in the United Kingdom can provide a useful indicator for the likely future development of the Australian market. Major supermarket chains have been selling petrol for over ten years, and the evidence suggests that this has produced benefits for consumers in terms of lower prices, and that it continues to do so today.

ACCC decisions

Shopper docket petrol discount schemes

The ACCC consulted widely in its examination of shopper docket petrol discount schemes. The ACCC can review these sorts of arrangements and seek to oppose them if it considers they are not in the overall public benefit. The ACCC therefore looks at the benefits that arise from the schemes in comparison to the anti-competitive detriments that might also flow from them. In looking at these benefits and detriments, the ACCC has to be careful not to attribute to the shopper docket schemes benefits and detriments that might flow from other factors.

The ACCC considers that there are significant benefits to consumers from shopper docket petrol discount schemes. In particular, the ACCC considers the proposed arrangements, along with initiatives by competitors in response, will benefit consumers in a number of ways, including:

- **Lower petrol prices for consumers:** The ACCC considers that the shopper docket petrol discounts will bring lower petrol prices for consumers, and that the involvement of such significant participants as Coles/Shell and Woolworths/Caltex would mean a greater availability of cheaper fuel because there will be more petrol sites offering the shopper docket discounts. In addition, the conduct is generating a culture of discounting, as demonstrated by the competitive response by many independents who are offering their own discounts.

- **Increased non-price competition**: The petrol and grocery sectors are already seeing some variety in the types of loyalty programs being devised in response to those proposed by Woolworths and Coles, notably Metcash/IGA's loyalty scheme. Further, some competitors to the Coles/Shell and Woolworths/Caltex arrangements are considering a number of other innovative responses to attract and retain custom.

The ACCC notes that petrol prices in Australia are determined by a combination of factors. These factors include international prices, the Australian/US dollar exchange rate, federal excise and the GST, state government subsidies, price cycles and the level of competition in local markets.

The ACCC accepts that there are a number of factors in petrol and grocery wholesaling and retailing which are contributing to changes in those industries. While the structural changes facing the petroleum industry will affect all market participants they have greater implications for the independent sector. In the past the independents have increased their market share as they were able to source supply from independent imports at competitive prices. The difficulty of importing fuel from independent sources in the Asia-Pacific region that meets the new Commonwealth fuel standards from 1 January 2004, together with the expected shortfall of petrol in the Asia-Pacific region by 2006, is likely to make imports by independents into Australia less viable.

In its investigations the ACCC considered claims that the discount schemes would reduce the number of independents operating. However, the shopper docket schemes in themselves cannot be said to be responsible for many of the effects on smaller independent businesses. Shopper docket petrol discounts are the latest innovations in industries that have been undergoing significant change for some time. The ACCC considers that the shopper docket schemes are likely to result in an overall benefit to the public. Moreover, the independent sector has responded with its own shopper docket petrol discounts and loyalty schemes. In fact, the ACCC has received more than 100 notifications of similar schemes by other petrol and grocery outlets to provide petrol discounts to consumers. All these notifications of shopper dockets are similarly allowed to continue. These arrangements are largely in response to the schemes offered by Woolworths and Coles and are positive developments, bringing further benefits to consumers.

Short term arrangement between Woolworths and Caltex

The ACCC conducted confidential market inquiries initially regarding a proposed joint venture between Woolworths and Caltex and, subsequently the short term arrangement, with a range of interested parties including fuel refiner/marketers, independent fuel wholesalers and marketers, fuel distributors and service station representative organisations, motoring organisations, retail grocery participants, consumer organisations and State and Federal governments.

On the information and evidence currently available, the ACCC does not propose to oppose the short term arrangement as the ACCC does not consider that the short term arrangement will result in a substantial lessening of competition.

The parties have advised that negotiations are continuing between Caltex and Woolworths as to final arrangements. The ACCC has not seen nor made any decision in relation to any long term arrangements. At such time as any long term arrangement is agreed between the parties, the ACCC will review that arrangement, particularly having regard to any material differences to the present short term arrangement.

Acquisition of independent grocery outlets by Coles

The ACCC recently examined a series of 20 acquisitions of independent supermarkets over 12 months by Coles. Up until October 2002, Coles had approached the ACCC in regard to the proposed acquisition of 12 independent supermarkets. Following industry speculation that this may represent the vanguard of a widespread program of acquisitions, the ACCC requested that Coles provide a list of any further proposed acquisitions. Coles subsequently advised that it intended to acquire a further eight supermarkets over the subsequent six months, bringing the total to 20 independent supermarket acquisitions in a period of around twelve months.

Following its analysis of these acquisitions, the ACCC does not consider that they are likely to result in a substantial lessening of competition. Accordingly, the ACCC does not intend to intervene. However, the ACCC will continue to closely monitor and scrutinise independent supermarket acquisitions by national grocery chains, and will enforce the Act in relation to a series of acquisitions which is likely to result in a substantial lessening of competition.

Other issues

In the course of the ACCC's investigations, a number of parties expressed concern about other types of conduct that may also raise competition or consumer protection issues, including claims of unconscionable conduct, misleading and deceptive conduct, and conduct that is claimed to constitute misuse of market power in the form of predatory pricing. The ACCC will continue to take these sorts of allegations very seriously and will continue to investigate allegations like these on a case by case basis.

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Introduction

The Australian Competition and Consumer Commission (the ACCC) has decided to allow shopper docket petrol discounting schemes and related arrangements to continue under the *Trade Practices Act 1974* (the Act). The ACCC has also decided not to oppose certain acquisitions of independent supermarkets by Coles Myer Ltd (Coles).

The aims of this report are to explain the ACCC's reasons for these decisions and outline the industry context in which they have been made. The ACCC has consulted a large range of interested parties in making its decisions. Confidential information provided to the ACCC in the course of these inquiries has not been included in this report.

The ACCC is required to make a number of specific decisions in relation to the petroleum and grocery industries. These relate to:

1. **Third line forcing notifications:** These concern "shopper docket" schemes tying petrol discounts with grocery purchases. The main schemes under review relate to discounts offered by a subsidiary of Coles resulting from an alliance between Coles and The Shell Company of Australia Ltd (Shell) and by Woolworths Limited (Woolworths) and one of its subsidiaries, Australian Independent Retailers Pty Ltd (AIR).

2. **Acquisition of shares:** This arrangement includes an acquisition of shares by Caltex Australia Ltd (Caltex) in AIR, which is the company honouring the discounts. This arrangement is referred to as the "short term arrangement".

3. **Acquisition of assets:** The acquisition of a number of independent supermarkets by Coles has also been considered by the ACCC. In 2002, Coles advised the ACCC of its intention to acquire a total of 20 independent supermarkets over a period of approximately twelve months.

In short, the ACCC has decided, for the reasons outlined in the report, not to intervene in or oppose either the shopper docket schemes or the acquisitions referred to in this report.

The report outlines the competition law tests the ACCC has applied in its decisions. The purpose of competition law and policy generally is to promote and protect competition in the interests of consumers. Competition law does not aim to preserve competitors or protect certain sectors of business from the rigours of competition.

The role of the Act and the ACCC is fundamentally to enhance the interests of Australian consumers by promoting fair, vigorous and lawful competition, whether it be between big, medium and/or small businesses. A vigorously competitive marketplace will provide businesses and consumers choice, information to make that choice, convenience and higher quality and lower prices for goods and services. Protecting certain businesses or any particular sector of the Australian community from fair, vigorous and lawful competition for whatever reason brings with it corresponding costs to the Australian public. This is not the ACCC's mandate.

Businesses that are able and motivated to take advantage of the competitive environment through innovation, improved efficiencies, keen pricing, quality service standards and other forms of vigorous competition will thrive. The shopper docket schemes that are part of the consideration of this report are a case in point. They illustrate efficient and dynamic businesses including small businesses developing timely, innovative and competitive responses to the benefit of Australian consumers. Often, small businesses have the capacity to react to the changing disciplines of competition very quickly, and often a lot more quickly than big business. If businesses are unable or unwilling to respond to the challenges of competition they may languish and ultimately fail.

It may be the case that to promote and nurture fair vigorous and lawful competition in a market, it is necessary to intervene to protect competitors or a class of competitors in that market from substantial damage or indeed elimination as a result of a course of behaviour by another competitor. However, where this is done it should be in the interests of furthering competition.

Competition will by its very nature cause difficulties for individual firms. Vigorous competition is not anti-competitive behaviour: one leads to clear public benefit; the other results in public detriment. It is essential that the primary focus remains on the interests of consumers – that is to say, the community at large – and is not diverted to protect certain sectors of business from normal competitive disciplines.

Whilst the competitive provisions of the Act are directed at promoting and protecting competition and not protecting individual firms, there are also provisions that act to protect smaller firms in their dealings with larger enterprises.[1]

In the course of the ACCC's consultations, a number of interested parties have expressed concern about conduct other than the three arrangements above, that may also raise competition or consumer protection issues, including claims of unconscionable conduct, misleading and deceptive conduct, and misuse of market power in the form of predatory pricing. Whilst this report does not specifically address these issues, the ACCC will continue to investigate allegations such as these on a case by case basis.

The Australian petroleum and grocery industries have been experiencing change for some time, with significant impact on many market participants. These industries, as with many others, are evolving in light of ongoing, long-term developments. This report reflects the ACCC's examination of the evolution of these industries, to provide some useful context in which the above decisions have been made.

The petroleum industry has undergone a period of considerable change in response to the forces of supply and demand over the last three decades. A reflection of this change is the significant decline in the number of service stations – it has declined by around 60 per cent since 1970. Over this time, the independent sector has developed as a competitive force in many locations.

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[1] ACCC *Submission to the Senate Economics Reference Committee Inquiry into the effectiveness of the Trade Practices Act 1974 in protecting small business*, 2003, p. 8

Similarly, the Australian grocery industry has experienced a high degree of consolidation over the last several decades. The largest players in the industry are now Woolworths and Coles, the companies seeking to expand their arena of competition into petroleum retailing.

The expansion of Woolworths and Coles into petroleum retailing and the offering of petrol discounts by grocery retailers should be seen in the broader context of changes that have occurred at all levels in the petroleum industry in response to market forces. It is also an attempt by retailers to increase petrol and grocery sales through satisfying changing consumer lifestyles and preferences, and adjusting to changing supply side conditions. Petroleum and grocery retailing are now in the process of converging.

The report is divided into two separate parts: the first part aims to provide some industry context to the changes taking place, in particular, in the petrol and grocery sectors. The second part focuses on the decisions the ACCC has been required to make and the reasons for those decisions.

Part I: Industry context

PETROLEUM INDUSTRY

This section of the report provides a summary of relevant background information on, and recent changes in, the petroleum industry in Australia and outlines current issues confronting the sector.

The ACCC has undertaken substantive analysis of the petroleum industry in the past and in recent years has prepared reports on various aspects of the petroleum industry.[2] These reports can be consulted to obtain more analysis on the petroleum industry.

Industry participants

Participants in the petroleum industry operate at three broad levels:

Refining and importing

There are four integrated refiners/marketers operating refineries in Australia (**BP**, **Caltex**, **Mobil** and **Shell**). BP, Caltex and Shell operate two each and Mobil operates one. The refineries are distributed across the mainland states. The total primary capacity is 792,000 barrels per day (bpd), with an average of 114,000 bpd.[3]

The refiner/marketers and some independent operators import fuel into Australia. The major independent importer has been **Trafigura**, which has imported into New South Wales and Victoria.

Wholesale and distribution

The refiner/marketers also operate at the wholesale level and have equity in distributor operations. A number of independent operators – such as **Liberty** – also operate at this level and they may source fuel either from the refiner/marketers or imports.

Retail

The petrol retailing industry is made up of three broad categories that have different market structures and operations:

- The four vertically-integrated refiner/marketers (ie, BP, Caltex, Mobil and Shell) (commonly known as the “oil majors”) which own and operate their own sites and also market through franchises;

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[2] ACCC, Inquiry into the petroleum products declaration, August 1996; Reducing fuel price variability, December 2001; and Terminal gate pricing arrangements in Australia and other fuel pricing arrangements in Western Australia, December 2002; ACCC, *Report on the Movement in Fuel Prices in the September Quarter 2000*, October 2000.

[3] Jim Hoggett, *Petroleum Refining: Rationalisation or Atrophy*? Institute of Public Affairs Backgrounder, Volume 15/1, 2003, p. 2. These figures have been adjusted to reflect the closure of the Port Stanvac refinery.

- Independent operators selling largely their own brands, which range from supermarkets (such as **Woolworths**[4]), the large independent chains (such as **7-Eleven**, **Gull**, **United** and **Matilda**) to small 1-2 site operations; and

- Independent operators that own their own sites and market branded fuel from the four refiner/marketers.

The four major oil companies are the largest players at the retail level accounting for around three quarters of sales. Of these, Caltex and Shell have a larger share than the others. Independents (including Woolworths) account for the rest of retail supply.

The ACCC's role in the petrol industry

Prior to 1 August 1998, the petroleum industry was declared under the *Prices Surveillance Act 1983* and the ACCC determined maximum wholesale prices for petrol and diesel. Since deregulation, the ACCC has had an informal monitoring role and monitors retail petrol, diesel and automotive LPG prices in metropolitan areas and around 110 country towns throughout Australia. It also monitors international crude oil and refined product prices and published terminal gate prices.

