

7.42. Finally, the vertically integrated chains may provide a source of new entry. Their existing warehouse facilities are set up to supply large, relatively standardised grocery deliveries to their own supermarkets. They carry a smaller range of products than is required by the range of independent retailers and do not have the necessary administrative systems for billing and collection of sales tax. To the extent that the independent retailers are not in competition with the chains own stores, supply of groceries to them may be a means of maximising sales and profitability. Depending on existing capacity utilisation, they may also be able to achieve lower unit costs from the higher warehouse turnover. However, unless the profit opportunities are significant (taking account of the need for investment and the likely reaction of incumbents), such a venture may be regarded as diverting management attention from their main activity as supermarket chains. To date the chains have only supplied wholesale services to independent retailers in Tasmania (Woolworths); and some cash and carry activities from retail outlets elsewhere. Independent retailers in Tasmania have expressed dissatisfaction with the services provided by Woolworths in that state and the overall level of concentration in the Tasmanian grocery industry which this situation reflects was considered by the Tasmanian Prices Inquiry to be a major factor accounting for relatively high prices in that state.<sup>80</sup> Although Jewel claims that offers have been made, Coles have denied that they have any current plans to use their new wholesaling division to supply independent retailers.

#### **Availability of substitutes**

7.43. Potential sources of substitutes were discussed under market definition in chapter 5. However, there remains a question as to the availability of substitutes *within* the relevant market, that is the supply elasticity of market participants. If supply elasticity is high, reflecting constant or declining marginal costs, the anti-competitive effect of a concentrated market structure may be undermined. This will tend to be the case in grocery wholesaling; as long as warehouse facilities are sufficiently large to accommodate a full product range, turnover can probably be increased over a considerable range by increasing throughput and only accruing the marginal cost of labour and transport.

7.44. The significance of additional throughput for costs and profitability is emphasised in the application and is reflected in the intense competition between wholesalers in Victoria and Queensland and to a lesser extent in New South Wales.

7.45. The potential for such vigorous competition between even small numbers of suppliers tends to reinforce the adverse effect on competition of the proposed merger. The lessening of competition which is likely to occur in Victoria and New South Wales from the replacement of a duopoly with a monopoly are likely to have more substantial effects than might otherwise be the case.

#### **Countervailing Power**

7.46. The customers of the parties to the proposed merger comprise a large number of small retailers. Most of them would not have any countervailing power vis a vis the wholesalers. Only an independent chain or buying group providing significant throughput and with the capacity to provide their own warehousing facilities, e.g. Jewel, Foodlink or the petrol company convenience chains, would be able to exert any significant countervailing power. Jewel's volumes provide it with significant

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<sup>80</sup> The Prices Inquiry Board (1989), *op.cit.*

countervailing power, adding to the downstream competitive constraint in this sub-market, imposed by competition between independent supermarkets and the chains. However, most independent retailers are not sufficiently well organised to provide a credible threat of vertical integration and thereby exert countervailing power.

### **Dynamic Characteristics**

7.47. The Australian Bureau of Statistics retail census indicates a trend towards the concentration of retail grocery sales in larger stores. Between 1985/6 and 1991/2, there was a reduction of 9.6 per cent in the number of "supermarket and grocery stores", but an increase of ten per cent in total floor space and a 15.9 per cent increase in turnover.<sup>81</sup> The average store size increased by 22 per cent. This in turn reflects trends in lifestyle patterns and deregulation, e.g. increased labour force participation of women, two income households, increasing use of motor vehicles, demand for greater product range and extended supermarket opening hours.

7.48. There has also been a significant expansion in sales of fresh foods - meat and poultry, deli, fruit and vegetables, bakery items, etc. - by supermarkets. Supermarket and grocery stores now account for 45.7 per cent of fresh meat and poultry sales, 52.3 per cent of fresh fruit and vegetable sales and 56.1 per cent of bread, cake and pastry sales.<sup>82</sup> Of shoppers surveyed for the Food Marketing Institute, 47 per cent usually buy fresh fruit and vegetables in a supermarket; while 48 per cent, 62 per cent and 52 per cent usually buy meat, delicatessen and bakery products respectively in a supermarket.<sup>83</sup> Good quality fruit and vegetables was the most commonly identified factor determining the choice of supermarket by shoppers, and shoppers considered that supermarkets have significantly improved their fresh food offering.<sup>84</sup>

7.49. Both these trends have resulted in an increasing proportion of retail grocery sales being channelled through the vertically integrated chains, who offer larger stores and product range and increasingly are open for extended trading. Woolworths average store size is 1,976m<sup>2</sup> while Coles and Franklins stores are slightly smaller at 1,802m<sup>2</sup> and 1,537m<sup>2</sup> respectively.<sup>85</sup> Fresh food now accounts for forty per cent of Woolworths sales, compared with twenty per cent in 1986/7.<sup>86</sup> Woolworths have led the growth in fresh food retailing by supermarkets, but both Coles and Franklins have followed. Better fruit and vegetables and greater variety of products have become increasingly important reasons identified by shoppers who have switched supermarkets.<sup>87</sup> The combined share of national grocery sales accounted for by Coles, Woolworths and Franklins increased from 38.3 per cent in 1973 to 69.8 per cent in 1994.<sup>88</sup> However,

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<sup>81</sup> Australian Bureau of Statistics (1993), Retailing in Australia 1991-92, Cat.No.8613.0, Table 3, p.11.

<sup>82</sup> Australian Bureau of Statistics (1994), Retail Industry Commodity Sales Australia 1991-92, Cat.No.8624.0, Table 3.

<sup>83</sup> Food Marketing Institute, Trends in Australia: Consumer Attitudes and the Supermarket 1994, p.40.

<sup>84</sup> Ibid., p.13 and p.9.

<sup>85</sup> Davids Ltd Submission, 2 February 1995, p.4.

<sup>86</sup> Supermarket, August 1994.

<sup>87</sup> Food Marketing Institute, op.cit., p.27.

<sup>88</sup> FAL submission, 3 November 1993, in relation to Authorisation Application No. A90553, Volume 1 p. 4 and Davids Ltd submission, 2 February 1995, Appendix A (derived from Retail World).

some of this growth is accounted for by the transfer of independent stores into ownership by the chains.

7.50. The independent retail customers of the grocery wholesalers are predominantly smaller stores, which have lost custom from these trends. Even the average Festival store is only 1,045m<sup>2</sup>, they generally have a smaller fresh food range and fewer instore bakeries; while the average Foodtown and Welcome Mart are only 473m<sup>2</sup> and 295m<sup>2</sup> respectively, with only limited fresh food offers.<sup>89</sup> Jewel supermarkets are some of the largest independent supermarkets, they have been highly price competitive with the vertically integrated chains, but they have only recently begun to offer fresh foods. Independent grocery retailers have lost sales to the vertically integrated chains with the consequence that the markets for the supply of grocery wholesale services to independent retailers are shrinking.

7.51. In these circumstances, the likelihood of new entry reducing concentration, particularly given the barriers to entry discussed above, is likely to be low. This is not offset by any likely technological or regulatory changes which might reduce these barriers. If anything, economies of scale and sunk cost requirements in grocery wholesaling are increasing with the increasing use of computer systems for stock management and ordering etc..

7.52. Access to generics and private label products may also be an increasingly important barrier to entry. These products have become increasingly important in overseas grocery markets, particularly in the UK where they account for 35 per cent of grocery sales and over fifty per cent of sales by major retailers.<sup>90</sup> In Australia, they still only account for fifteen per cent of sales, but their role can be expected to increase. Coles has expanded its premium Farmland products, which have reportedly been successful in attracting shoppers<sup>91</sup> and Davids has developed the IGA premium label. More shoppers are reporting buying shop brands as a means of economising on food bills.<sup>92</sup>

7.53. If the decline in independent convenience stores were to be matched by an increased number of independent supermarkets, offering a comparable combination of price, service and convenience to the vertically integrated chains, the declining market for independent grocery wholesale services could be arrested. There have been some significant investments in new independent supermarkets and hypermarkets, e.g. the Q Superstore in Queensland, the Big Crow in Adelaide and the Rainbow stores in Victoria and NSW. The applicant's public benefit claims are based in part on the need to accelerate the development of new independent retail stores. This is discussed further below, but if it were to occur, the decline in market size may be arrested or at least contained.

7.54 GEMMnet may eventually enable the integrated chains to service more remote country areas, extending the geographic spread of competition. However, it seems unlikely to provide a substitute for the convenience shopping provided by independents.

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<sup>89</sup> Davids Ltd Submission, 2 February 1995, p.4.

<sup>90</sup> Retail World, 12-16 September 1994.

<sup>91</sup> Foodweek, 7 June 1994.

<sup>92</sup> Food Marketing Institute, op.cit., p.24.

