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SPAR Australia Limited

Submission to the Competition Policy Review

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Summary of SPAR Australia Limited Submission

- Section 46 of the Competition and Consumer Act has been a failure in preventing misuse of market power.

- There have only been eleven successful prosecutions out of eighteen under section 46 of the Competition and Consumer Act (previously the Trade Practices Act) in 38 years up until 2012. (See Appendix A). This demonstrates the total failure of section 46 to prevent market abuse.

- SPAR have firsthand experience of market abuse and the failure of the current legislative and regulatory framework to be able to address it. (See attachment Appendix B)

- Market abuse continues in the wholesale independent grocery market dominated by Metcash.

- Despite the 2008 ACCC inquiry into the retail grocery sector, nothing has changed.

- In the absence of reform of section 46 of the Competition and Consumer Act 2010, market abuse will essentially continue unchecked.

- Section 46 needs to be rewritten and consideration be given to make breaches of section 46 either a criminal offence or an economic crime punishable by severe penalties to provide a real deterrent to market power abuse participants

Introduction

SPAR welcomes the opportunity to provide a submission to the Competition Policy Review

The issue in particular that SPAR would like to submit to the Review pertains to the question posed in Chapter 5 of the issues paper, Competition Laws, and the issue of misuse of market power under section 46 of the CCA.

The issues paper poses the question:

> *"Given structural changes in the economy over time, how should misuse of market power be dealt with under CCA?" (p29)*

The issue of misuse of market power is one that SPAR has first-hand experience of in terms of suffering commercially from market power abuse and seeing first-hand the total incapacity of the current legislative and regulatory framework to address it.

It is interesting to note that since the 2008 Grocery Inquiry conducted by the ACCC and its examination of the retail grocery market, the power of the two supermarket chains Coles and Woolworths and the power of Metcash as a wholesale provider to the independent sector, not much if anything has changed.

Coles and Woolworths continue to dominate the retail sector and Metcash continues to dominate the wholesale independent sector, with the ultimate loser being the Australian consumer, with small independent family owned businesses being collateral damage along the way.

Background - Who is SPAR?

SPAR is a broad based wholesaler and the only competitor to Metcash in the supply of packaged grocery products to the independent supermarket sector. As such SPAR seeks to provide a competitive force to Metcash in the market for packaged grocery products, but is facing increasing anti-competitive behaviour that if successful and unchecked, will even further limit choice for the independent supermarket retail sector, which will ultimately be to the detriment of consumers, particularly in rural and regional Australia.

Currently SPAR supply around 400 independent retailers, predominately located in Queensland, New South Wales and the ACT and mostly in rural and regional centres.

From both SPAR's commercial experience and anecdotal observations of what is happening in the market place, it is clear that section 46 has been a failure in preventing ongoing market abuse and is in need of reform.

What is a typical SPAR Franchise?

A classic small business with most SPAR franchisees employing less than 20 staff.

The key distinguishing attributes of a SPAR franchise are:

- Most SPAR store owners are single store operators.
- Most are NSW and Queensland country/rural based.
- In some cases these stores would be the only supermarket in the town.
- In some cases these stores are the largest business and employer in the town.

The Role of the Small Business Independent Supermarket Retailer and the issues they face:

The Market in which they operate

The retail market in packaged goods is dominated by Coles and Woolworths.

They have an approximate 80% market share, with Metcash and the independents accounting for about 18%.

By contrast, in the UK the five largest retailers control just over 70% with the biggest, Tesco controlling 28% and in the USA the biggest, Walmart has 25% (IBIS World industry research report).

SPAR would pose the question where else in a modern economy would the regulator allow a cosy duopoly where two large market players control an 80% market share in what industry participants such as SPAR are consistently told is a 'competitive market'?

If it is that competitive then, how is a duopoly able to maintain an 80% market share if it wasn't due to a failure of the existing law, market power abuse, predatory pricing, barriers to entry or any combination thereof?

The remainder of the market is made up of the international players ALDI and Costco, which are growing strongly but are not widely represented.