As noted earlier, the ACCC has prepared reports on various petrol pricing issues at the request of the Commonwealth. Following the 2001 *Reducing fuel price variability* report the ACCC introduced an initiative to increase consumers' understanding of petrol price cycles and how to take advantage of them. The ACCC's website provides data on petrol price cycles in the five major metropolitan cities, information on petrol issues and links to other websites.

Under its responsibility for administering the Act the ACCC has conducted investigations into allegations relating to issues such as price fixing, predatory pricing and other anti-competitive activities in the petroleum industry. There are currently two cases relating to alleged price fixing in Ballarat and Geelong before the Federal Court.

The ACCC also assesses applications for mergers as well as public interest exemptions (referred to as "authorisations" and "notifications") under the Act.

As part of its responsibilities in the implementation of the New Tax System ("NTS"), the ACCC monitored the passing on of the fuel sales grant scheme and ensured compliance under the price exploitation provisions of the Act. These responsibilities ceased with the end of the NTS transition period on 30 June 2002.

[4] While Woolworths could be considered an "independent" operator in the petroleum sector, in the sense of being independent from the oil majors, it is not an "independent" operator in the grocery sector where it operates as one of the two major supermarket chains.

Refining and wholesale

Refining

There have been some significant developments over the last decade which have shaped the refining sector, which are worth noting here.

In December 1994 Ampol and Caltex announced they intended to enter into a merger of their refining and marketing interests in Australia. The then Trade Practices Commission (TPC) had particular concerns about the competitive environment in which the proposed acquisitions were to take place under section 50 of the Act (which prohibits anti-competitive mergers). There were no significant imports of petrol into Adelaide, Melbourne, Sydney or Brisbane at that time and there was concern about the supply of petrol to independent operators.

In March 1995, the TPC decided to allow the merger to proceed subject to legally enforceable undertakings that the TPC considered enhanced the position of independents in the industry to the benefit of consumers. These undertakings offered by the companies and accepted by the TPC included the divestiture of oil terminals, distributorships, depots and retail sites in order to ensure supplies to independent retailers. These undertakings contributed to the subsequent growth of independents in all levels of the industry.

On 1 July 2003, Mobil ceased production at its Port Stanvac refinery in South Australia (which had a capacity of 78,000 bpd). When it announced the closure of Port Stanvac, Mobil commented that the Adelaide refinery was one of the smallest refineries in the Asia-Pacific region and under the current market conditions it could not compete with the much larger regional refineries that can produce petroleum products at a lower cost. However, they proposed to maintain the refinery in a condition that would allow a re-start should viable operations be sustainable in the future.[5]

Australian refineries are small compared to world scale. New refineries in the Asia-Pacific region, and particularly those engaged in export, are significantly larger. For example, Singapore's largest refinery has a capacity of 375,000 bpd, South Korea 819,000 bpd, Taiwan 524,000 bpd and Thailand, 277,000 bpd.[6]

Singapore refineries are currently operating at approximately 60 per cent of their capacity while Australian refineries are operating at around 85-88 per cent of their capacity. Australian refineries are geared towards petrol production whereas the refineries in the Asia-Pacific region are configured towards diesel production. In effect, petrol is a by-product of diesel production, resulting in an over-supply of cheap petrol in the Asia-Pacific region. Low petrol prices in the Asia-Pacific region,

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[5] Mobil media release, *Adelaide Refinery*, 8 April 2003.
[6] Hoggett, *op. cit*, p.3.

coupled with structural over capacity in the Australian refining industry, have tended to put downward pressure on petrol prices in Australia in recent years.[7]

Prior to July 2002 there were refinery exchange agreements between the four refiner/marketers in Australia, under which they guaranteed supplies of petroleum product to the other refiner/marketers in the locations where they did not have refinery capacity. These arrangements were primarily articulated in volumes, although there were apparently payments between the companies to reflect the different fuel standards among the states.

In July 2002, these arrangements were replaced by buy/sell arrangements, under which the oil companies charge each other commercial prices for fuel. This has given the refiner/marketers greater flexibility in responding to market forces. For example, a refiner/marketer may choose to import fuel into a state where it does not operate a refinery, instead of buying it from the refiner/marketers with a refinery in that state. Similarly, a refiner/marketer may export product if price differentials are attractive rather than supplying the product into the domestic market.

Imports

In 2002-03, imports were around 1,686 megalitres (which represented around 9 per cent of total sales). The major source of imports was Singapore (852 megalitres, which represented around 51 per cent of total imports). In 2002-03 Australia also exported 1,053 megalitres of petrol. The major export market was New Zealand (841 megalitres, or around 80 per cent of exports).[8]

Although local refineries have enough capacity to supply the whole Australian market, some petrol is imported.[9] The extent of imports depends on the availability of import terminals, local conditions (such as the Northern Territory which does not have a refinery) and the availability of product overseas at viable prices which meets Australian fuel standards. In some markets the larger independent wholesalers and retailers source some of their product from independent importers, increasing their bargaining power with the domestic refiner/marketers.

Wholesale/distribution

There are currently around 140 distributors in Australia.[10] This number has declined significantly over recent years – there were 7,000 distributors in 1970 and about 400 in 1996.[11] Achievement of economies in supply (such as reduced transport costs from the use of higher volume trucks and lower handling costs through more direct deliveries from storage terminals) and improved logistics (matching supply and demand) have contributed to the declining number of distributors.

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[7] Department of Industry, Tourism and Resources (DITR), *Downstream Petroleum Industry Framework 2002*, pp. 5-6.
[8] DITR, *Petrol – Frequently Asked Questions (November 2003)*, p. 10, available on the DITR website.
[9] *Ibid*, p. 10.
[10] DITR, *Downstream Petroleum Industry Framework 2002*, p. 7.
[11] ACCC, 1996 report, Volume 1, p. 16.

Retail

Liquid petroleum fuels in Australia provide more than 95 per cent of Australia's transport needs and this is not expected to change significantly in the future.[12] Australian motorists bought 18,873 megalitres of petrol in 2002-03. Unleaded petrol represented 91 per cent of total sales (at 17,174 megalitres). Australian motorists bought 1,699 megalitres of leaded petrol.[13] Industry forecasts indicate a slow growth in demand of around 1 to 2 per cent annually in volume, mainly driven by gasoline and diesel.[14]

Market structure

The petrol retailing industry is made up of the four vertically-integrated refiner/marketers (ie BP, Caltex, Mobil and Shell) that have retail operations in all states in Australia and "independents" (which includes the supermarket operations, the larger independent chains and smaller independent operators).

The refiner/marketers retail some of their fuel through their commission agent sites, which they directly own and operate, but the major proportion of their sales are through their franchise operations. In recent years BP, Mobil and Shell have adopted the strategy of multi-site operations in their franchise arrangements, partly as a response to the *Petroleum Retail Marketing Sites Act 1980* ("the Sites Act", which is discussed in more detail below), achieving additional economies of scale and scope in marketing fuel.

The independent sector comprises a variety of operators, ranging from large independent chains (Woolworths, 7-11, Gull, United and Matilda) to small 1-2 site independent petrol retailers. Some independent operators sell branded fuel of the four oil majors (often referred to as 'branded independents') and other independents sell their own brand ('non-branded independents'). Independents are supplied from local production (either refineries or distributors) and in the past some have also sourced product from overseas (eg Woolworths).

The market share of the non-branded independent sector has increased significantly over recent years. In January 1997 the market share of non-branded independents was estimated to be around 20 per cent of sales volumes.[15] This had increased to approximately 25 per cent by 2003.[16] A significant contributor to the growth in the market share of the non-branded independents was the entrance of Liberty and Woolworths into petrol retailing.

[12] Hoggett, op cit, p 6.
[13] Department of Industry, Tourism and Resources (DITR), *Petrol – Frequently Asked Questions (November 2003)*, p. 10, available on the DITR website.
[14] Hoggett, op. cit, p. 6.
[15] Caltex Australia Limited*, Submission to Senate Economics References Committee: Inquiry into Fair Prices and Better Access for All (Petroleum) Bill 1999 and multi-site franchising*, December 1999, p. 11.
[16] ACCC estimate.

Retail sites and rationalisation

There are currently around 8,000 retail sites in Australia.[17] There has been ongoing rationalisation of retail sites in Australia over the past thirty years. In 1970 there were 20,000 sites, decreasing to 12,500 sites in 1980.[18] Service station rationalisation has been a feature of most developed countries over recent decades.

While rationalisation of service stations has occurred for many reasons, changes in underlying supply and demand factors in the petroleum market have been important contributors. On the supply side lower operating costs have been achieved through the development of high volume service stations, the use of self service technology, and the availability of complementary goods and services (such as the sale of convenience goods) with petrol. Another development on the supply side has been the entrance of large independent chains into the market, and more lately supermarkets, providing greater competition.

At the same time, the demand facing service stations has changed with the different driving pattern of motorists due to the development of highways and major arterial roads to accommodate higher traffic volumes, consumers' desires for longer shopping hours and more convenient arrangements in the buying of goods and services.

A further factor has been changes in Government regulation at the Commonwealth and state level. For example, the introduction of the Sites Act in 1980 limited the number of sites that could be owned and operated directly by the refiner/marketers. This may have encouraged a move by some refiner/marketers to change their marketing strategies. For example, there has been a move by some of the refiner/marketers to sell more fuel through multi-site franchises. It may also have assisted in the expansion of independent retailers into the market because the Sites Act does not apply to them.

Although the fall in the number of service stations has slowed over the last decade, further rationalisation in service station numbers is likely as the industry continues to respond to the above forces.

There are more service station sites in the country than in metropolitan areas, but the majority of fuel is sold in the metropolitan areas. In 2000, approximately 40 per cent of retail sites were located in metropolitan areas (ie the capital cities and major centres) and approximately 60 per cent of retail sites were located in the country. In terms of volume, in 2000 approximately 70 per cent of fuel was sold in metropolitan areas and 30 per cent in the country.[19]

The ACCC understands that the refiner/marketers currently own around one third of retail sites, independent operators with refiner/marketer branding own around 40 per cent of sites and independent operators without refiner/marketer branding own just under 30 per cent of sites.

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[17] ACCC estimates.
[18] Industry Commission, *Petroleum Products*, report No.40, 5 July 1994, p. 17.
[19] ACCC, 2001 report, p. 143.

Influence of independents

In terms of influence on price competition in the market, it is important to make a distinction between the larger independent chains and the small independent operators. The independent chains tend to have a significant influence on price competition in the retail petroleum industry because they often lead the market down in the petrol price cycles that occur in the major metropolitan cities. They have some capacity to do this as they can achieve economies of large scale operation and obtain discounts from suppliers because of the large volume of fuel they buy.[20]

The small independents tend to have less impact on price competition as they are generally price followers. They operate on a smaller scale and buy fuel in small volumes and therefore do not have access to supply discounts. They also tend to operate retail sites that are not as well located as the larger independent chains or the oil majors and tend to have more limited shop facilities on site. Their volume throughput is generally lower than other market participants. As a result, they may have difficulty competing with other market participants, especially at the bottom of the price cycle when profit margins may be low or negative. These smaller independents have been the most affected by the process of retail site rationalisation.

Commonwealth regulation

Two Commonwealth Acts apply to retailing in the petroleum industry: the Sites Act, which restricts the number of sites the oil majors can own and operate; and the *Petroleum Retail Marketing Franchise Act 1980* (Franchise Act), which deals with the relationship between franchisees and franchisors by setting minimum terms and conditions for franchise agreements.

The Sites Act applies only to the oil majors — the independent chains are excluded from the scope of the Sites Act. The Franchise Act is relevant only to the oil majors, because only the oil majors operate franchising networks. As noted earlier, some of the oil companies have adopted other marketing strategies, such as multi-site franchising, in response to the Sites Act.

The determinants of petrol prices in Australia

Petrol prices in Australia are determined by a combination of factors.[21] These factors include international prices, the Australian/US dollar exchange rate, federal excise and the GST, state government subsidies, price cycles and the level of competition in local markets.

Movements in fuel prices in Australia tend to follow international benchmarks.[22] The benchmark for petrol is the spot price of Singapore Mogas 95 Unleaded. This is the price for refined petroleum product rather than the crude oil price.

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[20] *Ibid*, pp. 34-36.

[21] This section draws on material in ACCC, *Report on the movement in fuel prices in the September quarter 2000*, October 2000, pp. 27-29.

[22] This can be seen clearly in the charts showing movements in the monthly average price of Singapore Mogas 95 Unleaded and in monthly average five capital city unleaded petrol prices over the period in July 2002 to June 2003 on pages 97 and 98 of the ACCC *Annual report 2002-03.*

Australian refiners tend to follow movements in international refined product prices rather than international crude oil prices because they have to compete with refiners in the region in marketing refined petrol in Australia and Asia. Furthermore, refined petrol is an internationally traded commodity, and if prices in Australia were lower than international prices, domestic producers would have an incentive to export product overseas, which could lead to shortages in Australia. Singapore prices are used because Singapore is the closest major refining and marketing centre to Australia and is the most likely source of imported product into Australia.