### **Vigorous and effective competitor**

7.55. The Commission's market inquiries indicate that Davids and CBL compete vigorously, particularly in Victoria. This competition revolves around both price and service, e.g. product range, delivery arrangements and retail support services. Retailers may switch between wholesalers in order to gain a better deal or use the offer from one to extract better terms from the other. The effect of the merger will be to remove this competition. The only constraint on a merged Davids-CBL would be AIW in NSW and the threat of entry, and downstream competition between independent supermarkets and the chains.

7.56. Some retailers have been reluctant to switch to CBL in NSW because of concerns regarding their long term viability. This in turn has put less competitive pressure on Davids in NSW.

7.57. CBL's recent entry into the Tasmanian market appears to have provided a significant boost to competition, being the only wholesaler not connected to Woolworths. If their volume growth was to continue, they may be able to establish a Tasmanian warehouse and the basis for longer term competition. Davids has stated that they will continue to supply Tasmanian retailers, providing it is commercially viable. However, they would seem unlikely to provide the basis for a longer term injection of competition into Tasmania, having already entered and exited that market and having now licensed Festival and IGA to TIW.

7.58. The applicant claims that the potential loss to competition from the proposed merger is diminished because CBL no longer represents a substantial long term competitive force in the market by reason of its damaged financial position. The Commission does not accept this argument. Significant losses were incurred in 1993/4, attributable mainly to losses from non-core activities and excessive costs in its core operations. A study by KPMG for ANZ Bank in mid 1994 endorsed the remedial action being proposed by the new management team. Subsequently CBL has turned the loss making situation around, selling off non-core activities and cutting costs in the core grocery wholesaling operations, which are now operating profitably. Submissions and market inquiries indicate that the cost cutting has not involved any reduction in service levels. CBL's withdrawal from supply of fresh food and retail investment are business decisions which do not necessarily reflect a failing firm. Retail customers now receive fresh food supplies direct, as do Davids' customers.

7.59. AIW will remain as a competitor in New South Wales. AIW is currently a relatively small operator. However, it could benefit from any disaffected customers of a merged Davids/CBL. It is particularly well placed to service country retailers, where there is less downstream competitive constraint from the chains.

### **Vertical integration**

7.60. The parties to the merger have vertical links into retailing, through direct ownership of retail outlets, franchising (e.g. some Payless stores franchised by CBL and Clancys stores franchised by Davids in New South Wales) and banner groups. However, direct ownership is limited, with most retailers simply belonging to a banner group and switching from the banner group of one wholesaler to that of another is not very difficult. Even if the retail customers of the wholesalers were wholly owned by the wholesalers, there would be downstream competition between them in retail markets.

Consequently, these vertical links do not have any discernible effect on competition or potential competition between the parties.

### **Effect on prices and profit margins**

7.61. The merger will result in the replacement of two evenly matched competitors by a monopolist, protected by significant if not insurmountable barriers to entry, in the Victorian market.

7.62. In New South Wales, CBL is currently a less effective competitor than it is in Victoria and AIW will remain in the market, with the potential to grow by gaining customers from Davids. However, CBL has the potential to become a more effective competitive force in the absence of the merger. Hence the acquisition may prevent or hinder competition in terms of section 4G of the Act. Nevertheless, the reduction in competition would be less in the New South Wales market than in the Victorian market.

7.63. In Tasmania, Davids would be in competition with TIW. However, it seems likely that such competition would be less vigorous than the current level of competition between CBL and TIW.

7.64. In the absence of constraints, this reduction in competition would be likely to result in a combination of increased prices, reduced settlement terms and diminished service levels, reflected in a higher profit margins and/or increased cost inefficiency.

7.65. However, these effects would not be felt evenly by all the retail customers of the merged group or by the final downstream customers of those independent retailers. There is an important distinction to be made between price increases to retailers and price increases to final consumers. As the *QIW* decision indicated, regardless of the relevant retail markets, a monopoly wholesaler may be able to significantly increase their prices (the wholesale margin) and profits, without adding significantly to the total cost of wholesale supply, which would be absorbed by their retail customers. This would redistribute profits from the retail to the wholesale level. However, whether the wholesaler can impose further increases in price, and whether retailers can in turn pass these on to final consumers, will depend on the degree of retail price constraint from the chains. The applicant makes a useful distinction between three types of independent retailers.

7.66. First are those independent retailers in close competition with the vertically integrated chains. Following the *QIW* decision, the Commission considers these to be the larger independent supermarkets, such as Festival, Tuckerbag, Jewel and Rainbow stores, located within the catchment area of one or more vertically integrated chain stores. These retailers would be least likely to suffer from increased charges and reduced service levels. This would only erode their competitive position at retail and hence their demand for wholesale services. Indeed, the merged group is likely to pass on any benefits from rationalisation and other efficiencies in lower prices and improved service, allowing the retailers to compete more strongly, benefiting consumers and increasing their demand for wholesale services. It is notable that in Western Australia, where FAL has a wholesale monopoly, independent supermarkets offer highly competitive prices and services, and indeed are regarded as market leaders in new retail developments, such that independent retailers now account for 53.5 per cent of total grocery sales.

7.67. Second are those independent retailers not in direct competition with the chains, but who compete with another independent, either supplied by or with the option of being supplied by another wholesaler. This group comprises smaller stores, and supermarkets in country towns not served by the chains. Competition between these stores and the wholesalers supplying them is strong. The proposed merger would almost eliminate wholesale competition, except for AIW. Competing stores which were previously able to get the best deal offered by the two wholesalers and pass through the benefits to consumers in order to win retail trade from their rivals, will face a single supplier. Davids could increase prices and decrease service levels to both retailers, raising the cost of supplies and reducing the extent of possible retail competition. However, the extent of such an increase in price would be constrained by the increased role of the chains in provision of convenience shopping. If Davids were to maintain consistent pricing across banner groups, regardless of geographic location, the constraints imposed by the chains in certain geographic retail markets would be extended into geographic markets in which they are not directly represented. If prices to these retailers did not increase or were reduced (and services were not reduced or were increased), retail competition would be maintained or enhanced, since there would be no aggregation of ownership at the retail level.

7.68. Third are independent retailers who do not face any competition, either from other independent retailers or from the chains. This group would comprise some smaller stores not facing competition for convenience retailing and some country supermarkets. However, the number of such stores is likely to be small. These stores can currently charge monopoly prices, regardless of supply prices, but subject to the threat of retail entry, with potential entrants having access to competitively priced wholesale services. The proposed merger would enable Davids to increase supply prices to these retailers and to potential entrants, increasing the downstream limit price. The only competitive threat would be from entry by a retailer obtaining supplies from AIW. Even in the absence of actual or likely entry, there is currently competition for the market, which would be removed by the acquisition; this has flow on benefits for consumers in the form of retail services and reliability of supply, even if retail prices do not benefit.

7.69. Hence the proposed merger has the potential to increase both wholesale and retail prices and reduce service levels to and from independent retailers, particularly those not in close competition with the chains. However, where independent retailers are in close competition with the chains, Davids are likely to pass through the benefits of rationalisation in lower prices, enhancing retail competition. As discussed in chapter 5, less than thirty per cent of Davids' and CBL's sales are to smaller retailers, less than fifteen per cent of the NSW and Victorian population is not directly served by the vertically integrated chains and less than ten per cent are not within 50km of a chain. As discussed in chapter 5, if the applicant's narrower definition of convenience stores and wider definition of chain store catchment areas is accepted, less than twelve per cent of sales would not be competitively constrained. The use of banner groups would enable the merged group to effectively price discriminate between types of retailers. Whether the monopoly prices charged to the second and third groups of retailers would be higher than the competitive prices before the merger would depend on their demand elasticity and the extent of cost rationalisation achieved by the merger.

7.70 As described in chapter 6, the applicant has given statutory undertakings to the Commission to address these concerns and to ensure that rationalisation benefits from the merger are passed through to the public. Such undertakings could potentially

prevent an increase in wholesale prices, but they would need to ensure that there was no equivalent increase in other charges to retailers, and that CBL retailers switching to Davids' pricing structure did not incur a price increase. However, while undertakings may be able to prevent price increases and ensure that the immediate benefits of rationalisation are passed through to retailers and consumers, the extent to which future increases in productivity will be passed on depends on the extent to which the merged entity is constrained by actual or potential competition. Furthermore, the extent to which undertakings can adequately address other dimensions of competitive behaviour which manifests itself in vigorous competition in relation to wholesale services such as product range, stock levels, delivery schedules, stock control, pricing and ordering systems and retail support services is problematic and will depend largely on the flexibility of such undertakings in addressing the full range of service and on the practical monitoring and enforceability of such undertakings. The undertakings which have been given to the Commission address these issues by incorporating the broadest possible definition of price, by providing for the maintenance of CBL's terms unless retailers choose to switch to Davids' terms, by adopting the broad definition of service contained in the Trade Practices Act and providing for dispute resolution and monitoring by an Independent Industry Ombudsman.