Both are relatively new entrants into the retail, but importantly, both have zero presence in rural and regional Australia and are unlikely to do so as their business models only support serving large population centres in order to drive profit through large volume through put. As such rural and regional Australia in particular will continue to see less competition even with the entry of new players such as ALDI and Costco.

This sees the wholesale market in rural and regional Australia dominated by Metcash with a 98% market share and SPAR and others 2% supplying to the independent retail supermarket sector.

Even with just 2% market share it is becoming clear to SPAR that Metcash will do whatever it can to stifle SPAR's growth.

Key Issues faced by the Small Business Supermarket Retailer

Small business as a whole is one of the biggest employers and wealth creators in Australia.

However, in the retail sector they are becoming increasingly extinct, with anti-competitive, market abuse behaviour a key driver of their extinction.

Of those remaining small businesses, they provide a valuable service, as well as employing thousands of people in the towns and rural areas in which they operate, but face continual threats to their very survival with Government and regulators seemingly unable or unwilling to prevent, both the march of increasing market concentration and the stamping out market power abuse.

The 2008 ACCC Grocery Inquiry

In the context of the current review it is worth revisiting some findings from the 2008 ACCC Grocery Report Inquiry as it helps to highlight, as was mentioned previously, that nothing has really changed since this report came down nearly six years ago.

Hence, small business needs as much assistance as it can get and SPAR sees this review as an opportunity to hopefully address market abuse activity that is prevalent and detrimental to the growth of small to medium sized business in the wholesale and retail supermarket sector.

The 2008 report found for instance in regards to Metcash in particular that:

- Independent supermarkets provide a competitive force in grocery retailing, often providing consumers with a more convenient alternative to the major supermarket chains (MSCs)

- There are a reasonable number of independent supermarkets that have the size and location that should give them the ability to compete strongly with Coles and Woolworths on price. Indeed, some independent supermarkets do compete on price. <u>However, the ACCC considers that the prices Metcash sets for its wholesale packaged groceries are a significant factor holding back many independent retailers from more aggressive price competition.</u> *(SPAR emphasis)*

- Large independents which do opt to compete on price with the MSCs are often only able to do so by <u>earning little net margin on goods supplied by Metcash.</u>

- The inability of independent retailers to source grocery products from Metcash at competitive prices makes it difficult for large independent retailers to compete aggressively on price.

- <u>Metcash is able to achieve healthy margins primarily because it is the only national wholesaler to independent retailers</u>. There is some evidence that Metcash is acting to protect this position by locking in retailers and suppliers. However, it is clear that Metcash has expanded its profit margins and now achieves in excess of those achieved by the MSCs.

- <u>The ACCC considers that Metcash is extracting some 'monopoly' profits because of the lack of alternative wholesaling arrangements available to most independent retailers. The size of these 'monopoly' profits is likely</u>

to be a small percentage of retail prices. However, given that grocery retailing is a high turnover business with low EBIT margins, this is significant. Moreover, there is some evidence that Metcash is acting to protect its business as the only national grocery wholesaler supplying independent retailers. Metcash is implementing strategies that appear to unnecessarily impede independent retailers from dealing directly with suppliers or leaving Metcash to set up their own wholesaling operations.

Failure of Section 46 of the Competition and Consumer Act 2010

(For prove of the failure of Section 46 and the ACCC in bringing cases under section 46 SPAR would refer the Review Panel to the article in Appendix A.)

As the article in Appendix A states:

"The real issue in relation to Section 46 is not that the ACCC regularly loses such cases (which is not borne out by the numbers), but rather that it simply does not take enough Section 46 cases. In the 38 years since Section 46 was enacted, the ACCC (and the TPC before it) only commenced 18 cases which alleged a contravention of Section 46, or only one Section 46 case every two years. The ACCC should be much more active in investigating and litigating Section 46 allegations - only by taking such cases will the law in relation to Section 46 be clarified."

SPAR would suggest to the review panel that either the law is deficient in regards to section 46, or the ACCC is deficient in not seeking to litigate more cases under Section 46.

SPAR notes that the Dawson Inquiry from 2003 recommended no change in regards to Section 46. It is therefore encouraging the current Government has commenced the Competition Policy Review which includes a review of Section 46.