Although refined international product prices generally closely correlate to world crude prices, demand and supply factors (such as increased demand for petrol in particular countries and refinery shutdowns) can cause these prices to diverge. The difference in price between Tapis crude oil (which is from Malaysia and is the most relevant crude oil price for Australia) and refined product (Singapore Mogas 95 Unleaded) is known as the refiner margin. Over the last three years the refiner margin has averaged around $US3.00 per barrel. However, in December 2003 and January 2004, as a result of short-term supply and demand issues in the Asia-Pacific region, the refiner margin was at times four to five times that difference. This changed at the end of January 2004 when the refining margin declined substantially.

Since international prices are generally expressed in US dollars, the price in Australia will also depend on the Australian dollar/US dollar exchange rate. It generally takes one to two weeks for movements in international prices to fully influence domestic prices, as a result of the averaging formula used by domestic refiners.

At the Commonwealth level, excise is levied on petrol on a cents per litre (cpl) basis. The current level of excise is 38.14 cpl for unleaded petrol. The rate of excise was previously indexed twice yearly to take account of movements in the consumer price index, but this indexation was abolished on 1 March 2001. Furthermore, like most products, petrol is subject to a 10 per cent GST.

Some state governments provide subsidies, at either the wholesale or retail level, which lower the effective price of petrol to consumers. These range from 8.35 cpl in Queensland to zero in the ACT, Western Australia and parts of New South Wales and South Australia.

Wholesale prices in Australia tend to be based on international product prices (adjusted for the Australian dollar/US dollar exchange rate), excise, state subsidies (if applicable), a margin for terminalling costs and profit, and the GST. Prices at wholesale are generally based on terminal gate prices or oil company list prices with a discount.[23] Wholesale prices will also be influenced at times by specific local factors (such as a refinery closure and the degree of competition in the local market).

Retail prices in Australia reflect wholesale prices, plus associated costs (such as branding and transport) plus a margin. Retail prices are also influenced by state subsidies (if applicable), by local price cycles and the degree of competition in the

[23] The oil company list prices are often based on the old maximum endorsed wholesale price formula of the ACCC.

local market. Petrol prices in the major metropolitan cities tend to move in cycles. The ACCC examined petrol price cycles extensively in 2001 and concluded that it is likely that consumers in aggregate benefit overall from price cycles.[24]

Current issues influencing the petroleum industry

There are a number of issues which are currently influencing the petroleum industry, leaving aside the issue of shopper dockets which is discussed in more detail in the second part of this report. These issues have been raised in a number of submissions received by the ACCC in its investigation of the shopper docket schemes and are summarised below.

Changes in supply and demand in the Asia-Pacific region

The supply of petroleum in the Australian market is likely to become more restricted over coming years, resulting in upward pressure on wholesale and retail petrol prices. This is due to changing dynamics of petrol supply and demand in Australia and the Asia-Pacific region, including the new Commonwealth fuel standards.

As noted earlier, in recent years there has been oversupply of petrol in the Asia-Pacific region and as a result there was the availability of cheap petrol for imports into Australia. The independent sector in Australia took advantage of this opportunity to import fuel. In 2001-02 imports of petrol by companies other than refiner/marketers represented 5.6 per cent of total sales.[25] With an alternative supply of fuel to that of the local refiner/marketers the independent wholesalers and retailers had some countervailing power in the purchase of their fuel from refiner/marketers.

A recent study conducted for the Asia Pacific Economic Cooperation (APEC) forum suggests that by 2006 there is likely to be a shortfall of petrol in the Asia-Pacific region. As a result, the viability of importing fuel into Australia by independent importers will be affected by both the tight supplies in the Asia-Pacific region as well as the availability of fuel at competitive prices that would meet the Australian specifications.

Furthermore, supply of petrol in Australia is likely to have been affected by the closure of Mobil's Port Stanvac refinery in South Australia (which had a capacity of 78,000 bpd) on 1 July 2003. Mobil now operates only one refinery in Australia, the Altona refinery in Victoria. However, this supply shortage may be offset by Mobil importing fuel into South Australia from overseas and there is the possibility of other refiner/marketers doing the same. Furthermore, the domestic refiners may have some capacity to increase supply from their domestic refineries.

[24] ACCC, *2001 report*, p. 44-46. From November 2002, the ACCC has provided information on petrol price cycles in the five major metropolitan cities (Sydney, Melbourne, Brisbane, Adelaide and Perth) on its website. The aim of this site is to increase consumers' understanding of petrol price cycles and how to take advantage of them. Consumers can take advantage of the information on this site to determine the best time to buy petrol.
[25] DITR, *Downstream Petroleum Industry Framework 2002*, p. 7.

New fuel standards

The Commonwealth introduced new fuel standards for Australia in 2002, which are being progressively introduced between January 2002 and January 2006. The standards include several key elements, including a restriction on the benzene content of unleaded fuel to a 1 per cent maximum by volume from 1 January 2006 and a restriction on methyl tertiary-butyl ether (MTBE, which is used for enhancing the octane rating in fuel) to a 1 per cent maximum by volume, and a restriction on olefins to 20 per cent maximum by volume from 1 January 2004.

Some states have taken an individual approach to fuel standards and introduced their own ahead of the Commonwealth. These are: Western Australia (in January 2000), Queensland (in July 2000) and South Australia (in March 2001). Each state introduced differing standards, which reduced the number of sources from which fuel was previously available.

Where state standards are more stringent than the Commonwealth standards (which is the case, for example, with MTBE standards in Western Australia) the ACCC understands the state standard will prevail.

The new Commonwealth fuel standards have implications for supply, prices and competition in the Australian petroleum industry. They require domestic refineries to make significant investment to comply with the new standards. Independent importers will also be affected as the ACCC understands that supplies of fuel that meet the new Commonwealth standards from refineries in the Asia-Pacific region that are not linked to the refiner/marketers in Australia are likely to be subject to a price premium from January 2004.

Terminal gate pricing

In broad terms, terminal gate pricing (TGP) refers to the sale of fuel from the terminal gate without additional services that may be provided such as freight, branding and marketing. However, in discussions about TGP arrangements, there is often a lack of clarity about what exactly is meant by TGP or the conditions, if any, that would be applied to its implementation.

TGP arrangements were introduced on a regulatory basis in Western Australia and Victoria in 2001 and on a voluntary basis in the other states by a number of the oil companies in 2002. A summary of these arrangements is provided in the ACCC's 2002 report.

The views of the ACCC on TGP arrangements have been publicly outlined in its recent reports on the petroleum industry. In those reports the ACCC has expressed concerns that, depending on the type of arrangements introduced, TGP can lead to less discounting in the wholesale market, particularly to the larger independent chains. As noted earlier, these independent chains are key drivers of prices and competition in the retail sector, and if their capacity to obtain discounts in the wholesale market is reduced there is likely to be less competition and higher prices in the retail market.

Summary

The independent sector (particularly the larger independent chains) has been an important source of competition in the petroleum industry over recent years. While the structural changes facing the petroleum industry will affect all market participants they have greater implications for the independent sector. In the past the independents have increased their market share as they were able to source supply from independent imports at competitive prices. As a result, they had bargaining power in negotiating fuel supplies from the refiner/marketers. This facilitated their growth and attracted new entrants into the industry at the wholesale and retail level.

The difficulty of importing fuel at competitive prices from independent sources in the Asia-Pacific region that meets the new Commonwealth fuel standards from 1 January 2004, together with the expected shortfall of petrol in the Asia-Pacific region by 2006, is likely to make imports by independents into Australia less viable. As a result, the independent wholesalers and retailers in Australia will have less sources of supply and their bargaining power in negotiating supply prices with domestic refiner/marketers may diminish. This may constrain their operations and they may be less competitive. There is considerable diversity in the independent sector of the petroleum industry. It is likely that some of the smaller independents are likely to be affected more in the new environment and may exit the industry.

GROCERY INDUSTRY

This section of the report provides a summary of relevant background information on, and recent changes in, the grocery industry in Australia and outlines current issues confronting this sector.

At its broadest level, the grocery sector comprises a range of different operational structures, including one-stop shops, top-up outlets, national convenience retail stores, and specialist operations, for example, fruit and vegetable, meat, fish and delicatessen outlets.

In addition, there are several methods of distribution undertaken by industry participants. These include the internalised wholesale distribution functions of the major chains, the distribution undertaken by major wholesalers to the independent supermarket sector, and a broad route and convenience store delivery system involving both general and specialist wholesalers of manufacturers and suppliers delivering direct to retailers.

For the most part, the ACCC's consideration of matters in the retail grocery industry has focussed on what it sees as the arena of competition comprising primarily the supermarkets. It is from these outlets that most consumers undertake their main grocery shopping, although the ACCC recognises that a number of factors have led to supermarkets encroaching into the top-up segment that is usually associated with convenience stores.

Industry participants

The participants in the Australian grocery sector are best described in the following categories:

Vertically integrated supermarket chains that operate at the wholesale and retail levels, namely **Woolworths** and **Coles**. Coles also owns **Bi-Lo**, a discount supermarket chain;

Independent wholesalers such as Metcash Trading Limited Australia (**Metcash**), Foodland Associated Limited (**FAL**) and Australian Retail Logistix Ltd (ARL). These groups typically have distribution arrangements with banner groups comprised of franchised retail outlets, for example Metcash's **IGA** Distribution that distributes to IGA stores, FAL which distributes to banner groups including **Foodland** and **Action** Supermarkets, and ARL which distributes to the 5 Star and SPAR supermarket groups; and

Independent retailers such as IGA, Foodland, Action, **Aldi Australia**[26] and the new **Franklins** chain operated by the South African supermarket retailer Pick'n'Pay. Many independents form banner groups in order to provide a strong market presence and to take advantage of benefits accruing to the more focused brand presence.

In the discussions relating to the grocery sector in this paper, the term "independents" is used to refer collectively to independent wholesalers and independent retailers unless specified otherwise.

Vertically integrated supermarket chains

Woolworths is Australia's biggest grocery distributor and trades across Australia. It operates more than 690 supermarkets, and more than 220 liquor stores trading under various brands. Woolworths is also involved in other retail activities through various discount stores, food manufacturing and processing, women's fashion retailing and retailing electronic products.

Coles has two grocery divisions: Coles and Bi-Lo. Coles operates more than 460 full service supermarkets throughout Australia, while Bi-Lo operates more than 205 stores nationally. Like Woolworths, Coles is also involved in general merchandising, liquor retailing, and women's fashion retailing.

Independent wholesalers and retailers

Following the demise of the Franklins group in late 2001, Metcash has strengthened its position as a major force in the Australian grocery sector, particularly in the east of Australia. Metcash is Australia's largest independent grocery wholesaler and distributes groceries, refrigerated goods and general merchandise to independent

[26] Aldi Australia is part of the Aldi International group, a German grocery retailer which is a major supermarket chain in Europe and one of the top ten global retailers. Aldi is currently expanding its non-European operations and commenced its Australian operations in 2000.

retailers in all states and territories in Australia, except Western Australia, where FAL is the major supplier to independents.

Metcash services around 4,500 independent retail stores, including IGA, **Foodworks**, **Australian United Retailers**, **Foodway**, and individual non-banner independent supermarkets. As well as providing groceries, Metcash provides services designed to strengthen the IGA brand and the individual businesses, such as retail system support, in-store training, marketing and support for the development of new stores. Other banner groups provide similar support to their members, often supported by their wholesaler.

FAL has wholesale grocery operations and distribution centres in Western Australia and has recently expanded to Queensland. In Western Australia, FAL provides wholesaling services to independent supermarkets in addition to operating its own Action supermarkets. FAL also operates Action supermarkets in Queensland and Northern NSW.

ARL, which commenced in 1997 and became a non-public listed company in December 2002, operates its wholesale business from Queensland, supplying to approximately 300 stores across Queensland, New South Wales, the Northern Territory, and the Australian Capital Territory.

Many independent retailers operate under banner groups that are supplied by a grocery wholesaler. Members of banner groups collectively purchase products, share common store signage, store layouts and product ranges and participate in the joint advertising and promotion of products. A banner group can offer a collective brand and/or position in the market. It is common for a fee to be levied on each banner member.

The following table provides an outline of the respective share of grocery sales for the major supermarkets on a national basis. These share figures are taken from the *Foodweek-Aztec Quarterly Retail Market Share report*, 3 March 2003 and are based on the sum of over 100 major grocery/perishables categories across the dry grocery, beverages, confectionary, household, health and beauty, dairy case, frozen and petfood departments. Sales for all "fresh" categories such as meat, produce, in-store bakery and seafood are excluded from reporting.[27]

[27] *Foodweek-Aztec Quarterly Retail Market Share Report*, 3 March 2003, p. 9.

National Retailer Value ($) Shares – Defined Grocery/Perishables

	per cent share of all defined grocery	
	Year ending 27/01/02	Year ending 26/01/03
Woolworths	39.3	42.0
Coles / Bi-Lo	34.3	35.2
Metcash	11.3	13.3 (a)
FAL (incl Action)	3.9	5.0
Franklins (new)	0.5	2.3 (b)
Franklins (old)	7.1	0.0
Other (independent)	3.6	2.2

Source: Foodweek-Aztec Quarterly Retail Market Share report cited in *Foodweek* of 3 March 2003.
(a) While Metcash is not a retailer, this figure indicates the share of the retailers it supplies, excluding Franklins.
(b) Franklins is currently supplied by Metcash. However, recent press reports have revealed that Franklin's $600 million supply agreement with Metcash will terminate at the start of 2005. See *Metcash loses biggest customer* Australian Financial Review 30 January 2004 at page 63.