## **Grocery retailing**

7.71. The proposed acquisition has its immediate competitive impact on the grocery wholesaling markets discussed above. However, it also has an impact on retail grocery markets. Davids' and CBL's direct retail assets are relatively small, but through the provision of goods and services to independent retailers, they have a significant impact on the competitive position of those retailers in downstream markets. Indeed, enhanced retail competition is a major public benefit claimed for the proposed acquisition.

7.72. This issue is discussed in greater detail below, but it should be noted here that if the acquisition results in lower prices and/or enhanced retail investment and support services, competition in retail markets will be enhanced. Independent retailers will be able to offer their customers lower prices, improved product range and a better shopping environment.

7.73. Competition between independent retailers and the chains and competition between one independent retailer and another, will provide the incentive for independent retailers to pass through these benefits in the first and second category of retail markets discussed above. Only in the very few retail markets which fall into the third category will there be no such pressures.

## **The wholesale distribution of liquor**

7.74. Depending on the relevant market(s), the acquisition will result in Davids and ALM supplying anything from nineteen per cent of a wholesale liquor market in NSW to 83 per cent of a wholesale wine and spirits market in Tasmania. Relevant market shares for CBL, Davids and ALM combined are given in the table below:

	<b>Liquor</b>	<b>Wine and Spirits</b>
<b>NSW</b>	19%	41%
<b>Victoria</b>	31%	67%
<b>Tasmania</b>	33%	83%
<b>Australia</b>	24%	57%

**Source: Davids' Submissions 23 February and 9 March 1995; CBL Submission 9 March 1995.**

7.75. In NSW and Victoria the merged group will face significant downstream competition from Coles and Woolworths in the retail markets, who supply liquor through their Liquorland and Macs stores. Woolworths in NSW are themselves supplied by ALM, but have a credible threat of vertical integration allowing them to secure a competitive price. However, Coles does not operate in Tasmania and Woolworths only operates a single, warehouse type retail outlet. This reflects licensing laws in Tasmania which restrict the sale of liquor for consumption off premises to hotels and restaurants, except for sales over nine litres. This is the major factor accounting for the much larger market share in Tasmania. The licensing laws would seem to prohibit any significant entry by Coles or expansion by Woolworths in Tasmania.

7.76. In Tasmania, CBL provides the major source of competition to ALM, which would be removed by the proposed acquisition. It is also a major source of competition in Victoria.

7.77. However, direct supply continues to be a viable alternative and barriers to market entry are relatively low. While small grocers may not require sufficient volume to meet minimum order requirements, outside Tasmania they compete with large retail groups, such as Liquorland and Macs, that do. Hence the prices they can charge consumers, and indirectly the prices Davids can charge the retailers, are constrained. Wholesale licences are not difficult to obtain, minimum efficient scale is smaller than for groceries and sunk cost requirements are minimal. Buying groups of hotels, restaurants and retailers can and do provide a viable alternative to wholesale services. The Commission's market inquiries indicate that the market is a highly competitive one with frequent entry.

7.78. The only potential barrier would appear to be if the merged entity were to acquire exclusive distribution licences for competing products. This only appears to be a potential problem in Tasmania, where mainland wine and spirit producers may not distribute directly. ALM has already provided the Commission with a statutory undertaking, in relation to its acquisition of Chancellors, not to acquire any exclusive Tasmanian licences.

7.79. Since the merged group will face continued competition from direct supply by wine companies and merchants and the prospect of further competition from new entrants, e.g. buying groups of independent hotel and liquor stores, the Commission does not consider that the merged group will be able to significantly raise prices or profit margins in the wholesale supply of liquor.



## **Public benefit assessment**

### **Rationalisation**

7.80. Davids estimates that the proposed merger will result in incremental net pre-tax earnings to Davids of approximately \$13-16 million in year one. This net increase in Davids' earnings derives from estimated cost savings of \$16-18 million, minus head lease losses, bad debts and amortisation of goodwill, plus CBL's existing forecast operating profit. Estimated cost savings derive from the rationalisation of warehouse facilities, overheads and transport costs and reduced costs of working capital. Further savings are also likely to be achieved through further economies of scale in various areas, e.g. transport costs, particularly for perishables, through better utilisation of vehicles, and technology, e.g. EFTPOS and Scanning.

7.81. When considering the application by FAL to acquire CBL in 1993, both FAL and CBL agreed that savings of \$30 million could be achieved by the rationalisation of Davids and CBL's operations in Victoria and NSW. John Ragg provided the Commission with an independent evaluation of these estimates, advising that they were not excessive and may have been understated.<sup>93</sup> The higher estimated costs savings in the previous application are attributed to the inclusion of anticipated cost savings arising from the rationalisation of cash and carry operations, which do not form part of the current proposed merger; and some cost savings having already been achieved by CBL in the last year.

7.82. The Commission accepts that the estimated cost savings from rationalisation of Davids and CBL's operations are reasonable. The achievement of these savings is dependent on the acquisition. As discussed above, the Trade Practices Tribunal has considered such savings to be public benefits, even where they are not passed through into lower prices. However, the Tribunal also considered that where the benefit accrues to shareholders, rather than being spread more widely through the community, they may be given less weight.

7.83. The Commission considers that these cost savings are likely to be passed on to those retail customers who are in competition with the chains. Lower prices and improved services will allow independent supermarkets to compete more effectively with the chains, maintaining or increasing demand for wholesale services. Through such competition, consumers will in turn receive the cost benefits through lower prices and better service.

7.84. It is less clear that such savings would necessarily be passed on to other independent retailers who do not face competition from the chains. The creation of a monopoly in the wholesale supply of groceries to these stores in Victoria and a near monopoly in New South Wales would increase the market power of Davids and enable prices to be raised above competitive levels, to a limit determined by the height of barriers to entry (and competition from AIW in New South Wales). The combined effect of increased market power and lower costs may result in higher or lower prices after the acquisition than before. The net result would depend on the extent of the cost savings

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<sup>93</sup> John Ragg & Co. (1993), A Submission to the TPC on the Application for Authorisation by Foodland Assoc. Ltd., 15 December.

and the elasticity of demand. The Commission does not have sufficient information to estimate the net effect.

7.85. The extension of trading hours in Victoria and New South Wales, by increasing substitution between the chains and convenience stores, is likely to have increased demand elasticity for these stores, and hence the derived demand for wholesale services, where consumers have access to the chains. This makes it more likely that these retailers and their customers would receive the benefits of rationalisation. However, in some country areas, this substitution does not exist and hence the demand elasticity facing Davids will be lowest in relation to these retailers. Competition between CBL and Davids will have been removed and the likelihood of price increases is probably greatest here. In New South Wales, AIW is particularly active in country areas, tending to increase the demand elasticity faced by Davids, but there is no such constraint in Victoria. Hence it is least likely that cost savings would be passed on in these areas.

7.86. In 1993 the Commission obtained advice that 89 per cent of the New South Wales population and 86 per cent of the Victorian population are served by a chain store within their immediate area (and that 92 and 91 per cent respectively are within 50km of a chain store.)<sup>94</sup>. Retailers serving the remaining population would be the most likely to suffer price increases and reduced service levels following the proposed acquisition. This includes significant country towns, such as Yass, Bourke and Cobar in New South Wales and Anglesea and Orbost in Victoria.

7.87. In order to overcome concern that the benefits of rationalisation are less likely to flow through to retailers and their customers not in competition with the chains, Davids has given undertakings to pass through \$6-8 million per annum directly to retailers in the form of increased rebates, in two stages of at least 0.25 per cent each, six and twelve months after the merger. The undertakings also provide that Davids will not unreasonably discriminate between members of any particular banner group, in terms of wholesale prices, services or otherwise. The Commission considers that if these undertakings can ensure that the savings are passed through to retailers, and are not taken back in some other form, they will be passed through to consumers through retail competition. Even in the extreme case of a grocery retail monopoly, some savings would flow through to consumers.

7.88. Davids claim that there will be additional benefits because CBL's customer's will receive Davids' lower prices. However, comparisons of net prices charged by Davids and CBL have proved very difficult, due to the different basis on which retailers are charged and where various expenditure burdens, such as banner advertising, fall. Furthermore, the Commission does not consider that any such pricing differential represents a public benefit in itself. If Davids' prices are lower, CBL customers can access those prices now through the competitive market process. They may choose not to, due to some other perceived benefit of CBL that outweighs any price disadvantage. However, to the extent that CBL retailers are currently worse or better off than Davids' retailers in terms of price, then moving them onto Davids' pricing structure would mean that more or less of the rationalisation savings would be passed through to CBL retailers. Ferrier Hodgson's price comparison for the Tuckerbag and Festival banners indicates that Davids' prices are currently lower than CBL's. To the extent that this is representative of price differences between other banner groups, and assuming that CBL retailers

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<sup>94</sup> Jebb Holland Dimasi (1993), Provision of Chain Supermarkets-NSW and Victoria, report to the Trade Practices Commission.

choose to switch to Davids' pricing, a larger proportion of the rationalisation benefits will in effect be passed through to retailers. CBL dispute the extent of the price difference, but not its direction.