The Government has tasked the Competition Policy Review with the following question:

> *"Given structural changes in the economy over time, how should misuse of market power be dealt with under the CCA?" (P29 Competition Policy Review Issues Paper).*

This is an important question and the community now has another ten years of business behaviour to examine from the Dawson Review, particularly the behaviour of the major supermarket chains and Metcash in which to address this question.

While the article claims that the ACCC has had more success than the community would believe the actual facts up until 2012 show that between 1974 and 2012 the ACCC has only prosecuted a total of 18 cases alleging a breach of Section 46. So that is 18 cases in 38 years.

To the casual observer how can this be considered a success? How can this constitute proof that Section 46 is working as intended, in being both a deterrent to and prosecution of market abuse behaviour?

In those 18 cases, the ACCC was successful in 11. So 11 successful cases under Section 46 in 38 years, so once again to the casual observer how is this considered to be a success?

The key point SPAR would make is that either Section 46 is deficient as it currently stands, or the ACCC is remiss in not bringing more cases to court under Section 46 or both.

In SPARs view and from its only commercial experience it is indeed both.

With 18 cases in 38 years, it is clear that Section 46 is but a mere irritant to major corporations who on a rare occasion are bought to account under Section 46. For many, SPAR would argue it is just the cost of doing business.

Both prosecutions to date and penalties to date show that Section 46 is not working as intended and the ACCC has been reluctant to bring cases under Section 46, no doubt through fear of failure in the courts or a lack of resolve to want to do so.

Suggested improvements to section 46

As the consultation paper itself states, *".....determining when a firm's independent behaviour is (or should be) illegal, as opposed to a legitimate competitive action is one of the most complex and controversial areas in competition policy"*. (P29).

This is a fair statement, but by the same token, at what stage do policy makers come to the conclusion 11 successful cases out of 18 over 38 years represents a total failure of the intention of Section 46, that being the prevention of the abuse of market power.

It is clear that what constitutes abuse and misuse of market power needs to be rewritten.

The obvious questions are, what is a market and what is misuse of market power, rather than just good old fashioned competition?

Fundamentally, Section 46 needs to be rewritten to give it teeth so its acts as a real deterrent, rather than the failure it has been to date. That means changing the definitions that currently exist to make it easier for the ACCC to prove misuse of market power.

The Review Panel should also consider making it a criminal offence with liability resting not just with those individuals responsible for the market abuse behaviour, but also holding the board of the company to account as well. This would ensure that boards become more involved to ensure that market abuse behaviour was negated and questionable practices prevented or stopped.

If criminal liability is seen as a step too far than then contravention of Section 46 should be seen as an economic crime with appropriate penalties. The current penalties are seen by perpetrators as no more than the cost of doing business in SPARs opinion, but giving the Courts power to impose real economic sanctions, such as the breakup of a company, or a fine up to say 10% of the net asset value of the company would send a real message.

After all, market abuse is an economic cost borne ultimately by all in the community, so why shouldn't the cost of that abuse be recompensed by the company responsible for the abuse?

Conclusion

SPAR would encourage that the Review Panel in its deliberations and recommendations to Government recognise the failure of Section 46 to prevent ongoing market abuse practices in the Australian market place.
A revamped Section 46 making it easier to prove misuse of market power with enhanced penalties would act as a very strong deterrent to those that wish to engage in market abuse behaviour.

Without change to Section 46 there will not be any change in the behaviour of those that seek to engage in market power abuse behaviour.

Eleven successful cases under section 46 in 38 years, SPAR believes provides proof of that.

APPENDIX A

ACCC's record on section 46 cases

(*This article first appeared in Keeping good companies, the Journal of Chartered Secretaries Australia Ltd, April 2012, Volume 63 No. 3, pp. 158-161. – reproduced in full)*

The ACCC has been more successful in winning s 46 cases than is generally thought. The popular view is that the ACCC rarely wins such cases. This view has been given considerable credence by comments made by the ACCC, for example the following statements made by former ACCC Chairman Graeme Samuel in 2010:

The tests involved in proving allegations of abuse of market power have been inconsistently interpreted in the courts over recent years. As a consequence, it has become unrealistically difficult to overcome the hurdles necessary to prove contraventions of the law – resulting in few successful cases.