Rationalisation in the grocery industry

In order to put current grocery competition issues into perspective and particularly the acquisitions the ACCC is examining, it is useful to recount the ACCC's involvement in assessing conduct in this sector, particularly in terms of dealing with rationalisation in the industry.

The late 1980s saw rationalisation in the grocery sector. In 1984-85, the then Trade Practices Commission (TPC) considered the acquisition of 9.9 per cent of the issued capital of Woolworths by Coles. It informed Coles of its opinion that if it moved to take over Woolworths such a move would be in breach of section 50 of the Act (which at the time prohibited only mergers which created or strengthened dominance), principally in respect of food. [28]

In mid-1985, as part of Coles' acquisition of the Myer group, the ACCC required Coles to divest itself of the 9.9 per cent shareholding of Woolworths it had earlier acquired. The ACCC noted that the market power of Coles Myer would be substantial by any test but did not result in a position of dominance in any market and was therefore not opposed under the dominance test which applied at that time.

Subsequently, Woolworths and Safeway merged their operations. The TPC did not seek to restrain that merger either – the strengthening of Woolworths was seen as important in the context of its future competitive abilities against the Coles Myer group.[29]

[28] See *Trade Practices Commission*, Annual report 1985-1986.
[29] Ibid.

In 1986-87, the TPC investigated the proposed acquisition by Coles Myer of John Weekes Holdings Pty Ltd, which operated the Bi-Lo grocery stores (a no-frills discount chain) in and around Adelaide. The TPC's concern stemmed from the buying power of the Coles Myer group and the ability of Coles Myer to superimpose its buying power of grocery products on the market presence of Bi-Lo. Following an examination of Coles Myer's buying practices and of its perceived strength as a purchaser of groceries, the TPC did not oppose this acquisition.

In 1987, representatives of Shoeys, a New South Wales based discount supermarket chain, sought the TPC's views on the proposed acquisition of Shoeys by Coles Myer. The TPC objected to the purchase of Shoeys stores in northern New South Wales because of the anticipated post-merger market dominance of Coles-Myer in the Newcastle area. As a result, Coles Myer agreed to sell some of the chain's 45 stores, which were bought by Davids Ltd (now Metcash).

In 1993, the provisions of the Act dealing with mergers and acquisitions were amended from prohibiting only acquisitions that resulted in the creation or strengthening of a dominant position, to prohibiting 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 1980s were able to proceed without challenge under the dominance test.

In 1994 Rank Commercial, a New Zealand company, announced a take-over bid for the Australian and New Zealand assets of FAL, the only independent grocery wholesaler operating in the state of Western Australia. Prior to the merger, the Coles supermarket chain had a 23 per cent share of the Western Australian retail grocery market, with FAL being the largest player, supplying 51 per cent of the groceries sold in that state.

A proposed agreement between Rank Commercial and Coles would have seen FAL's Australian assets pass to Coles, increasing its market share to 75 per cent. Because FAL was (and is) the only wholesaler of groceries to independent retailers in Western Australia the acquisition would have resulted in Coles supplying groceries to independent retail stores competing with its own retail outlets.

The ACCC obtained an injunction to restrain Rank Commercial from issuing its take-over documents. Rank Commercial/Coles subsequently decided not to proceed with the bid, ostensibly on commercial grounds. The Court then made final orders preventing Coles and Rank Commercial from proceeding with the bid.

There have been several developments of note in more recent years. Perhaps the most significant in terms of retail supply of grocery was the demise and sale of the old Franklins chain in 2001 which fundamentally altered the competitive dynamics of the market. The sell-down provided an opportunity for independents to expand their presence via the acquisition of old Franklins supermarkets. Metcash customers acquired 104 stores from the break-up of the old Franklins chain. In addition, FAL acquired a large network of supermarkets in Queensland and Northern New South Wales, while South African retailer Pick 'n' Pay acquired the Franklins brand and an extensive network of stores in New South Wales. Woolworths and Coles also benefited from the sale process, acquiring many of the larger Franklins outlets. Woolworths in particular benefited from the sell down, acquiring 71 stores and adding substantially to its sales base.

Another important development was the decision by independent supermarket banner group Foodworks to change its wholesale supplier from the Woolworths owned Australian Independent Wholesalers (AIW) to Metcash, which triggered the exit from the market of AIW and delivered increased market share to Metcash.

The independents' response

In the early 1990s Davids considered that if it could increase its size, by joining together all of the independent wholesalers in Australia, they could attain the necessary efficiencies and volume of purchases to compete with Woolworths, Coles and Franklins on equal footing. Thus, Davids undertook a program of acquisitions of regional and state based independent wholesalers to build itself up as a "fourth force", a unified wholesaler which could provide retail and financial support to independent retailers to help them compete with larger supermarket chains such as Woolworths and Coles.[30]

It was considered that independent retailers could survive only if they were part of a larger group that could deliver the benefits of scale and scope in terms of buying and marketing, merchandising, store design, information technology, signage etc., while retaining the advantages of an owner operator at the store level.[31]

In Davids' application for authorisation of its proposed acquisition of Queensland Independent Wholesalers ("QIW") in 1996, Davids referred to the need for the independent sector to respond to the dynamic changes in the grocery sector, in order to provide effective competition to the larger supermarket chains such as Woolworths and Coles. Davids submitted that the independent wholesalers must effectively become a fourth force or chain with the stores they supply. Davids envisaged the establishment of a strong unified wholesaler to provide retail and financial support to a coordinated, disciplined and formula driven group of independent and corporately owned retailers to combat the chains.

Davids pursued a deliberate strategy of mergers, acquisitions and rationalisation of banner groups and retail stores. The larger integrated group would have greater volume and therefore greater buying power and be better able to obtain terms and prices similar to those enjoyed by Woolworths and Coles.

In early 1998 Davids was acquired by South African grocery wholesaler Metro Cash & Carry (Metcash) and has since had considerably more success in implementing these reforms. Metcash has pursued a number of different strategies to revive its declining market share, including splitting Davids into different divisions; encouraging refurbishment of the 3,500 retail stores that buy from it; selling the majority of Davids' 130 company owned supermarkets; instituting new trading terms

[30] Australian Competition and Consumer Commission submission to the Joint Select Committee on the Retailing Sector, 1999.
[31] IBIS Business Information Pty Ltd (April 1995) *Review of the Supermarket & Grocery Store Retailing Industry and the Grocery Wholesaling Industry,* pp 32 - 33.

with suppliers; and a retail banner rationalisation program. Metcash has acted to consolidate its 29 banners into three channels (based under the IGA banner),[32] aiming to obtain better marketing economies of scale.

In 1999, following the acquisition of Davids wholesaling operations by Metcash, independent operators had an 18.9 per cent share of the supply of packaged groceries as defined by AC Nielsen.[33] By the beginning of 2003 this figure had increased to more than 22 per cent.[34] In part this has resulted from the acquisition of new customers as a result of the Franklins break-up and the closure of AIW; but market share has also been growing on a constant store basis. Indeed, Metcash's latest annual report shows that its IGA Distribution channel experienced same-store growth of 7.3 per cent in 2003.[35]

Current issues influencing the grocery sector

Expansion strategies in retailing

Overall growth in food sales in Australia is fairly limited (subject to increases in population). Accordingly retailers and wholesalers are seeking to grow through a variety of expansion strategies. For instance, Woolworths and Coles appear to be increasingly entering regional and rural markets.[36] It has been put to the ACCC, however, that there is still ample scope for them to expand in major urban centres, particularly Melbourne and Sydney.

Recent developments in the industry have been characterised by the continued expansion of Woolworths and Coles in particular, but also of Metcash and FAL. This expansion has come partly in the form of organic growth of sales by existing stores, partly via "greenfields" development of new stores, and partly through the acquisition of existing supermarkets. In the last financial year, Woolworths opened 18 new stores[37], Coles 16, Bi-Lo 26[38], and 37 new stores operating under the IGA banner were opened.[39]

Woolworths' August 2002 submission to the Dawson Review of the Act[40] states that in new locations where Woolworths wishes to establish a store, it prefers to construct a new supermarket rather than acquire an existing supermarket business. Acquisition tends to be a more costly option. In addition to the purchase cost, most acquired stores require extensive refurbishment in order to meet the Woolworths' standards.

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[32] IGA Supermarkets in the top channel, IGA Everyday in the middle channel, and IGA Express or Friendly Grocer, depending on metropolitan or suburban or country location, in the bottom channel.
[33] *Retail World's Australasian Grocery Guide 2002,* 12th Edition, p.4.
[34] Foodweek-Aztec Quarterly Retail Market Share Report appeared in *Foodweek* of 3 March 2003.
[35] Metcash, *Annual report 2003,* p.4.
[36] Traditionally, smaller regional and rural markets were not considered promising primarily due to the smaller size of these communities relative to the metropolitan areas. In *Davids Limited* (1995) ATPR (Com) 50-185 it was considered that the coverage of Woolworths and Coles in non-metropolitan areas was limited.
[37] Woolworths, *Annual report 2003.*
[38] Coles Myer, *Annual report 2003*. Note: refers to both Coles and Bi-Lo.
[39] Metcash, *Annual report 2003*.
[40] *Review of the Competition Provisions of the Trade Practices Act,* January 2003.

One major chain has reported to the ACCC that around 5 per cent of its new stores come from acquisitions, with the balance from "greenfield" developments.

While the construction of a new supermarket outlet is likely to affect the market share of any incumbents, whether an independent or national chain, the overall competitive effect is difficult to determine. Further, the construction of a new outlet would not fall for consideration under the relevant section of the Act which prohibits anti-competitive mergers or acquisitions (section 50).

Although organic growth (comprising "greenfields" development and increased sales of existing outlets) is a major source of growth for Woolworths and Coles, as noted above growth by acquisition has also been a strategy that has been pursued. It is in respect of this activity that the ACCC's merger assessment processes become relevant.

The ACCC has, on previous occasions, examined from a competition perspective the acquisition of independent grocery stores by the major chains and the impact on competition at the retail level and in the upstream markets for acquisitions of groceries and related products. The national retail grocery chains have generally undertaken acquisitions of independent supermarkets in locations where they were not represented, and therefore have been unlikely to raise competition concerns at the local retail level. The ACCC is increasingly focussing on the possible effect of such acquisitions on the wholesale level and on producers and manufacturers, where competition issues can also arise as a result of acquisition of independents by Woolworths and Coles.

This process of acquisitions by the majors of independent operators is often referred to as a process of "creeping acquisitions". While this process is not limited to supermarkets, for example participants in the taxi, diagnostic health services and optical dispensary industries have all referred to this in discussions with the ACCC, it is in retail grocery (including liquor acquisitions) that this issue is most commonly raised.

It has been put to the ACCC that, as it would be most unlikely for a single acquisition of a retail store, absent local market issues, to lead to a measurable change in concentration such as to attract the attention of section 50 of the Act, the series of acquisitions will eventually lead to a substantial lessening of competition without the ACCC ever being in a position to challenge any single acquisition. That is, over time the aggregation of market share associated with the series of individual acquisitions could never be effectively addressed by the ACCC while it is limited to assessing each acquisition in isolation.

The detriment inflicted on an independent grocery wholesaler from the acquisition of independent supermarkets by the national retail grocery chains arises from the loss of sales volume. This loss of sales volume undermines economies of scale which then results in higher costs at the wholesale level.

In the event that an independent wholesaler absorbs the cost increases arising from acquisitions by the national chains, it may be reflected in non-price factors such as retail support and customer service for independent supermarkets in the short-term, thereby affecting the competitiveness of independent supermarkets. In the longer run, the independent wholesaler along with its retail customers, may become unviable, exit or diminish to the supply of groceries through a fringe segment of stores supplying isolated consumers unable to access competitive prices.

Higher costs at the wholesale level will most likely be passed on to independent retailers creating upward pressure on prices paid by consumers. Higher retail prices charged by independent retailers may in turn evoke a response from consumers, some of whom could substitute the service package of the national grocery chains for that of independent supermarkets. Loss of volume for independent wholesalers may trigger a vicious cycle leading to the serious erosion of competitiveness for the independent grocery sector.

There are several mechanisms through which creeping acquisitions may have a detrimental impact on the operations of independent wholesalers:

- Due to a reduced customer base, an independent wholesaler will have fewer customers over which to spread the cost of its overheads for items such as warehouse, transport and administration.

- There may be a negative impact upon the terms of trade received by independent wholesalers, referred to as on-invoice costs. Suppliers achieve cost savings by delivering their products in whole truckloads or some other minimum order quantity. In order to encourage wholesalers to order quantities which are convenient to deliver, it is common practice for suppliers to offer quantity buy allowances or volume discounts.

- This problem can be overcome and the independent wholesaler retain the quantity buy allowance by ordering the same amounts less frequently. However, this cannot be achieved without incurring an additional cost burden in the form of higher average warehouse costs per sale.

- An important source of funds for independent wholesalers is discretionary monies, which are known as off-invoice benefits, consisting of such things as supplier rebates for achieving a certain pre-determined sales volume, sales growth, or promotional success targets. Any reduction in sales of a supplier's product is likely to have adverse consequences for off-invoice benefits.