7.89. The Commission considers that the estimated rationalisation benefits are likely to be achieved and constitute a public benefit. Even in the absence of undertakings, a significant proportion of retailers will share these benefits, which will in turn be passed through to their customers through retail competition. The undertakings given by Davids make it likely that all of Davids' and CBL's customers will receive a proportion of the benefits, which in turn will flow through to consumers through retail competition. This broad flow through of rationalisation benefits increases the weight which the Commission attaches to the public benefit.

### **Purchasing Power**

7.90. Davids claims that the merger would result in increased purchasing power through larger volumes. AAW currently receives the same standard rebates as the national chains. The merger of Davids and CBL would be unlikely to have any effect on these rebates. Davids is already bigger than the Franklins chain and it seems unlikely that a further increase in size alone would significantly increase Davids' access to promotional deals.

7.91. The significant advantage which chains offer to manufacturers is vertical control over retail outlets to ensure that promotions are effective. AAW is a loose buying group and is not able to secure such advantageous promotional deals as the chains because of its limited vertical control over retailers. It is not able to guarantee minimum sales, nor necessarily ensure that promotional prices are passed through. Many promotional deals are negotiated with individual wholesalers and banner groups rather than with AAW, but their vertical control over independent retailers is also limited.

7.92. The Commission does not accept that Davids will have significantly greater vertical control over the combined stores of a merged Davids/CBL than it has over its existing stores. There may be some increase in vertical control through financial investment by Davids in new stores and store refurbishments, but the basis of the "Fourth Force" is in the development of existing banner groups, not the development of franchising operations which would provide a significantly greater degree of vertical control.

7.93. There may also be some benefits in the form of lower supply prices in Victoria and New South Wales arising from the lower costs of supplying a single independent wholesaler in those states. Some manufacturers consider this to be the case.

7.94. There may also be some improvement in trading terms arising from better buyer information. Davids will gain access to information regarding any preferential terms obtained by CBL and will be able to take advantage of that information to combine the best of each of Davids' and CBL's terms. This appears to have been a consequence of Davids' acquisition of IHL.

7.95. Cost savings are likely to accrue from the rationalisation of the generic Black & Gold and Payless labels, leading to increased volumes. If the merger results in increased investment in retail store development and upgrading, leading to more stores achieving IGA accreditation, this is also likely to result in volume benefits to supply prices of IGA private label products. Davids have supplied supporting evidence from

suppliers of these products. These volume benefits are dependent on the proposed merger.

7.96. The Commission accepts that the benefits of increased volume purchases of generic products would constitute a public benefit. Generics are an increasingly important competitive tool in grocery retailing. To the extent that Davids supplied stores are in downstream competition with the chains, it can be expected that a significant proportion of these benefits will flow through to retailers and consumers.

### **Banner Rationalisation**

7.97. The Commission accepts that savings would accrue from banner rationalisation. These would derive from reduced overheads, significant economies of scale in advertising and potentially improved access to promotional deals from manufacturers, who would find it more attractive to deal with a larger group of stores. To the extent that these banners are in competition with the chains, these benefits are likely to be passed through to retailers and consumers. In addition, the undertakings provide for a process whereby the members of the banner groups must vote for rationalisation. This process should ensure that banner members receive some benefit from the rationalisation. Retail competition will in turn ensure that these benefits are passed through to consumers in most instances.

7.98. The Commission does not accept that banner rationalisation alone will provide CBL retailers with access to a national banner, IGA accreditation and improved retail services. CBL retailers already have access to these things through the competitive market process and have chosen not to be supplied by Davids. However, to the extent that rationalisation savings (including savings from the rationalisation of banners) and improved access to capital result in increased retail investment, increased access to IGA accreditation may be attributed to the merger (see below).

7.99. Rationalisation of banner groups may also help the competitive position of independent retailers through the creation of a smaller number of "brand names" which consumers recognise and associate with a certain level of service. In particular, "banner loyalty" comparable to the chains would enhance the ability of independents to gain access to prime shopping sites. In most cases, the provision of new supermarkets occurs through shopping centres. Supermarkets and other large retailers pay much lower rents than speciality stores, because they are used as anchor tenants to draw shoppers into the centre. The national chain supermarkets are regarded as more effective in this regard than independents. A national survey of 128 shopping centres found that of 221 supermarkets contained in them, only sixteen were independents, of which four were Jewel stores.<sup>95</sup> Development of fewer, more recognisable, banners of independent supermarkets may increase their attraction to consumers and therefore to shopping centre managers and developers. In Western Australia, where independent supermarkets are regarded as market leaders and names such as Action Food Barns attract strong brand loyalty, these retailers have been much more successful in gaining access to prime retail sites.

7.100. However, the extent of banner rationalisation deriving from the merger is uncertain. It will be dependent on a majority vote of retailers in the relevant banners. While it would seem to be in retailers interests to extract the potential benefits of

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<sup>95</sup> Jebb Holland Dimasi (1993), FAL Application for Authorisation: Review of New Store Development Proposals, report to the Trade Practices Commission.

rationalisation, submissions have indicated a strong resistance from many independent retailers to losing the separate identity of their banners. Consequently, it is difficult for the Commission to give significant weight to banner rationalisation as a public benefit likely to arise from the proposed merger.

### **The Fourth Force**

7.101. The Commission accepts that investment in new and improved stores, with improved retail support, to compete with the chains would benefit retail competition and consumers. This would enable independent retailers to offer a product range and quality comparable to that available from the chains, particularly in relation to fresh foods; but in addition they can offer consumers a different option in terms of service, through their independent ownership and specialised training. Such an alternative option would be particularly important if the Jewel chain of discount supermarkets, which is currently for sale, were to disappear as an independent source of retail competition.

7.102. However, this will only constitute a public benefit to the extent that such store developments and retail support services result from or are enhanced by the proposed merger. The Commission accepts that individual retailers do not have the same access to capital as a wholesaler, although Davids is already investing in new and improved stores, e.g. Rainbow and Festival IGA. Independent retailers can choose to access these resources and the retail services associated with Davids' banners and IGA recognition through a competitive wholesale market. Alternative wholesalers may offer a different type of support for new retail developments, e.g. franchising, which would give independents the necessary backing to access sources of capital.

7.103. As discussed above, Davids are only proposing to pass through part of the rationalisation benefits from the proposed merger to retailers in the form of increased rebates. It is proposed to retain the remainder as Davids' return on capital invested and to increase investment in retail development. The Commission accepts that downstream competition from the chains will provide an incentive for Davids to make such investments. The chains have been actively upgrading stores and building new stores and have planned capital expenditure levels of \$3-500 million each for the period 1994-97, compared to \$50 million for Davids. If the independent sector does not increase investment in upgrading retail facilities, it is likely to lose sales to the chains. The competitive pressure will be felt most intensively on independent supermarkets, who compete most closely with the chains. However, extended opening hours have increased the degree of competition between the chains and smaller grocery retailers. In order to win back sales, these retailers and Davids as their wholesaler, would benefit from new types of retail development such as the Mini Food Emporium proposed by Davids.

7.104. Most significantly, the Commission considers that a merged Davids-CBL is likely to have better access to external sources of capital for such investments, in terms of both price and quantity. When considering FAL's proposed acquisition of CBL in 1993, the Commission received independent advice that such an outcome was likely to arise from the increased profitability arising from rationalisation savings, liquidity and size (particularly for CBL) of the merged firm. Most of these benefits derived from the merger and rationalisation of Davids and CBL.<sup>96</sup> The report by County NatWest

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<sup>96</sup> AIDC Limited (1993), A report for the Trade Practices Commission relating to the Foodland Merger Proposal, 13 December.

Securities, submitted by Davids is consistent with the Commission's independent report. Such improved access to external capital provides the potential for a much more significant increase in retail development attributable to the proposed merger.

7.105. Increased retail investment is also likely to result in more stores reaching the necessary standards for IGA accreditation. Davids submitted supporting information from IGA that this could result in significant scale economies in training and retail support services, which would in turn benefit retail competition and consumers. The Commission accepts that some benefits are likely to accrue in this manner.