This sentiment has also been echoed more recently by the current Chairman of the ACCC, Rod Sims:

Further, over the years only a handful of cases under section 46 have succeeded in court. Indeed, section 46 cases are always hard fought, as major companies are necessarily involved, and they are usually defending what they may see as a key part of their business strategy.

The guidance to be derived from case law – at least in successful cases – is relatively modest.

So, the ACCC finds itself in the middle, with high public expectations on one side and high legal standards and few successful cases on the other.

However, in reality the ACCC has won more than 70% of the s 46 cases which it litigated to a conclusion:

ACCC and TPC Section 46 cases – 1974 to 2012

Case	Year	Claims	Result
CSBP & Farmers Limited	1980	ss. 45, 46	Lost
Carlton United Breweries Limited	1990	s.46	Won - consent
CSR Limited	1991	ss.45, 46	Won - consent
Commonwealth Bureau of Meteorology	1997	s.46	Won - consent
Darwin Taxi	1997	s.46	Won - consent

Cooperative Limited			
Garden City Cabs	1997	s.45, 46	Won - consent
Safeway Limited	2003	ss.45, 46	Won - contested
Rural Press Limited	2003	s.45, 46	Lost s.46 case but won s.45 case
Boral Limited	2003	s.46	Lost - High Court
Qantas Limited	2003	s.46	No result – case settled with each party bearing their own costs
Universal Music and Warner Music (CD's case)	2003	s.45, 46, 47	Lost ss.45 and 46 cases but won s.47 case
FILA Pty Ltd	2004	ss.46, 47	Won - uncontested
Eurong Beach Resort	2005	s.45, 46, 47	Won - consent
Cardiothoracic surgeons	2007	ss.45, 46	No result – s.46 claim dropped as part of the settlement
Baxter Limited	2008	ss.46, 47	Won - contested
Cabcharge Limited	2010	ss.46, 47	Won - consent
Ticketek Pty Ltd	2011	s.46	Won – consent
Cement Australia Pty Ltd	Ong oing	s.46	Judgment reserved

Since the introduction of s 46 in 1974, the ACCC, and its predecessor the TPC, has instituted 18 cases alleging a contravention of s 46. Of these 18 cases, the ACCC:

- achieved successful outcomes in 11; lost four, dropped the market power allegation in one case, effectively drew one case and is awaiting judgment in the final case.

The ACCC has won 11 of the 15 s 46 cases which have gone to a final decision, a success rate of 73%. Further, the ACCC has resolved 8 of its 11 successful cases by consent, which would suggest that the ACCC is very good at "picking winners".

Conclusions

The real issue in relation to s 46 is not that the ACCC regularly loses such cases (which is not borne out by the numbers), but rather that it simply does not take enough s 46 cases. In the 38 years since s 46 was enacted, the ACCC (and the TPC before it) only commenced 18 cases which alleged a contravention of s 46, or only one s 46 case every two years. The ACCC should be much more

active in investigating and litigating s 46 allegations - only by taking such cases will the law in relation to s 46 be clarified.

In this regard, the comments of the current ACCC Chairman, Rod Sims, soon after he took up his position, are welcomed:

The ACCC now believes that it is time to resolve the unanswered questions surrounding section 46. Recent amendments to the Act and likely future court actions are providing guidance on how to successfully prosecute companies that misuse their market power.
However, the ACCC must also make sure that when it does come across a promising s 46 case that it does not sell the case short by settling the case for an insignificant penalty.

Parliament's decision to amend s 76 of CCA to introduce vastly increased penalties from 1 January 2007 for anti-competitive conduct should have made it abundantly clear to both the ACCC and the Federal Court that Parliament expects such conduct to be punished much more severely than it has in the past. Unfortunately, the size of the penalty in the Ticketek case is quite out of step with Parliament's intent – namely, to get serious about punishing anti-competitive conduct.