Anecdotal evidence and discussions with market participants indicates that, due to increased discipline in the banner groups, benefits of rebates, price support from manufacturers and special support campaigns are now flowing through to the end consumer. This is likely to lead to the increasing competitiveness of the independent sector in relation to the major chains. It is arguable that a loss of volume can lead to a loss of a substantial part of these support payments, with a negative impact on the ability of the independent sector to maintain its competitiveness.

Another issue of importance is the impact increased concentration of buying power upstream can have on both suppliers and independent wholesalers. A number of suppliers to the national chains argue that there is an increasing risk of oligopsony power and the associated anti-competitive effects that may arise from a concentration of buyers. These could include pricing below the competitive level and the exit of market participants that would otherwise be viable in a competitive market.

If a number of the independent supermarkets supplied by an independent wholesaler were acquired by the national chains, this loss of volume could damage the ability of that wholesaler to negotiate favourable prices with manufacturers and producers and ultimately the price which supermarkets can offer consumers.

A reduction in the competitiveness of an independent wholesaler would also be likely to have the flow on effect of weakening the bargaining power of upstream suppliers against the national chains, since suppliers would no longer benefit from the competitive tension imposed by the presence of a strong alternative buyer. This would also diminish the options available to suppliers in the event that the national chains became unwilling to offer the prices, access and conditions that suppliers could expect in a competitive market.

While the ACCC recognises the challenges that "creeping acquisitions" present, it also notes that the industry remains a dynamic, competitive one that is responding to an ever more demanding consumer. The industry remains innovative and competitive, with new entry in the form of players such as Aldi and Pick 'n' Pay, which in the Commission's view are helping to maintain competitive tension in the markets in which they operate. In addition, there appears to be continued growth in the independent wholesaling sector, with Metcash's latest annual report showing that its IGA Distribution channel experienced same-store growth of 7.3% in 2003[41].

That is not to say that the ACCC is not conscious of the potential competition problems that continued acquisitions may result in and it will continue to assess acquisitions in the grocery industry in the context of the state of the market at that particular time. In order to promote and protect competition in the interests of consumers, the ACCC will enforce the Act in relation to a series of acquisitions which is likely to result in a substantial lessening of competition.

Another strategic development by Woolworths and Coles is their development of smaller, more focused, retail stores in urban areas. On top of this, they are developing a variety of other new formats in their drive to respond to consumer demand and increase market share by broadening their offer to customers. The following are some illustrations of the changing nature of supermarket retailing:

Generics

In Australia and overseas, there has been a growing prominence of generic products. All retailers now require private label products as part of their product range. Private labels include the generic or no frills label, the house label which is branded with the retailer's store name and the private label which is exclusive to particular retailers. Franklins was the first retailer to introduce a generic range (No Frills) with Amalgamated Australian Wholesalers Pty Ltd (a national purchasing body for independent wholesalers) introducing its Black and Gold generic brand in response. The rise of generic products, has facilitated strong price competition in the industry and encouraged the entrance of new players, such as the discounter Aldi.

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[41] Metcash, *Annual Report 2003,* p.4

Changes in trading hours

While small supermarkets formerly enjoyed a competitive advantage over national chains due to state legislation which allowed them to operate at times when the larger supermarket chains were not permitted to open, recent changes to the regulation of trading hours in most states and territories has led to many supermarkets, particularly those operated by Coles and Woolworths, being open until midnight and some stores opening 24 hours a day. The loss of the comparative advantage arising from the more flexible trading hours has been a significant influence on the independent sector. It has also driven independent wholesalers and their retail clients to adapt and innovate in order to match the national chains' offering.

Changes in formats and product range

In November 1997, Woolworths launched the Woolworths Metro, a smaller store format that specialises in pre-prepared foods for 'time poor' customers. These stores aim to deliver a wide range of products in a trading area smaller than the average supermarket. In response, Coles launched the Coles Express with a similar format.

Coles has recently increased its range of grocery products and services through the development of new formats: including ready-to-eat meals, dedicated health and Asian food areas in selected stores, key cutting, photo labs, dry cleaning and photocopying.

Both Woolworths and Coles have introduced fresh flowers to their supermarkets under the 'Clover Hill' and 'Floral Sense' brands respectively. The ACCC understands that Woolworths and Coles are now the largest retailers of fresh flowers in Australia.

Woolworths has launched its Ezy Banking service in conjunction with the Commonwealth Bank of Australia, and offers banking services in conjunction with its retail operations. Coles has recently launched its Source Mastercard offering reward points following the relaunch of the FlyBuys loyalty program.

Technological advancements

The grocery industry has benefited from advances in technology such as state of the art distribution networks, electronic banking facilities, scanning facilities, data warehousing and electronic commerce, and internet retailing.

Information technology permits the integration of the whole supply chain often resulting in a cheaper, higher quality product to market. Scanning provides the retailer full knowledge of the rate of sale of each product in each store, and facilitates daily replenishment. Increasing the speed of response to consumer demand benefits the retailer through lower inventories and the consumer through fresher produce. The retailer is now able to influence the specification and production of merchandise.[42]

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[42] Bell R, Davies R and Howard E, "The Changing Structure of Food Retailing in Europe; the Implications for Strategy", Long range Planning V 30 No 6 December 1997, p.855 cited in ACCC submission to the Joint Select Committee on the Retailing Sector, 1999.

Australian companies are now adopting efficient consumer response technologies. These technologies involve data warehousing and electronic commerce to enhance the efficiency of the supply chain generally, and inventory practices specifically. Data management can allow the chains and independents to better stock control and supply consumers at a lower cost. For instance, the technology allows them to target particular products to particular stores and geographic areas.

Examples of the grocery industry embracing technological improvements include Metcash's liquor distribution arm recently introducing Voicepick technology to its warehouse, reducing the error rate in stock order filling. It is also currently building a platform to accept customer orders directly.[43] In 2003 Woolworths, through technological and managerial improvements, was able to reduce its inventory levels to under 30 days for the first time.[44]

Another technological development that may affect the structural changes that are occurring in the retailing sector is internet shopping, which is now offered by both Coles and Woolworths in certain areas. While internet shopping may simply be an extension of the home delivery concept (which Woolworths, Coles and independents already offer), it is too early to say whether it will herald a major shift in consumers' shopping patterns.

Other changes to the industry

A major development in the evolution of supermarket retailing is the convergence of petrol and grocery retailing, and the marketing practices (like shopper dockets) which facilitate this convergence. This issue is discussed in more detail below, and in terms of the decisions discussed in Part 2 of this report.

As supermarkets expand their lines of products and services, from offering flowers, newsagency and pharmaceutical lines to photo processing and dry-cleaning services, "one-stop" shopping appears to be favoured by an increasing number of consumers. The ACCC notes that this trend is not isolated to Australia, but can be seen in all developed economies as time-constrained consumers increasingly demand that supermarkets rework their offer to satisfy demand.

In addition, demographic, transportation and income changes have resulted in consumers favouring one-stop shopping.[45] Until recently, the responses from market participants to these changes were most apparent in the activities of Woolworths and Coles. However, independent operators are increasingly formulating their own responses to respond to such changes in demand.

The fact that supermarkets are grouping a larger range of products can benefit consumers beyond availing them of one-stop shopping. For instance, with increased sales comes the opportunity to spread overheads further, potentially enabling lower prices. As supermarkets move into areas which traditionally have been the domain of specialty shops, there is the potential for margins to be squeezed as Woolworths, Coles and independents compete against each other in these specialty areas, leading to

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[43] Metcash, *Annual report 2003,* p.6.
[44] Woolworths, *Annual report 2003*, p.11.
[45] OECD Roundtable on Buying Power, background paper by the Secretariat, October 1998, p. 3.

lower prices for consumers than the specialty stores charge. However, the extent to which any cost savings achieved are actually passed through to consumers depends on the competitive pressure in the relevant markets.

On the other hand, one-stop shopping and the expansion of chain formats may have economic implications for independent and specialty stores. Modern supermarkets' formats are designed to give consumers what they want in terms of store presentation, product range etc. The development and implementation of new store formats is a capital intensive activity. Independent retailers have often, in the past, been unable to implement these new formats, due largely to the difficulties they had in accessing capital. However, the wholesale sector is able to provide both capital and logistical assistance to independent retailers to upgrade their supermarkets enabling them to compete more effectively with the wider range of goods available from the major national chains. Last year there were 91 major refurbishments of IGA stores.[46]

Related developments in retailing

The ongoing expansion of both the national grocery retail chains in liquor retailing is another area which is attracting community attention and being monitored by the ACCC. Some independent liquor outlets argue they find it difficult to compete against the increasing number of national grocery owned chain outlets. The "warehouse" style liquor stores being introduced in many areas, by Woolworths, Coles and some independents, also have the potential to affect the nature of competition in these markets through the introduction of lower prices on a wide range of products.

The increased presence of the national grocery chains has the potential to impact on the upstream supply of liquor products by placing greater pressure on their pricing behaviour. However, market inquiries in relation to the recent acquisition of independent liquor outlets revealed no concern from suppliers about their ability to sell beer, wine and spirits. Further, some wine producers endorsed the proposed acquisition, saying that the acquisition may increase their opportunity to negotiate increased shelf space with a new operator and the removal of any strong private label brands.

Recent press reports and industry intelligence indicate the possible move into pharmacy by Woolworths. This will also directly affect the retail landscape. Pharmacy ownership and operation remains highly regulated to such an extent that the involvement in the major retail chains has been largely precluded. By opening pharmacy outlets within or adjacent to current grocery outlets the national grocery chains have the ability to provide an almost complete "one-stop-shop" for all primary/daily retail purchases.

The ACCC understands that given the current regulatory arrangements under which pharmacies operate, any move by a major chain into the retail pharmacy sector would be limited in terms of ownership and operation. Each State and Territory requires pharmacists to hold appropriate qualifications and be registered. State and Territory

[46] Metcash, *Annual report 2003*, p. 2.

legislation also prohibits people other than registered pharmacists from handling or selling certain pharmaceuticals in a retail environment. Other related restrictions:

- limits on the number of pharmacies that an individual may own (between two and four, depending on the jurisdiction);
- permitted ownership structures (for example, the requirement for all shareholders and directors of bodies corporate to be registered pharmacists); and
- provisions that prevent non-pharmacists from having direct or indirect pecuniary interests in a pharmacy (for example, holding shares in a pharmacy business or profiting from the transactions of that business).

State and Territory pharmacist legislation is closely interlinked with the regulation of drugs, poisons and controlled substances, and with Commonwealth legislation underpinning the Pharmaceutical Benefits Scheme (PBS). Pharmaceutical benefits are mainly supplied by approved pharmacists. Other suppliers include approved doctors (usually practising in isolated areas), Friendly Society pharmacies, and approved hospitals. All suppliers are issued with approval numbers by the Health Insurance Commission. A pharmacist approved to supply medicines under the PBS:

- can only supply benefits from the pharmacy that he/she is operating;
- will not supply to anyone any pharmaceutical benefit that attracts a Commonwealth contribution for free, or for a price that is less than the relevant patient contribution;
- will clearly advertise that any offer for free or cut-price medicines does not include pharmaceutical benefits which have a Commonwealth contribution;
- will not pay rebates or refunds of patient contributions;
- will publicly display a notice setting out the pharmacy's normal trading hours;
- is obliged to supply pharmaceutical benefits at the pharmacy at any hour if a prescription is marked 'urgent' and initialled by the prescriber;
- will keep adequate stocks for the supply of pharmaceutical benefits;
- may be called on by HIC to provide details of stocks of pharmaceutical benefits or preparations for pharmaceutical benefits; and
- must keep the duplicates of all old format pharmaceutical benefit prescriptions, and the patient/pharmacist copies of all new format pharmaceutical benefit prescriptions, with a Commonwealth contribution for at least one year from the date of supply.

As at 30 June 2002, the number of approved pharmacies in Australia was over 4,900.[47]

In short, the regulatory regime does not allow for ownership by entities such as Woolworths or Coles, preventing them from operating stand alone pharmacies across their networks. Any model that incorporated pharmacies into supermarkets would by law need to be one of co-location, with the independent pharmacist still operating and dispensing. This would, in effect, make little difference to consumers compared to

[47] Pharmacy Guild of Australia website, www.guild.org.au, under Frequently Asked Questions.

the situation where a pharmacy is located next, or in close proximity, to a supermarket.

The benefits of co-location, it is argued, would accrue from savings that are likely to arise in, for example, distribution and logistics, IT systems, and leasing costs of plant and equipment and store rental.

Summary

The grocery industry consists of a range of operational (retail) structures, with differing categories of participants. The largest participants are the national grocery chains, Coles and Woolworths, who operate at both the wholesale and retail level. The independent sector provides a competitive influence at both levels of the supply chain through individual wholesalers and retailers and the emergence of retail banner groups.

Recently, the industry has witnessed the expansion of both the national grocery chains and the independent sector, through increased sales in existing stores, "greenfield" developments and acquisitions. Concern has been raised that the expansion of the national chains through the acquisition of independent retailers will result in an anti-competitive industry structure. The acquisition of independent retailers will continue to be monitored by the ACCC, however, it should be noted it is only one factor influencing the structure of the grocery sector. Other factors include the development of generic products, changes to trading hours, new shop formats and product ranges, and technological advancements.

CONVERGENCE OF PETROL AND GROCERY RETAILING

The sale of petroleum and grocery products is again converging.[48] Early in the twentieth century, petrol was sold outside grocery or convenience stores. As consumer demand for petrol grew, petrol was also sold by a wider range of outlets, including ironmongers and hotels. The sale of petrol gradually became confined to outlets that specialised in repair of vehicles.