## **Other Issues**

### **Corporate Control**

7.106. The applicant has sought authorisation to acquire all the issued shares and other securities in CBL to which Davids has no entitlement (stated to be as at the date of the application 16, 045, 998 ordinary shares, 692, 000 converting preference shares and \$20, 000, 000 of convertible notes<sup>97</sup>). Davids has provided an updated submission setting out its understanding of the relevant interests in CBL as at this time, as set out below:

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<sup>97</sup>This may not be a complete list of the shares or other securities in CBL as at that date. Importantly, it is noted that Coles Myer in addition to holding the \$20, 000, 000 of convertible notes hold a special share in CBL which entitles it to a vote equivalent to 19.9% of the issued shares in CBL. The Commission considers that the general description in the application is sufficiently broad to encompass the Coles Myer special share and any other relevant share or security on issue.

	<b>Current Position</b>			
	<b>Ordinary shares</b>		<b>Voting Control</b>	
	<b>Number</b>	<b>%</b>	<b>%</b>	<b>Note</b>
Davids Group				1
Ordinary shares	6,876,855	29.12%	23.30%	
Convertible notes	–	0.00%	0.00%	2
Convertible preference share	–	0.00%	0.00%	2
<b>Total Davids Group</b>	<b>6,876,855</b>	<b>29.12%</b>	<b>23.30%</b>	
Coles				
Ordinary shares	–	0.00%	0.00%	
Convertible notes/special share	–	0.00%	19.99%	3
<b>Total Coles</b>	<b>–</b>	<b>–</b>	<b>19.99%</b>	
<b>Other</b>	<b>16,737,998</b>	<b>70.88%</b>	<b>56.71%</b>	
<b>Total</b>	<b>23,614,853</b>	<b>100.00%</b>	<b>100.00%</b>	

	After conversion of Coles notes at \$2/share		
	Ordinary shares		Voting Control
	Number	%	%
Dauids Group			
Ordinary shares	6,876,855	20.46%	20.46%
Convertible notes	–	0.00%	0.00%
Convertible preference share	–	0.00%	0.00%
Total Dauids Group	6,876,855	20.46%	20.46%
Coles			
Ordinary shares	10,000,000	29.75%	29.75%
Convertible notes/special share	–	0.00%	0.00%
Total Coles	10,000,000	29.75%	29.75%
Other	16,737,998	49.79%	49.79%
Total	33,614,853	100.00%	100.00%

Notes:

1. Securities other than ordinary shares consist of ten \$2 million convertible notes held by Coles, 569,975 \$1 convertible notes held by the Davids Group and 314,000 convertible preference shares held by the Davids Group.
2. There is a Standstill Agreement between IHL and CBL dated 6 June 1994, which may effect conversion dates.
3. Coles has a special share which is entitled to 19.99% of the votes at a general meeting. This voting right diminishes proportionally with conversion of the notes.

7.107. The Commission considers that it is not so limited that it can only authorise the acquisition of all the described shares and other securities. Rather, the Commission considers that it can authorise the acquisition of all or any portion of such shares and securities. However, this raises a further question as to whether there should be a minimum requirement so that Davids is not authorised to acquire less than a certain portion of such shares and securities.

7.108. Given that it is unlikely that the public benefits that the Commission has accepted as flowing from an acquisition of CBL by Davids will be achievable unless Davids gains control of CBL, the Commission is satisfied that an appropriate minimum condition should be that Davids acquire sufficient shares or securities so as to gain control of CBL. The Commission accepts the rather uncontroversial submission of Davids that provided it acquires sufficient shares so as to entitle it to cast more than 50



per cent of the votes which may be cast at any general meeting it will be in a position to control or obtain control of CBL. Accordingly, the Commission considers that any authorisation it grants should be conditional on Davids acquiring control of CBL.

7.109. In this regard, the possibility of Coles Myer converting its convertible notes and so diluting the voting power of any shares which Davids may acquire through a takeover offer must be recognised. Such conversion may have a significant dilution effect which would depend on Coles Myer entitlements at the time of conversion (although as Coles Myer already has an existing entitlement to vote up to 19.99 per cent the dilution effect has largely already happened). This dilution effect could remove a position of control which Davids would be required to obtain. One practical consequence of this would be that the undertakings that Davids has given to the Commission would cease to operate. Accordingly, the Commission considers it appropriate that any requirement for Davids to obtain control of CBL, if it does proceed to make a takeover offer, should have regard to the possible conversion of existing convertible notes and other securities.

7.110. The Commission has received confidential submissions suggesting that if Davids acquires a position of control less than that which would entitle it to compulsorily acquire all outstanding interests in CBL (that is less than 90 per cent of the relevant shares and securities), then it will not be able to merge fully the Davids and CBL operations and therefore Davids will not be able to achieve the full rationalisation benefits claimed. Indeed this concern was raised by the Commission itself in its first request for further information from Davids. The Commission has taken its own advice on this issue and, while recognising that there are certainly some implications in Davids not acquiring full control of CBL, the Commission considers that they are not so significant as to alter its principal assessment of public benefit in this case.

### **Timing and Manner of Takeover**

7.111. Another matter that has been raised with the Commission in this matter by several parties is the effect of uncertainty and delay in knowing whether Davids will be in a position to make a takeover offer for CBL. The Commission is sensitive to these concerns and has sought to ensure that Davids does not unduly delay the conclusion of the Commission's deliberations. Another aspect of uncertainty may arise as to the time in which Davids, if it is granted authorisation, may make a bid for CBL. The mere act of authorising a takeover offer by Davids for CBL will not require Davids to make such a bid. Nor would it be appropriate for the Commission to require Davids to make a takeover offer. The decision to make a takeover offer and the timing of such an offer are matters upon which private parties must be free to make their own commercial decisions. To the extent that there may be some concern at the uncertainty as to whether Davids will make a takeover offer, and concern at the delay in any such offer, this position is simply part of the commercial framework in which takeovers may or may not be made and has nothing to do with the operation of the provisions of the Trade Practices Act or the Commission's decision in this matter.

7.112. However, the question of the timing and the manner of any takeover offer which Davids does chose to make are relevant for other reasons. As to timing, a Commission decision to grant authorisation based on circumstances at one point in time can not be an open authorisation to make such an offer at any point in time. It is appropriate for the Commission's authorisation to be limited as to time.

7.113. Furthermore, a Commission decision which is based on public benefits resulting from Davids acquiring control, should be dependent on Davids acquiring that control. As noted above, the Commission considers that Davids should have a minimum obligation to acquire shares, in the event that it seeks to acquire further shares in CBL, sufficient to give it control of CBL. The most appropriate and effective way to ensure that this outcome is achieved is to make any authorisation conditional on Davids proceeding by way of a takeover scheme. Accordingly, the Commission considers that a condition to this effect should be included in its determination.

## **Review of Undertakings**

7.114. The undertakings which have been provided by Davids to the Commission are not limited as to time. However, the Commission considers that it would be appropriate to review those undertakings at some later time in order to see if they are still relevant and appropriate. Section 87B of the Act envisages that a party who has given undertakings to the Commission can seek Commission consent to vary or withdraw them. The Commission considers that it would be appropriate to review the operation of the undertakings beyond the fifth year of their effective operation.

## **Review of Authorisation**

7.115. The Commission's determination is made based on current circumstances. However, section 91(4) of the Act provides that at any time after the Commission has granted an authorisation, if it appears to the Commission that the authorisation was granted on the basis of evidence or information that was false or misleading in a material particular, that a condition to which the authorisation was expressed to be subject has not been complied with, or that there has been a material change of circumstances since the authorisation was granted, the Commission may, after giving relevant interested parties reasonable opportunity to comment, make a determination revoking the authorisation and, if appropriate, grant a further authorisation in substitution for the authorisation so revoked.

## **Conclusion**

7.116. In bringing together the evaluation of competition and public benefit issues arising from the application for authorisation, the Commission has adopted the approach set out by the Trade Practices Tribunal of comparing the position that would apply in the future were the proposed acquisition not given effect, with the position in the future which would arise if the proposed acquisition were given effect.

7.117. In the absence of the proposed merger, competition would likely continue in the markets for the supply of grocery wholesaling services to independent retailers. The Commission does not consider CBL to be a failing firm, although its future in NSW is less certain than in Victoria, where it has a significant market share and supplies the strong Tuckerbag retail banner group.

7.118. At the retail level, the chains will continue to invest heavily in new retail developments which are proving popular with consumers. Davids and some independent retailers will also continue such investments, although at a significantly lower level than the chains. Deregulation of trading hours and changing lifestyles will probably continue to erode the traditional role of independent grocers as convenience

and top up stores, although such a role will continue to exist, particularly to provide services for people without motor vehicles or who require the personal service association with independently owned stores. The new generation convenience retailing, based around petrol stations will continue to play an important role, providing a significant customer base for grocery wholesalers.