Initially, a number of different brands of petrol were sold from one site. However, in the 1950s 'solus' trading, or the sale of one brand per site, was introduced. This development saw a rapid proliferation of service station sites in the 1950s and 1960s.

Competition amongst service stations at this time was largely on the basis of service provided to customers. In addition to the sale of petrol, service stations provided motor vehicle repair and maintenance services, as well as the sale of a range of motor vehicle related products and accessories.

The move away from servicing and repairs at service stations came as a result of improvements in car technology. Motor vehicles today need fewer oil changes, are

[48] This section draws on the discussion of this issue in the Industry Commission 1994 report, pp. 16-18.

more reliable and require less frequent servicing. Moreover, vehicle servicing became increasingly provided by specialist providers.

Today, convenience store sales at service stations have tended to replace motor vehicle servicing as the source of secondary income at service station sites. Indeed, depending on site location, convenience store sales may constitute the majority of site profits. In general, petrol retailing has become increasingly competitive in recent decades, especially in the major metropolitan centres. As petrol sales yield low margins the service station owners require alternative revenue streams, such as convenience store sales, to ensure the viability of their sites.

The rise of convenience retailing as a component of petrol retailing has developed in tandem with changes in consumer preferences and lifestyle. Consumers today are time poor, and increasingly value convenience in their petrol purchases.

As sales of food and grocery items have become more important to most service station sites, the petrol-grocery link has come full circle. Convenience stores on petrol forecourts have increased in size and there are more petrol pumps located in or near supermarket car parks to allow consumers to take advantage of petrol discounts offered by supermarkets. Service stations are increasingly located within easy reach of consumers on major arterial roads and highways. The range of services at petrol stations is also increasing, with consumers being able to 'top-up' their weekly grocery shopping at service station convenience stores, purchase quick meals and wash their cars at some sites.

The first Australian supermarket to enter petrol retailing was Woolworths, which commenced operations in 1996. Prior to its recently announced alliance with Caltex, Woolworths had been able to rapidly expand its operations to some 290 sites that it operated on a stand alone basis. In the space of around eight years, Woolworths managed to obtain around 10 per cent of petrol retailing in terms of volume. Its rapid growth has been facilitated by the availability of imports by independent wholesalers, development of new sites and the purchase of sites from Liberty Oil.

Woolworths combined the opening of its first petrol site with a special discount offer whereby consumers would save on the purchase of Woolworths' fuel by producing a Woolworths grocery receipt showing they had spent a specified amount of money at a Woolworths supermarket. This concept is known as a "shopper docket". Such conduct may require an exemption under the Act

Woolworths' offer of shopper docket petrol discounts has prompted more widespread discounting and loyalty programmes, such as an arrangement promoted by Metcash under which IGA stores will offer discounts on groceries if any petrol purchase receipt is provided in conjunction with a purchase of groceries of more than $30. Foodland has also been trialling a shopper docket scheme in some areas.

In addition, the ACCC has been notified of over 100 similar schemes being offered by other petrol and grocery outlets to provide petrol discounts to consumers.

The ACCC sees such shopper docket discounts as the latest innovation in an industry that is undergoing significant change. Indeed, the low margin, high volume nature of petrol retailing in many locations necessitates such competitive innovations.

It should be noted that shopper dockets are not a unique Australian phenomenon. The entrance of supermarkets into petrol retailing in Australia follows similar developments in the petrol market in the United Kingdom (UK). Supermarkets have moved aggressively into petrol retailing in the last 10 or so years in the UK. Most of the supermarkets now operate petrol retailing sites at their larger supermarket sites.

In the UK, some grocery retailers link their petrol prices with the purchase of groceries. J Sainsbury plc, Safeway plc and WM Morrisons Supermarkets plc all offer tied discounts.[49] Safeway, Sainsbury's and Tesco reduce the price of petrol to reward grocery purchases above certain size thresholds. Safeway, for example, offers up to 20 pence (47 Australian cents) per litre discount, but this is on a purchase of UK £150 (almost Australian $350).

Morrisons, on the other hand, offers customers holding loyalty cards an incentive to buy its own petrol: after buying a minimum number of litres of petrol, a customer receives a voucher that may be redeemed against purchases in Morrisons' stores. Asda, another retailer, has recently discontinued a petrol loyalty card scheme. Tesco does not offer ongoing petrol or grocery discounts, but rather offers discounts from time to time. Its current discounting scheme involves a UK 5 pence (almost Australian 12 cents) per litre discount for in-store grocery spending of UK£50 or more.

Petrol and grocery retailers in the UK have also entered into arrangements on smaller petrol sites relating to the branding of forecourt convenience stores. This has seen arrangements whereby supermarket branded convenience stores have been positioned on petrol forecourt sites of major oil companies. The major linkages of this nature are between Esso and Tesco, BP and Safeway, and Shell and Sainsbury. This is a relatively new concept and there are a limited number of sites – there are 50 BP/Safeway sites in the UK compared with 1,200 BP sites. However, these arrangements do not involve cross promotions between petrol and grocery sales.

The Office of Fair Trading in the UK (OFT) reported in 1998 that "...price competition between the supermarkets and oil majors has contributed to petrol prices falling in real terms (minus tax and duty) by about a third since 1990, for ordinary unleaded petrol from 15.3 pence per litre in February 1990 to 10p per litre in February 1998 and for leaded petrol from 15.2p per litre to 10.2p per litre over the same period".[50] The OFT report also notes the reduction in the number of retail outlets selling petrol in the UK, which has fallen from 40,000 sites in 1964 to less than 15,000 in 1998 and around 11,500 today.[51]

The presence of supermarkets in petrol retailing in the UK has produced ongoing competition in the industry, due in part to competitive pressures exerted by the expansion of the supermarkets' in petrol retailing. The report conducted by the OFT in 1998 into competition in the supply of petrol in the UK, states that "…many independent retailers have left the market in the face of strong competition between

[49] Safeway has recently been allowed to bid for Morrisons by the UK Competition Commission.

[50] *Competition in the supply of petrol in the UK*, A report by the Office of Fair Trading, May 1998, p. 6.

[51] Ibid, p. 31; Discussions between staff of the ACCC and the UK Office of Fair Trading, 18 November 2003.

supermarkets and the oil majors and many others have required support from their suppliers to keep going".[52]

The report also noted that the OFT asked industry participants how the role of independent petrol retailers would develop over the next five years, and those that responded "…all agreed that the [independent] sector had slimmed down considerably in the face of supermarket expansion…"[53] The OFT report concluded that, amongst other things, "…there appears to be a sufficient number of strong players in the market at all levels to ensure that competition will continue to benefit consumers."[54]

CONCLUDING REMARKS ON INDUSTRY CONTEXT

Considerable changes in demand and supply in the petrol and grocery sectors have resulted in significant industry rationalisation and this can be expected to continue. In response to these changes, service stations are getting larger and are increasingly located within easy reach of consumers on major arterial roads and highways. In addition to being able to 'top-up' their weekly grocery shopping at service station convenience stores, consumers are also able to purchase quick meals and wash their cars at some sites. On the grocery side, the response of the sector to consumer demand for convenient and quick one-stop shopping has seen changes to formats, product range, trading hours and technology.

The ACCC views the expansion of the large supermarket chains into petroleum retailing and the offering of shopper docket petrol discounts in the broader context of these long term industry developments.

The ACCC considers the independent sector in the petrol and grocery industries face quite different challenges but, as they have already demonstrated, the independents have the capacity to adapt and innovate to meet those challenges and remain a competitive force in those industries. An important consideration for the ACCC is that the independent sector is but one part of the competitive landscape in those industries. The ACCC considers that competition in these industries continues to drive benefits to consumers including increased convenience and lower prices.

The experience in the UK can provide a useful indicator for the likely future development of the Australian market. Major supermarket chains have been selling petrol for over ten years, and the evidence suggests that this has produced benefits for consumers in terms of lower prices, and that it continues to do so today.

The ACCC is aware of concerns relating to increasing market concentration of major players and the potential misuse of market power, particularly in the grocery sector. However, as recognised in the ACCC's Merger Guidelines, a concentrated market is an indicator but not the sole determinant of market power. The ACCC will, as always, pay close regard to any aggregation or exercise of market power that could substantially lessen competition or otherwise fall foul of the Act.

[52] Ibid, p. 7.
[53] Ibid, p. 81.
[54] Ibid, p. 106.

The ACCC is also aware that a number of parties have expressed concern about other types of conduct that may also raise other competition or consumer protection issues, including claims of unconscionable conduct and conduct that is misleading and deceptive.

The ACCC will continue to investigate allegations like these on a case by case basis. Moreover, if the ACCC becomes aware of evidence that competition in the industry is likely to be substantially lessened, or benefits to consumers as a result of these arrangements are no longer continuing to arise, the ACCC has a number of options available.

In relation to mergers or acquisitions that substantially lessen competition under section 50, the ACCC has the power to seek injunctions, pecuniary penalties and divestiture. The ACCC can seek remedies such as pecuniary penalties for conduct that contravenes the misuse of market power provision contained in section 46 of the Act.[55]

Whilst the restrictive trade practices provisions of the Act are largely directed at promoting and protecting competition and not protecting individual firms, there are also provisions that act to protect smaller firms in their dealings with larger enterprises. These provisions under Part IVA of the Act provide a framework for fair trading relationships by prohibiting traders from engaging in unconscionable conduct in their dealings with others in a lesser bargaining position.

Finally, if the ACCC becomes satisfied that shopper dockets are no longer resulting in benefits to the public, it can review its decision not to oppose them.

[55] Section 46 prohibits a corporation that has a substantial degree of market power in a market from taking advantage of that power for the purpose of: eliminating or substantially damaging a competitor; preventing the entry of a person into that or any other market, or deterring or preventing a person from engaging in competitive conduct in that or any other market.

Part II: Decisions

The first part of this report has examined the evolution of the petroleum and grocery sectors and drawn out some of the topical industry issues they are currently facing. The ACCC has made several decisions that relate to these sectors, and which are to be seen in light of the changing nature of petrol and grocery retailing. This second part of the report outlines the decisions the ACCC has been required to make, the statutory tests it has applied, a summary of views put to it by interested parties, and the reasons for the decisions. The decisions relate particularly to:

1. **Third line forcing notifications:** These concern schemes tying petrol discounts with grocery purchases. The main schemes under review relate to discounts offered by a subsidiary of Coles Myer Ltd (Coles) resulting from an alliance between Coles and The Shell Company of Australia Ltd (Shell) and Woolworths Limited (Woolworths) and one of its subsidiaries, Australian Independent Retailers Pty Ltd (AIR);

2. **Acquisition of shares:** This arrangement includes an acquisition of shares by Caltex Australia Ltd (Caltex) in AIR, which is the company honouring the discounts. This arrangement is referred to as the "short term arrangement"; and

3. **Acquisition of assets:** In 2002, Coles advised the ACCC of its intention to acquire a total to 20 independent supermarkets over a period of approximately twelve months.

Under the Act, the ACCC is required to apply certain tests in order to assess conduct which may be at risk of breaching certain provisions in the Act. There are separate tests under the Act which must be applied in relation to mergers and acquisitions, and to third line forcing conduct.

The test to be applied in respect of assessing third line forcing notifications under section 93 of the Act is quite different to the test for assessing mergers and acquisitions (ie, acquisitions of shares) that is prescribed under section 50 of the Act. When assessing third line forcing notifications, such as the shopper docket schemes, for the ACCC to object, the ACCC must be satisfied that the likely benefits to the public will not outweigh the likely detriments (particularly the anti-competitive detriment) to the public.

In assessing both the acquisition of shares in AIR by Caltex in relation to the short term arrangement and the acquisition of 20 independent supermarkets by Coles, the key factor here (under section 50 of the Act, which is the relevant provision for acquisitions) is whether the acquisition (or merger) will, or be likely to, result in a substantial lessening of competition in any relevant market. If not, the ACCC may not intervene.

The application of these tests is discussed below.

Third line forcing notification test

Third line forcing conduct in essence can be described as the supply by one party of a discount or other offering in relation to goods or services on condition that the purchaser has acquired goods or services from a third party. Third line forcing conduct is prohibited under s. 47 of the Act. However, immunity for legal action against third line forcing can be obtained by notifying the ACCC under section 93 of the Act. Immunity from legal action for third line forcing conduct automatically comes into force 14 days after the notification is lodged with the ACCC.

However, if the ACCC is satisfied that the likely benefit to the public from the conduct or proposed conduct will not outweigh the likely detriment to the public from the conduct or proposed conduct, the ACCC may commence a process to revoke that immunity.

If the ACCC considers that the detriments flowing from the conduct do not outweigh the benefits the ACCC will allow the notification to stand and will not proceed to revoke the immunity.

The test the ACCC is required to apply in assessing notifications of this sort is a ‘net public benefit’ test. In assessing the net public benefit the ACCC’s approach has been developed over many years having regard to decisions of the Trade Practices Tribunal (and its successor, the Australian Competition Tribunal).

The ACCC and Tribunal have given a wide ambit to the public benefit concept, describing it as “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.”[56] The ACCC examines and assesses the weight it should attach to a wide variety of public benefits claimed to flow from the conduct, and weighs that assessment against the detriments, particularly those generated by any lessening of competition claimed to flow from the conduct.

There is no exhaustive list of what the ACCC can or cannot have regard to in assessing the net public benefit. It will however give greater weight to benefits and detriments that are supported by evidence rather than mere assertions. There must also be a nexus between the public benefits or detriments claimed and the notified conduct, for the ACCC to take those benefits or detriments into account.

An assessment of a notification is a very public process, with notifications and interested party submissions placed on a public register kept by the ACCC. There is however provision for the ACCC to grant confidentiality to commercially sensitive information.

The ACCC conducts its assessment of public benefits and detriments having regard to the particular relevant markets in which the effects of the conduct occur. Identifying the relevant markets means identifying the relevant areas of competition in which the effects of the conduct is to be assessed.

[56] *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (1976) 25 FLR 169.

Mergers and acquisition test

The role of section 50 is to contribute to the maintenance of competitive markets in Australia. Mergers perform an important role in the efficient functioning of the economy. They allow firms to achieve efficiencies such as economies of scale, synergies and risk spreading. They also encourage an active 'market for corporate control' in which under-performing firms and managers are replaced by better ones. However, in some cases mergers may also have anti-competitive effects by altering the structure of markets and hence the incentives for firms to behave competitively. The primary reason for this concern is that they increase the likelihood that the merged firm could set prices above the competitive level, or otherwise distort competitive outcomes, either alone or in coordination with firms in the same market.

A breach of section 50 occurs where a merger would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market for goods or services in Australia, in a state or territory. This test explicitly recognises the link between market structure and market power, and the need to respond to potential threats arising from the exercise of unilateral and/or coordinated market power.

To determine whether a particular acquisition breaches section 50 of the Act, the ACCC needs to determine:

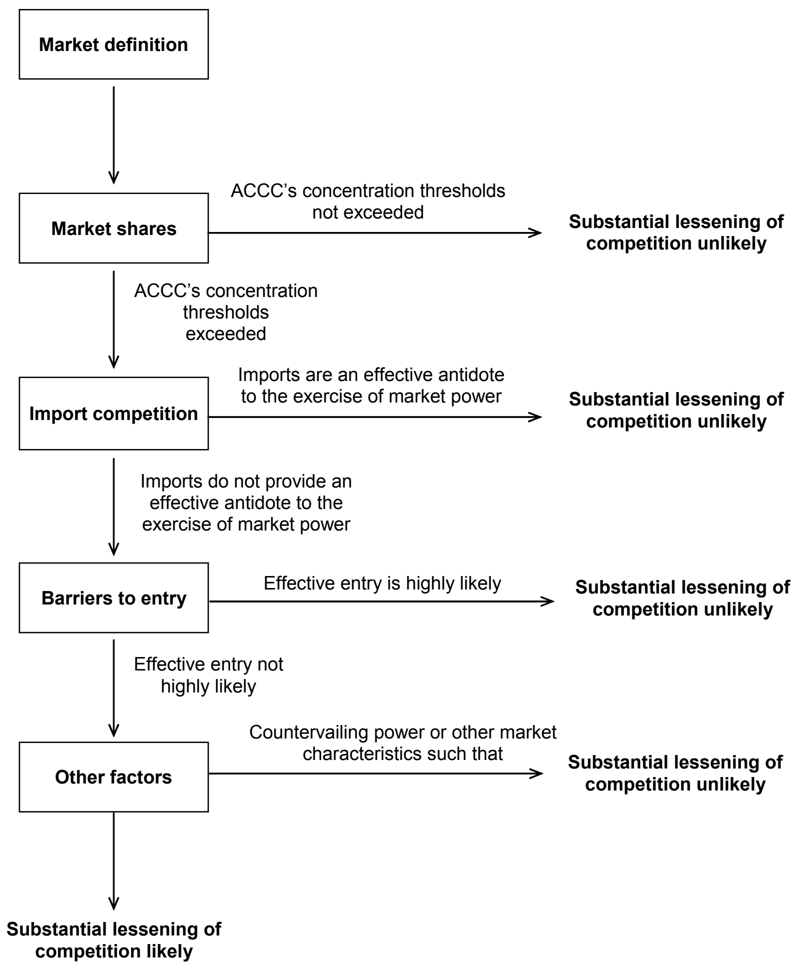
- the relevant market;
- whether that market is substantial; and
- whether the acquisition is likely to substantially lessen competition.

The three elements are interrelated. Identification of the relevant market is an integral part of the evaluation of the competitive effects of a merger; and only when the relevant market has been delineated, can its substantiality be determined.

To evaluate under sub-section 50 (3) whether a merger is likely to have the effect of substantially lessening competition in a substantial market, the ACCC considers a non exhaustive list of criteria. The ACCC's approach to the analysis of acquisitions under section 50 is explained comprehensively in the *Merger Guidelines June 1999*.

The following diagram is a brief guide as to how the ACCC evaluates the mergers/acquisitions that come before it.

The assessment of substantial lessening of competition



There has been public comment recently suggesting that section 50 of the Act is not able to adequately deal with the process of acquisitions by national grocery chains, "creeping acquisitions". It is argued that by their very nature, acquisitions of this type are individual and limited in size such that they are highly likely to avoid contravening the Act.

This is likely to be the case if the acquisitions are considered individually. However, it may be appropriate to consider a number of acquisitions taking place in a limited period of time on an aggregated basis.

Unlike the notification process, the ACCC's analysis of mergers and acquisitions is not a public process. Therefore, the ACCC is limited in terms of the information provided to it that it can release publicly.

ACCC consideration of relevant issues

Third line forcing notifications

The nature of the ACCC's involvement in relation to the shopper docket schemes, and the assessment it is required to make under the Act, depends on the structure of each particular shopper docket arrangement. The conduct will only be a third line force if the scheme involves a third party.

For instance, in the Coles/Shell scheme, Eureka provides the petrol discount to consumers on the condition that a certain amount of goods have been bought from a third party, in this case, certain companies within the Coles Myer group, including Coles supermarkets, Bi-Lo and Liquorland.

The ACCC considers that the most appropriate markets in which to assess the notifications include the markets for the supply of petroleum products and grocery products to consumers, at both the wholesale and retail levels.

In order to identify and measure the public benefits and detriments resulting from the notified conduct, the ACCC applies the 'future with-and-without test' established by the Australian Competition Tribunal. This requires a comparison of the public benefits and detriments resulting from the position that would be likely to exist in the future if the notification was allowed to stand (in this case, notified shopper docket conduct were to continue), with the position if the notification were revoked.

The ACCC has needed to distinguish between the shopper docket schemes and other external developments in the petroleum and grocery industries that may have an adverse effect on the competitive structure of, and behaviour within, the relevant markets. It is important to emphasise the distinction between these other developments and the shopper docket schemes, as the ACCC considers that these other developments may have a more significant impact on the relevant markets and their participants than the shopper dockets themselves.

These other developments include:

- changes in consumer buying patterns and underlying supply and demand conditions leading to ongoing rationalisation in the petroleum and grocery industries, including the acquisition of independent stores by the supermarket chains;
- the Commonwealth fuel standards that are being progressively introduced between January 2002 and January 2006, which restrict the MTBE, olefin and benzene content of fuels sold within Australia; and
- changes in supply of, and demand, for petroleum products in the Asia-Pacific region and actual and potential refinery closures in Australia.

As noted above, the ACCC considers that these developments are likely to have an impact on competition in the markets for the supply of petroleum and groceries to consumers and the ability of independents and small businesses to remain a competitive force in these markets. A number of these issues were raised by interested parties in their submissions to the ACCC in relation to the third line forcing notifications.

These other developments have been taken into account as part of the general market environment in which the notified conduct takes place. In addition, to the extent that there may be an incremental impact by the notified conduct on these ongoing dynamics and developments, such an impact has been considered in the analysis of public benefits and detriments flowing from the conduct.

In summary, the ACCC's analysis of the benefits and detriments in relation to the shopper dockets must focus only on those benefits and detriments that can be said to arise directly as a result of the shopper docket schemes. The ACCC considers that these external developments will have a more significant impact on competition in the relevant markets than the shopper docket schemes themselves.

Key issues raised by interested parties

In assessing the notified conduct, the ACCC conducted inquiries with a broad range of market participants, including refiner/marketers, independent fuel and grocery wholesalers and retailers, industry associations, consumer groups and government. Key issues raised by interested parties related primarily to:

- the ability of the major supermarket alliances to subsidise petrol sales with the proceeds from grocery sales;
- the linking of petrol discounts with grocery purchases was argued to further entrench the dominance of the supermarket alliances and the oil majors, increasing market concentration in the petrol and grocery sectors, which may result in the decline of the competitive force represented by the independent sector; and
- the ability for such schemes to generate low petrol prices for consumers and further competition in the petrol and grocery sectors.

In the petrol sector particularly, many interested parties accepted that there were a number of other developments which, in combination with the shopper dockets, were contributing to a change in the structure of the industry. Key factors highlighted by interested parties included a predicted tightening of supply in the Australian market, precipitated by the closure of the Port Stanvac refinery and the introduction of the new state and Commonwealth fuel standards with the resultant reduction in imports.

Below is a summary of the key issues raised by interested parties.

<u>Ability of the supermarket alliances to subsidise petrol sales with grocery sales</u>

A key concern expressed by interested parties was the effect of the conduct, particularly by Coles and Woolworths, in conjunction with Shell and Caltex, of linking petrol discounts with grocery purchases for the supermarket alliances on the independent grocery sector and on the independent petrol retailing sector.

It was put to the ACCC that the ability of the integrated operations of the supermarket alliances to subsidise petrol discounts from grocery operators, in addition to the scale advantages of the major supermarket chains, and the ability to receive fuel from their oil company partners at a discount to the price available to the independents, enabled them to increase their market share in the retail petrol market at the expense of the independent sector. It was argued that the ability of the independent sector to compete would decline, which would result in a reduced market share and allow the supermarket alliances to put up prices in the long term to the detriment of consumers. In addition, it was submitted that the supermarket alliances (and the remaining oil majors, BP and Mobil) would have the ability to maintain lower prices for a longer period, resulting in the independents spending more time 'at the bottom of the cycle' (where they may often lose money) and less time 'at the top of the cycle' (where they make money). As a result, total sales of some independent petrol retailers would no longer cover their costs and they may be forced out of business.

Linking petrol discounts with grocery purchases

A number of smaller competitors in the retail petrol and grocery markets have argued that the notified conduct would cause them to exit, reducing the level of competition in the market and increasing market concentration in the hands of the majors. It has been put to the ACCC that independents will be driven out of the market, entrenching the dominance of the majors, with long term effects on competition and prices.

Many interested parties expressed concerns about the impact of the arrangements on the concentration of both the petrol and grocery retail sectors, suggesting that, together with other developments in the sectors, those arrangements would see the retail petrol market dominated by the two supermarkets and the oil majors.

The above sentiments were also expressed by some interested parties who submitted that the shopper dockets would attract a greater share of customers to the supermarkets of Coles and Woolworths, to the detriment of the independent retail grocery sector. As the supermarket alliances increased their share of that market, choice and competition would become more limited, independent wholesalers would see a similar decline in their market share and competition in both retail and wholesale grocery would be lessened.

On the other hand, some major independent players, at least in the grocery sector, suggested to the ACCC that it was unlikely that the market share of independent wholesalers would decline as a result of the implementation by Woolworths and Coles of shopper docket schemes as the independent sector had responded with its own loyalty schemes, such as the arrangements being offered by Metcash and others. In addition, the ACCC has been notified of over 100 similar schemes since 1996, 40 of which have been notified in the last year, many by small independent petrol and grocery outlets.

Lower petrol prices for consumers

It has also been put to the ACCC in its inquiries that there would be substantial benefits arising from the conduct, most particularly lower petrol prices to consumers. Further, the conduct has been argued to be pro-competitive through driving competition between supermarket and petrol retailers, as players are encouraged to become more innovative in the range of non-price factors in order to maintain or increase their market share.

It was submitted that the independent sector was already responding to the Coles and Woolworths shopper dockets and that, if the ACCC removed the immunity of the notifications, these schemes would no longer be offered and the drive for further efficiency, innovation, competition and lower prices for consumers would be affected.

Weighing the public benefits and detriments

The submissions provided by interested parties were taken into consideration in the ACCC's assessment of the public benefits and detriments flowing from the conduct.

The ACCC considered the public benefits and anti-competitive detriments that are likely to flow from the shopper docket discount schemes (in the context of the discussion above), particularly by considering the situation if the ACCC were to revoke the immunity of the notifications many of the shopper dockets would no longer be offered.

On the detriment side the ACCC considers, in view of the submissions put to it, that the shopper dockets may have adverse effects on some independent operators (particularly the smaller ones) and may hasten the exit from the industry by some of these operators. However, the ACCC is of the view that the impact of the shopper docket schemes is not likely to lead to a reduction in competition overall in the industry. The ACCC also notes that innovations such as the shopper docket discounts can encourage further competition in the industry.

Interested parties were unable to demonstrate to the satisfaction of the ACCC that the shopper docket schemes in themselves will result in a restructuring of both the petrol and grocery sectors in such a way that independents would no longer offer a competitive force, and that consumers would suffer from a lack of competition.