7.119. It is difficult to make predictions, but it seems likely that some further erosion of the retail sales of independents will continue as a result of these trends. However, it is not clear that this erosion will be such as to make the continued efficient operation of two independent wholesalers unviable, particularly in Victoria, where there is a much stronger base of independent supermarkets.

7.120. If the proposed merger proceeds, direct competition between independent grocery wholesalers will cease in Victoria and will be greatly diminished in NSW. The merger may provide the opportunity for AIW to expand, particularly if the merged firm were to increase prices or reduce service levels. There is also some possibility of new entry, either from QIW or FAL or through the formation and extension of buying groups, such as Foodlink, into provision of wholesale services. It will be important for QIW and FAL to retain access to the Black and Gold generics, and AIW to retain access to Payless products, as provided for in the undertakings, in order to ensure they can provide retailers with a viable alternative. However, barriers to entry are significant and increasing as the size of the market declines.

7.121. There will remain a significant downstream constraint on the conduct of the merged firm, arising from competition between the chains and independent retailers. This constraint is felt most strongly through supplies to independent supermarkets in metropolitan areas and country towns where there is direct competition with chain stores. Increased prices and reduced levels of service to these independent retailers would reduce their ability to compete and significantly erode purchases of groceries from Davids. Deregulation of shopping hours has also increased the degree of competition between the chains and independent convenience stores, increasing the price elasticity of their demand for wholesale services and therefore the disincentive for the merged firm to increase prices or decrease levels of service.

7.122. However, there remains a significant likelihood that the merged firm would increase prices and/or reduce service levels to some retailers, particularly supermarkets in country towns without chain stores and convenience stores in both country and metropolitan areas.

7.123. Independent retailers are more likely than final consumers to be damaged by any reduction in competition arising from the proposed merger. Absent the undertakings, there would likely be a redistribution of profits from retailers to Davids. However, the majority of their retail customers can switch to chain stores and hence are unlikely to absorb any significant increase in prices or reduction in service.

7.124. In order to address this issue, Davids has provided undertakings not to increase prices to retail customers, to pass through an increased rebate of at least 0.5 per cent, to at least maintain existing service levels, and not to unreasonably discriminate between banner group members. These undertakings would be monitored by an Independent Industry Ombudsman, who would have the power to determine disputes between Davids and its customers and make directions which Davids would have to comply with. The Commission would be able to enforce the Independent Industry Ombudsman's determinations in the Federal Court. However, such behavioural undertakings can

never be an adequate substitute for a structurally competitive market. The effectiveness of such undertakings in a practical sense is always problematic. Furthermore, there are limitations in such undertakings which provide price and service guarantees at one point in time in ensuring that improvements in price and service will be passed through over time. The Commission does not expect that such undertakings can guarantee the same price and service performance as a competitive market. However, while the Commission is not prepared to rely solely on the provisions of the undertakings to address its competition concerns and to ensure that rationalisation benefits will, at least in part, be passed through, the Commission does consider that the undertakings given by Davids are likely to be effective and provide real support for existing Davids and CBL customers. Furthermore, given that the undertakings provide that Davids will not be able to increase prices, either directly or indirectly, then the Commission considers that Davids will find it in their own self interest to generally maintain and increase service levels in order to maximise the volume of sales, given the price cap. Poor levels of service will reduce retail sales and therefore wholesale volumes, particularly for retailers in close competition with the chains. Volume is critical in wholesaling; with a cap on price, increased volumes will increase revenue and decrease unit costs.

7.125. There will be significant rationalisation savings arising from the proposed merger, both in relation to warehousing, transport, overheads, generics, and banner rationalisation to the extent that it occurs. Competition between some independent retailers and the chain supermarkets will provide an incentive for Davids to pass through some of these benefits. In addition, Davids has provided undertakings to pass through part of the benefit directly to retailers in the form of increased rebates. The Commission is satisfied that the undertakings will require Davids to improve its wholesale prices through an ongoing increased rebate to Davids and CBL customers of at least 0.5 per cent. Retail competition will in turn ensure that these benefits flow through to consumers.

7.126. Competition and the undertakings are likely to ensure an improved offering in terms of price and service by most independent retailers, to the benefit of consumers.

7.127. Rationalisation is also likely to result, both directly and more importantly through improved access to capital, in the accelerated development of a "fourth force" in supermarket retailing, through investment in new and upgraded retail facilities and improved retail support services. Competition between Davids' retail customer base and the chains provides the incentive for such investment to occur.

7.128. The Commission is satisfied that in all the circumstances the acquisition of CBL by Davids would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

## **8. Determination**

8.1. For the reasons contained herein, the Commission grants authorisation to application A30165 made under section 88(9) of the Act. Authorisation is granted for a period of fifteen months, commencing on the day on which the authorisation granted by this determination comes into force, and is subject to conditions that:

- (a) Davids shall acquire any additional shares, convertible notes, debentures or other securities in CBL only by way of, in conjunction with or immediately followed by a takeover scheme, provided that this condition will not prevent the conversion in accordance with their terms of any convertible securities in CBL to which Davids is presently entitled; and
- (b) Davids will not acquire a share or shares issued by CBL which is not an ordinary share or ordinary shares unless by the acquisition Davids controls CBL within the meaning of that expression in the undertakings given by Davids to the Commission pursuant to s.87B of the Trade Practices Act, dated 29 May 1995; and
- (c) any takeover scheme announced by Davids is to contain a minimum acceptance condition to ensure that Davids will become entitled at the conclusion of the takeover scheme, or of any period of compulsory acquisition, to such number of shares in CBL as will entitle it to cast more than 50 per cent of the votes which may be cast at any general meeting of CBL. In calculating the number of votes which may be so cast, Davids shall treat all convertible notes and other convertible securities as if they had already been converted and Davids shall not waive its minimum acceptance condition unless it is or will become entitled to more than 50 per cent of the votes which may be cast at any general meeting of CBL.

8.2. This determination is made on 29 May 1995. If no application for review of this determination is made to the Trade Practices Tribunal in accordance with section 101 of the Act, the authorisation granted by this determination will come into force on 20 June 1995.

8.3. If an application for review is made to the Tribunal, the determination will come into force:

- (a) on the day on which the Tribunal makes a determination on the review and grants authorisation; or
- (b) where the application for review is withdrawn - on the day on which the application is withdrawn.

8.4. According to section 102(1A) of the Act, where a person applies to the Tribunal for review of a determination of the Commission relating to the granting of an authorisation under subsection 88(9), the Tribunal must make its determination on the review within sixty days after receiving the application for review. However, section 102(1B) provides that the sixty day time limit in subsection (1A) does not apply if the Tribunal considers that the matter cannot be dealt with properly within that period of sixty days, either because of its complexity or because of other special circumstances.

## Appendix A - Abbreviations

AAW	Australian / Asia Pacific Wholesalers Pty Ltd
ACT	Australian Capital Territory
AIW	Australian Independent Wholesalers Pty Ltd
ALM	Australian Liquor Marketers Pty Ltd
CBL	Composite Buyers Limited
CNWSAL	County NatWest Securities Australia Limited
EFTPOS	Electronic Funds Transfer at Point Of Sale
FAL	Foodland Associated Limited
FIS	Free Into Store
GEMMnet	Global Electronic Marketing & Merchandising Network
GMA	Grocery Manufacturers of Australia Ltd
IEL	Industrial Equity Limited
IHL	Independent Holdings Limited
MES	Minimum Efficient Scale
QIW	Queensland Independent Wholesalers Limited
RCMBA	The Retail Confectionary and Mixed Business Association
SIW	Statewide Independent Wholesalers
SSNIP	Small but significant and non-transitory increase in price
TIW	Tasmanian Independent Wholesalers
TPA	<i>Trade Practices Act 1974</i> (the Act)
TPC	Trade Practices Commission
VGD	Victorian Grocery Distributors

# **Appendix B - Section 87B Undertakings**

## DAVIDS LIMITED

### UNDERTAKINGS GIVEN TO THE TRADE PRACTICES COMMISSION

These undertakings are given to the Trade Practices Commission (the "Commission") by Davids Limited ("Davids") under section 87B of the Trade Practices Act 1974.

#### PURPOSE OF UNDERTAKINGS

If Davids controls CBL, these undertakings are intended to ensure the following outcomes and are given for the following purposes and shall be interpreted accordingly:

- to limit the effects on customers of Davids and CBL and on consumers of any lessening of competition
- to provide for improvement in rebates of at least 0.5% to the members of banner groups listed in Schedule 3
- to provide, in addition to all of the rights and remedies of the Commission to enforce these undertakings, mechanisms to review Davids' compliance with these undertakings
- to establish a system for resolution of complaints
- to ensure that there is no reduction in the nature, quality or level of services currently provided by Davids and CBL to their customers
- to ensure that there is no unreasonable discrimination between members of banner groups

## INTERPRETATION

AAW means Australian Asia/Pacific Wholesalers Pty Limited, A.C.N. 002 743 044 and its related companies within the meaning of the Corporations Law.

AIW means Australian Independent Wholesalers Pty Ltd, A.C.N. 060 951 733 and its related companies within the meaning of the Corporations Law.

A reference to a person who controls CBL means a person who is:

- (a) the holder of shares which entitle the person to cast or control 50% or more of the votes which may be cast at an Annual General Meeting or an Extraordinary General Meeting of CBL;

or

- (b) in a position to control the appointment or removal of a majority of the directors of CBL.

CBL means Composite Buyers Limited, A.C.N. 004 201 343 and its related companies within the meaning of the Corporations Law.

Dauids means Davids Limited, A.C.N. 000 031 569 and its related companies within the meaning of the Corporations Law.

Determination Date means the date of the Commission's determination of Davids' application for authorisation A30165.

Effective Date means the first date on which Davids controls CBL.

Independent Industry Ombudsman means an independent person with substantial knowledge of the grocery industry, of grocery wholesaling or of grocery distribution appointed in accordance with clause 12.1(b).

Review Date means 1 July in each year following the year in which Davids first controls CBL.

Services has the meaning ascribed by the Trade Practices Act and includes those services listed in Schedule 1.

Wholesale prices means wholesale prices and trading terms including all the elements on both the credit and debit side of both the direct and indirect cost of supply determined by having regard, among other things, to the matters listed in Schedule 2.



Where the context permits:

- a reference to the doing of or refraining to do any thing by a body corporate shall include the doing of or refraining to do that thing by a body corporate which is a related body corporate of the body corporate referred to. Where these undertakings require Davids to do or refrain from doing a certain thing, Davids shall use its best endeavours to procure that a relevant related body corporate shall do or refrain from doing that thing so as to ensure that thing is done or not done, as the case may be.
- a reference to the singular includes the plural, and vice versa, and a reference to a person includes a body corporate.

### UNDERTAKINGS

Davids undertakes as set out below:

#### 1. Provision of Wholesale Prices and Services to Davids' Customers

Davids undertakes to continue to provide both wholesale prices and services to each of its customers that are no less favourable than those provided by Davids to such customers on the Determination Date.

#### 2. Provision of Wholesale Prices and Services to CBL Customers

Davids undertakes to ensure that each of CBL's customers will continue to receive both wholesale prices and services that are no less favourable than those provided by CBL to its customers on the Determination Date.

#### 3. Increased Rebates

Davids undertakes that, within 12 months after the Effective Date, it will increase or procure the increase of the rebate provided to members of the banner groups listed in Schedule 3 by at least 0.5% and will thereafter maintain that increased rebate, such that these members will enjoy at all subsequent times a net improvement of at least that degree in their trading terms with Davids, as measured against their trading terms as at the Determination Date. The increased rebate shall be provided by an increase of at least 0.25% within 6 months of the Effective Date and a further increase of at least 0.25% within 12 months of the Effective Date.

#### 4. Transfer to Davids System

Davids undertakes to provide to any CBL customer which so requests in writing, or to any CBL banner group, the Committee of which so requests in writing, both wholesale prices and services that are no less favourable than those it provides to an equivalent customer (or banner group) of Davids and Davids shall not thereafter be obliged to comply with clauses 2 and 3 in relation to that customer (or banner group).

5. Transfer to CBL System

Dauids undertakes to ensure that any Davids' customer which so requests in writing, or any Davids' banner group, the Committee of which so requests in writing, will receive both wholesale prices and services that are no less favourable than those provided to an equivalent CBL customer (or CBL banner group) and Davids shall not thereafter be obliged to comply with clauses 1 and 4 in relation to that customer (or banner group).

6. Davids' Banner Groups

Dauids undertakes to continue to maintain each of its banner groups other than a banner group in respect of which a majority of the stores in that banner group otherwise agrees in a ballot in which one vote may be cast in respect of each store in the banner group.

7. CBL Banner Groups

Dauids undertakes to procure the continued maintenance of each of CBL's banner groups other than a banner group in respect of which a majority of the stores in that banner group otherwise agrees in a ballot in which one vote may be cast in respect of each store in the banner group.

8. Incentives

If Davids offers any benefit or incentive to any member of a banner group to agree to the discontinuance of that banner group or to act or vote in a certain way in relation to that banner group, then Davids undertakes to offer the same or an equivalent benefit or incentive to all other members of that banner group.

9. Discrimination between Members of Banner Groups

Dauids undertakes not to unreasonably discriminate, in terms of wholesale prices, services or otherwise, between members of any particular banner group.

10. Maintenance of AAW

Dauids undertakes to use its best endeavours to ensure that Black and Gold generic products and terms negotiated through AAW continue to be made available to existing members of AAW on the same, or a more favourable, basis as on the Determination Date and that supply of Black and Gold generic products and terms negotiated through AAW are offered to AAW members on a non-discriminatory basis.

## 11. Supply to AIW

Dauids undertakes to ensure continued supply of Payless generic products to AIW on terms which are no less favourable to AIW than are provided by CBL to AIW on the Determination Date unless AIW otherwise agrees in writing.

## 12. Independent Review of Undertakings

- 12.1 (a) Davids undertakes to initiate arrangements for the appointment of an Independent Industry Ombudsman answering the description in the interpretation section of these undertakings within 30 days of the Effective Date.
- (b) Davids undertakes that the Independent Industry Ombudsman will be appointed through the agreement of Davids and at least a majority by number of the Committees of the banner groups specified in Schedule 3 or, in the absence of such agreement being reached within 60 days of the Effective Date, appointed for the purposes of these undertakings by the President for the time being of the Institute of Chartered Accountants. The appointment of the Independent Industry Ombudsman shall be effected as soon as practicable.
- 12.2 In the event that, from time to time, an Independent Industry Ombudsman so appointed is unable or unwilling to continue, or if a majority of the Committees of the banner groups so request in writing, Davids undertakes to arrange for the replacement of the Independent Industry Ombudsman forthwith. The provisions of these undertakings shall apply, as if the necessary changes have been made, to the selection, appointment and replacement of the new Independent Industry Ombudsman.
- 12.3 Davids undertakes to cooperate fully with the Independent Industry Ombudsman on and from each Review Date and to assist the Independent Industry Ombudsman to prepare a report in relation to Davids' compliance with these undertakings during the period prior to the Review Date.
- 12.4 Davids undertakes to create, maintain and at all times have available, such books, accounts or other records as are necessary to enable the Independent Industry Ombudsman to accurately and conveniently assess Davids' compliance with these undertakings and to facilitate that assessment.
- 12.5 Davids undertakes to provide full and free access to the Independent Industry Ombudsman to such books, accounts and other records of Davids as are requested by the Independent Industry Ombudsman to enable the Independent Industry Ombudsman to prepare the report.
- 12.6 Davids undertakes to procure the Independent Industry Ombudsman to provide a copy of the report to Davids and to the Commission promptly following completion of the report.
- 12.7 Davids undertakes to bear all reasonable costs of the Independent Industry Ombudsman in relation to the report and to comply promptly and fully with any directions given by the Independent Industry Ombudsman in the report.

### 13. Report on Compliance to Banner Groups

- 13.1 Davids undertakes to procure the Independent Industry Ombudsman to prepare a report for a banner group if the Committee of that banner group requests the Independent Industry Ombudsman in writing to prepare a report regarding Davids' compliance with these undertakings in relation to the members of that banner group and provides a copy of its request to Davids, provided that Davids shall not be obliged by this sub-clause to procure more than 2 reports in any calendar year in respect of any particular banner group.
- 13.2 Davids undertakes to procure the Independent Industry Ombudsman to provide in the report such information as the Independent Industry Ombudsman considers necessary or appropriate from the books, accounts and other records referred to in Clause 12.4 in order to provide verification of Davids' compliance or non-compliance, but if the Independent Industry Ombudsman considers it more convenient or appropriate (particularly in the case of confidential information), the Independent Industry Ombudsman may provide such information separately to the Committee of the banner group in such manner as the Independent Industry Ombudsman considers appropriate.
- 13.3 The provisions of Clause 12 shall apply in relation to such a report as if it were a report prepared for the purposes of Clause 12.3.

### 14. Complaint Resolution

- 14.1 If a dispute arises between Davids and a banner group, a wholesaler or retailer customer (the other party to the dispute) about Davids' compliance with these undertakings, including a dispute concerning any ballot referred to in these undertakings, which is not otherwise resolved within 21 days after the other party to the dispute first makes a complaint to Davids, Davids undertakes, if so requested by the other party to the dispute, to immediately refer details of the complaint in writing to the Independent Industry Ombudsman and to provide a copy of the referral to the other party to the dispute.
- 14.2 Davids and the other party to the dispute may make written or oral submissions in respect of the complaint to the Independent Industry Ombudsman within any time limit prescribed by the Independent Industry Ombudsman.