It was contended by some interested parties that petrol discount schemes would mean some corresponding increase in the price of groceries. The ACCC is satisfied that competition in the retail supply of groceries would constrain the ability of grocery retailers to do this. Consumers tend to be very conscious of price competition when shopping for petrol and groceries, and will shop around for the best deals.

The ACCC considers that any detriment arising in the petroleum markets as a result of the notified conduct will be limited.

The ACCC considers that the claims in some of the submissions received that a large number of independents will leave the industry as a result of the notified conduct is not likely. It considers that exit from the industry will be due more to the on-going developments occurring in the industry (as a result of changes in the demand and supply factors noted earlier) and recent developments (such as the new Commonwealth fuel standards) than due simply to the competition generated by the shopper docket schemes.

In addition, the ACCC anticipates that there is likely to be little detriment flowing from the notified conduct in the grocery markets. The ACCC is mindful that there are other changes affecting these markets, such as growth, organically and through the acquisition of independents, by Woolworths and Coles, and the re-branding of the independent sector (i.e. fewer banner groups). However, such changes (to the extent they affect the net public benefit) are not a consequence of the notified shopper docket schemes.

To a limited extent, the ACCC acknowledges that there may be incremental effects in some markets that will flow from a combination of the notified conduct and other market developments. However, the ACCC does not consider that the notified conduct will adversely affect competition between market participants and considers that it is likely to potentially increase competition.

Further, the ACCC considers that there are significant public benefits arising from the proposed arrangements. In particular, the ACCC considers that the proposed arrangements, along with initiatives by competitors in response, will benefit consumers in a number of ways.

The ACCC considers that the notified conduct will bring:

- **Lower petrol prices for consumers:** The ACCC considers that the shopper docket discounts will bring lower petrol prices to consumers, and that the involvement of such significant participants as Coles/Shell and Woolworths/Caltex would mean a greater availability of cheaper fuel because there will be more petrol sites offering the shopper docket discounts. In addition, the conduct is generating a culture of discounting, as demonstrated by the competitive response by many independents who are offering their own discounts.

- **Increased non-price competition**: The markets are already seeing some variety in the types of loyalty programs being devised in response to those proposed by Woolworths and Coles, notably Metcash's loyalty scheme. Further, some competitors to the Coles/Shell and Woolworths/Caltex arrangements are considering a number of other innovative responses to attract and retain custom.

Conclusion on shopper docket discounts

In view of the above, the ACCC accepts that there are a number of factors in petrol and grocery wholesaling and retailing which are contributing to changes in those industries. However, the shopper docket schemes cannot be said to be responsible for many of the adverse effects (particularly those affecting smaller independent businesses) of the other changes. Indeed, the ACCC considers that the shopper docket schemes are likely to result in an overall benefit to the public in the relevant markets. Accordingly, the ACCC has decided to allow the notifications to stand at this time.

Moreover, the independent sector has responded with its own loyalty schemes (which potentially involve third line forcing). In fact, the ACCC has received more than 100 notifications of similar schemes by other petrol and grocery outlets to provide petrol discounts to consumers.

All these notifications of shopper dockets are similarly allowed to stand. These arrangements are largely in response to the schemes offered by Woolworths and, more recently, Coles and are positive developments, bringing further benefits to consumers.

Woolworths-Caltex arrangements

In November 2003 Woolworths and Caltex announced that a short term arrangement had been concluded under a simpler structure than previously contemplated under a joint venture announced between the parties in August 2003. The short term arrangement announced by Woolworths and Caltex includes the following terms:

- Woolworths and Caltex each have a shareholding interest in AIR. Woolworths has the right to all profits and sole right to appoint and remove all members of the board of directors of AIR;

- AIR has entered into an interim fuel supply agreement with Caltex whereby AIR will purchase petrol and diesel (motor fuel) for retail sale to customers at jointly branded premises occupied and used by Caltex (Caltex Woolworths Sites);

- Caltex will act as commission agent for AIR for the retail sale of motor fuel at the Caltex Woolworths Sites. AIR will set the price at which motor fuel is sold at the Caltex Woolworths Sites under direction solely from Woolworths. In this way Woolworths will have exclusive control over the retail pump price and the level of discount redemption offered at the Caltex Woolworths Sites;

- There will be no change to the existing ownership, leases or non-fuel operations of the Caltex Woolworths Sites. Caltex will be responsible for employing staff and otherwise conducting the business of the Caltex Woolworths Sites subject to its obligations as a commission agent for AIR in relation to the sale of motor fuel; and

- The short term arrangement will expire and terminate on the earlier of 31 March 2004 or the date on which the parties agree will be the commencement date for any longer-term arrangement. It is expected that in total approximately 43 Caltex Woolworths Sites will be rolled out under the short term arrangement by the end of March 2004.

The first Caltex Woolworths Sites were opened under the short term arrangement on 21 November 2003 in New South Wales. As at the release of this report, 32 co-branded sites had been opened across Australia.

The parties have advised that negotiations are continuing between Caltex and Woolworths as to final arrangements. The ACCC has not seen nor made any decision in relation to any long term arrangements. It would expect to review those arrangements before Caltex and Woolworths propose to implement them.

The short term arrangement has been assessed by the ACCC under section 50, which, as noted above, prohibits acquisitions with the likely effect of substantially lessening competition in a substantial market. If the ACCC considers that an acquisition contravenes section 50 and the parties do not agree to modify or abandon the acquisition, the ACCC can apply to the Federal Court for an injunction, divestiture or penalties.

The ACCC conducted confidential market inquiries initially regarding the proposed joint venture and, subsequently the short term arrangement, with a range of interested parties including fuel refiner/marketers, independent fuel wholesalers and marketers, fuel distributors and service station representative organisations, motoring organisations, retail grocery participants, consumer organisations and State and Federal governments.

Market inquiries conducted in relation to a merger or acquisition under section 50 of the Act are not a public process. Accordingly, all market inquiry information is kept confidential.

In examining an acquisition, the ACCC will initially assess the market concentration to which an acquisition gives rise. The Merger Guidelines outline certain concentration thresholds or “safe harbours” where acquisitions are unlikely to be of concern to the ACCC.

The ACCC considered, after its inquiries, that the combined market concentration of Woolworths and the co-branded Caltex sites, following implementation of the short term arrangement, would account for less than 15% of the retail supply of petrol and would not breach the ACCC's concentration thresholds.

Having had regard to market concentration, and the other relevant merger factors, the ACCC has determined that the short term arrangement entered into by Caltex and Woolworths for the retailing of motor fuel, would not have the effect or be likely to have the effect, of substantially lessening competition in any of the relevant markets, including the retail and wholesale markets in the petrol and grocery industries.

The short term arrangement will not result in either Caltex or Woolworths acquiring any wholesaling assets, nor will there be any change to the existing non-fuel operations of Caltex, Woolworths or the co-branded sites.

The ACCC acknowledges that, due to other factors such as the introduction of new Commonwealth fuel standards from January 2004, imports by independent operators may be constrained in the short term. The ACCC also acknowledges that there are some barriers to entry into the petrol retailing market. However, market opinions differed on the height of these barriers.

On the information and evidence currently available, the ACCC does not propose to oppose the short term arrangement because the ACCC does not consider that the short term arrangement will result in a substantial lessening of competition.

The parties have advised that negotiations are continuing between Caltex and Woolworths as to final arrangements. The ACCC has not seen nor made any decision in relation to any long term arrangements. At such time as any long term arrangement is agreed between the parties, the ACCC will review that arrangement, particularly having regard to any material differences to the present short term arrangement.

Coles/Shell Alliance

In May 2003, Coles Myer and Shell announced their proposed alliance whereby Coles Myer would take over the management of Shell's core retail service station network encompassing 584 sites across Australia.

The ACCC carefully considered the competitive impact of the proposed alliance and conducted extensive market inquiries consulting with a wide range of interested parties. In July 2003, the ACCC found that Shell would not increase its overall market share in fuel wholesaling simply through its participation in the proposed alliance whereas Coles Myer was an entirely new entrant into fuel retailing.

In effect, the ACCC was of the view that the proposed alliance would result in Coles Myer taking over an existing position in fuel retailing currently occupied by Shell. On this basis, the ACCC found the proposal would not cross any of the ACCC's concentration thresholds for the exercise of market power and as such, the proposed alliance was unlikely to result in a substantial lessening of competition.[57]

The ACCC understands the Coles/Shell alliance will continue to be rolled out in many states until mid-2004.

Acquisition of independent grocery outlets by Coles Myer

The ACCC recently examined 20 acquisitions of independent supermarkets over 12 months by Coles. Up until October 2002, Coles had approached the ACCC in regard to the proposed acquisition of 12 independent supermarkets. Following industry speculation that this may represent the vanguard of a widespread program of acquisitions, the ACCC requested that Coles provide a list of any further proposed acquisitions. Coles subsequently advised that it intended to acquire a further eight supermarkets over the subsequent six months, bringing the total to 20 independent supermarket acquisitions in a period of around twelve months.

The following is a list of the independent outlets that Coles proposed to acquire and when the ACCC was notified of these:

- August 2002 - IGA Narrandera.
- September 2002 - Merimbula Foodworks and Hourigan's IGA Umina.
- Early October 2002 - Melton Fresh Foodworks, Fairley's IGA Mooroopna, South Foodland Broken Hill, Hooper's IGA Ararat, and IGA Palm Beach.
- Late October 2002 - IGA Brunswick, IGA Blayney and IGA Coonabarabran.
- December 2003 - IGA Myrtleford, IGA Gulgong, Foodland Barmera, and IGA Charters Towers.
- March 2003 - IGA Cowes.

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[57] See ACCC media release, MR 145/03, Issued: 2 July 2003.

- May 2003 - IGA Daylesford, IGA Keysborough, AUR Wallan Food-Rite.
- July 2003 - Foodway Drouin.

Section 50 guards against any horizontal merger or acquisition which is likely to result in a substantial lessening of competition via the accumulation of market power in either of the following two forms:

- Unilateral market power, whereby a single firm may be able to undertake business decisions (such as increasing prices) unilaterally as other firms are unable to provide substantial competition; and
- Coordinated market power, whereby a merger creates market structures that may diminish direct competition, for example by being conducive to coordinated conduct, whether tacit or overt, and collusive outcomes.

Given the current structure of the grocery industry it is unlikely that such acquisitions would be likely to trigger concerns under the category of unilateral market power.

It is generally agreed that the presence of independent supermarkets imposes some constraint on the national chains. However, information provided to the ACCC and its own independent analysis suggests that Coles and Woolworths do compete vigorously against each other in the retail grocery sector. While the current program of acquisitions may negatively affect the competitiveness of the independent sector, the degree of competition between Coles and Woolworths indicates the acquisitions would not be likely to result in an increased likelihood of coordinated conduct.

The ACCC has also undertaken an assessment of the acquisitions by Coles in terms of another possible source of a substantial lessening of competition, namely "raising rivals' costs" (RRC). Under RRC, a series of acquisitions could lead to exclusionary effects by increasing rivals' costs of doing business through an acquirer raising input costs by foreclosing on their rivals' access to a sufficient customer base (referred to as customer foreclosure).

By reducing a wholesaler's customer base the per unit cost of each item is increased resulting in a likely pass through to retailers, increasing their costs and reducing sales, which further exacerbates the loss in the wholesalers customer base ending in a spiralling effect.

Despite the merits of applying RRC to analysis of such a program of acquisition in the grocery sector, in this instance the ACCC considers that the recent performance of the major independent wholesaler means that no substantial lessening of competition is likely to arise from Coles' acquisitions. Using RRC, the anti-competitive detriment arising from acquisitions by the national chains is predicated on a loss of volume for an independent wholesaler. However, current market analysis suggests that the major independent wholesaler has continued to increase its market share.

In addition, the proposed development of 20 new independent supermarket outlets and the refurbishment of more than 70 stores is likely to further improve the operation of the independent wholesale sector. A new grocery chain called Valuemart, which uses independent wholesaling services, has recently been launched in Brisbane. Valuemart has plans to expand to operate 20 supermarkets within the next few years. The re-launched Franklins which currently operates in New South Wales, also receives independent wholesaling services, is currently expanding at a rate of around 10 supermarkets a year, through a combination of independent supermarket acquisitions and greenfield entry. This suggests the independent wholesale sector is likely to continue to grow.

Section 50 of the Act also guards against the accumulation of market power through increased vertical integration within the supply chain such that the market power in one market can be transferred or leveraged into an upstream or downstream market with a detrimental impact on competition.

A recent ACCC report found that "…independent wholesalers…receive some of the better wholesale prices…".[58] In its investigation of independent supermarket acquisitions by Coles, the ACCC received evidence from a number of suppliers stating that they now offer Metcash their maximum level of rebate and that no other retailer enjoys better terms.

In this instance, given the current and projected growth of the independent wholesale sector, the concern that these acquisitions of independent grocery outlets by Coles will lead to the decline of the independent wholesaling sector does not appear to be realised.

Given the above, the ACCC does not consider that Coles' current program of independent supermarket acquisitions will result in a substantial lessening of competition. Accordingly, the ACCC does not intend to intervene in Coles' recent supermarket acquisitions. However, the ACCC will continue to closely monitor and scrutinise independent supermarket acquisitions by national grocery chains.

[58] *Report to the Senate by the Australian Competition and Consumer Commission on prices paid to suppliers in the Australian grocery industry*, September 2002, p. 2.