- 14.3 To enable the Independent Industry Ombudsman to determine a complaint, Davids undertakes to cooperate fully with the Independent Industry Ombudsman and to provide full and free access to the Independent Industry Ombudsman to such books, accounts and other records of Davids as are requested by the Independent Industry Ombudsman, including those specified in clause 12.4, and Davids undertakes to use its best endeavours to ensure that its officers cooperate fully with the Independent Industry Ombudsman.
- 14.4 Davids undertakes to be bound by the decision of the Independent Industry Ombudsman in relation to the complaint and undertakes to comply promptly and fully with any direction given or determination made (including a direction given or determination made by the Independent Industry Ombudsman pursuant to the instructions referred to in clause 15.1) by the Independent Industry Ombudsman in relation to the complaint
- 14.5 Davids undertakes to pay the reasonable fees and expenses of the Independent Industry Ombudsman in connection with the determination of any complaints, including any other reasonable fees or expenses incurred by the Independent Industry Ombudsman that are reasonably incidental to the performance of his or her duties under these undertakings.

15. Terms of Reference and Determinations of Independent Industry Ombudsman

- 15.1 The terms of reference of the Independent Industry Ombudsman shall provide that the Independent Industry Ombudsman:
- (a) must interpret these undertakings and Davids obligations under them in order to achieve the outcomes and advance the purposes for which these undertakings are given;
  - (b) must act fairly and expeditiously and must apply these undertakings in a practical fashion;
  - (c) shall make determinations within the absolute discretion of the Independent Industry Ombudsman as an expert and not as an arbitrator;
  - (d) may, in the absolute discretion of the Independent Industry Ombudsman, prescribe any procedures and time limits considered appropriate by the Independent Industry Ombudsman for the purposes of any particular complaint and may deal with any complaint in the manner considered most appropriate by the Independent Industry Ombudsman;
  - (e) may, in the absolute discretion of the Independent Industry Ombudsman, summarily dispose of any complaint if the Independent Industry Ombudsman considers that the complaint is frivolous, vexatious, repetitive, lacking in substantial merit or that it has been substantially previously dealt with;

- (f) may, in the absolute discretion of the Independent Industry Ombudsman, summarily dispose of any request for a report pursuant to clause 13 if the Independent Industry Ombudsman considers that the request is frivolous or vexatious;
- (g) must, as soon as practicable, notify the Commission in writing of any occurrence which, in the view of the Independent Industry Ombudsman, constitutes a breach by Davids of these undertakings, providing particulars of same;
- (h) shall, unless the complainant so requests or consents in writing, direct that neither party shall be entitled to be legally represented before the Independent Industry Ombudsman; and
- (i) may make such determinations as the Independent Industry Ombudsman considers appropriate including determinations that:
  - (A) any contract or any part of any contract between Davids and any customer or group of customers shall not be enforceable by Davids, either ab initio or from a date specified in the decision;
  - (B) the terms of any such contract shall be varied in a manner specified in the decision, either ab initio or from a date specified in the decision;
  - (C) Davids refund money, return property, allow a credit or rebate or other benefit or pay a sum of money to compensate a customer or group of customers for any loss that has been or may be suffered by it or them;
  - (D) Davids supply services and or goods to a customer or group of customers; or
  - (E) Davids do or refrain from doing any act or thing.

15.2 Nothing in these undertakings shall be interpreted so as to limit or restrict any right or remedy a customer or group of customers may have against Davids other than the rights and remedies provided in these undertakings.

#### 16. Notification of Non-Compliance

If Davids does not comply with any undertaking contained herein, it undertakes to promptly so notify the Commission and the Independent Industry Ombudsman in writing setting out the reasons for its failure to comply.

## 17. Effect of Undertakings

These undertakings will have no effect:

- (a) until the Effective Date;
- (b) if Davids ceases, by reason beyond Davids' control to control CBL, until it again controls CBL; or
- (c) in relation to a retail customer or wholesaler, who has notified Davids and the Independent Industry Ombudsman in writing that these undertakings are no longer to have effect in relation to that customer or wholesaler (as the case may be).

## 18. General

- 18.1 Davids undertakes that it will not at any time after the Effective Date divest itself of any part of its interest in any or all of its shares in CBL unless it first has the written consent of the Commission so to do.
- 18.2 Davids further undertakes to use its best endeavours to ensure that the purposes for which these undertakings are given and the outcomes intended to be achieved are not frustrated or impaired by any act or thing it does or omits to do.
- 18.3 Without limiting the generality of the foregoing, Davids undertakes not to do nor cause nor permit to be done any act or thing whatsoever that will diminish the value to customers of Davids or CBL of the undertaking given in clause 3.
- 18.4 Insofar as Davids' and CBL's trading terms with their suppliers influence wholesale prices and services to customers of Davids or CBL, Davids undertakes to use its best endeavours to obtain the best possible trading terms from those suppliers and in determining wholesale prices and services, regard shall be had to the prices and services provided to Davids and CBL by their suppliers.
- 18.5 Davids undertakes to supply any assignee or successor of any Davids or CBL customer on the same basis as that customer and to offer to supply any other new customer on the same basis as any other member of a banner group which the new customer joins or would be eligible to join.
- 18.6 Davids undertakes to advise the Commission in writing of the Effective Date and each occurrence of an event referred to in clause 17 within seven days of its occurrence.
- 18.7 Davids undertakes to provide a copy of these undertakings to all customers of Davids and CBL within seven days of the Effective Date.
- 18.8 Davids acknowledges that nothing in these undertakings is intended or is to be taken to in any way fetter or diminish the rights and remedies available to the Commission to enforce these undertakings, nor to fetter or constrain any order the Court may make on any application to it by the Commission.

SCHEDULE I

WHOLESALE SERVICES

Price Lists  
Shelf Labels  
Case Labels  
Store Plans  
Store Layout Assistance  
Shelf Management Program  
Host Support Services  
Prize Zone and Competitor Price Monitoring Services  
Training Programs  
Retail Systems  
Order Books  
Micro Fiche  
Retail Merchandising Services  
Stock Range (including liquor)  
Stock Levels  
Field Counsellor calls  
Advice on Equipment and Layouts  
Deli and Produce Specialists  
Meat Specialist  
Banner Group:                      Handbills  
    Television  
    Radio activity  
    Press



New Store support:

Re-ticketing  
Housebrand Relay  
External Signage  
P.O.S. Material  
Computer and Register conversions  
Fresh Food Training

P.D.E. Maintenance

P.D.E. Stocktake Service

Order, pick up and delivery arrangements

Shrink Wrapping of Pallets

Retail Accounting

Provincial promotional price zones

Delivery Rosters

Order Rosters

Demographics

Site Potential

Independent freight access to Davids' warehouses

## SCHEDULE 2

### WHOLESALE PRICES

#### A. Supplier Terms

1. Prices at and terms on which suppliers supply goods and services to Davids or CBL (as the case may be)
2. All discounts, allowances, rebates or credits in relation to goods or services supplied to Davids or CBL (as the case may be), including:

- Distribution Allowances
- Warehouse Allowances
- Supplier Settlement Discount
- Ullage
- Co-operative moneys
- Case Deals

#### B. Davids and CBL Terms

- Freight/Delivery fees
- Service Fees
- Rebates and Allowances
- Application of Bonus Stocks
- Wholesale Loadings
- Direct Charge through fees
- Retailer Settlement Terms/Finance fees
- Money into Price
- Franchise fees
- Advertising fees
- Refrigeration fees
- Banner Membership fees
- Minimum order fees
- Pallet fees

SCHEDULE 3

BANNER GROUPS

Dauids (New South Wales, Victoria and Australian Capital Territory)

Rainbow

Festival

Foodtown

Cheapa

Welcome Mart

Clancy's

CBL (New South Wales, Victoria and Tasmania)

Maxi

Tuckerbag

Payless

Riteway

Goodfellows

Budget Rite

MFC

Tiger Barn

Tasmanian Island Food Mart

EXECUTED ON 29 MAY 1995



THE COMMON SEAL of )  
DAVIDS LIMITED was duly affixed in )  
the presence of: )

*Jeffrey J. David*  
Signature

*John M. Patten*  
Signature

JEFFREY J. DAVID  
Print name

JOHN M. PATTEN  
Print name

DIRECTOR  
Office held

DIRECTOR  
Office held

ACCEPTED BY THE TRADE PRACTICES COMMISSION

*[Signature]*  
Deputy Chairman

Date: 29th

May 1995

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