

Australian United Retailers Ltd

Submission to the Draft Competition Policy Review Report , Sept. 2014

17 November 2014

Introduction

Australian United Retailers Limited (AURL), trading as FoodWorks, is pleased to make this second submission to the Competition Policy Review.

It is our view that action needs to be taken to foster greater competition within the Australian supermarket industry by strengthening and supporting the independent supermarket sector. A growing and prosperous independent supermarket sector will aid the Australian economy and create the necessary competitive tension in the supermarket industry to drive benefits for Australian consumers. This industry is highly concentrated and becoming even more so, being dominated by two large wealthy firms, creating the conditions for anticompetitive behaviour.

Reforms to the *Competition and Consumer Act 2010 (CCA)* and other State based legislation are needed to create a more equitable market and help reduce the potential for anti-competitive behaviour.

AURL has reviewed the Panel's findings and commend the Panel for a number of its recommendations. However, the report still remains silent on a number of important issues raised in our first submission. There are also a number of recommendations in the report that we oppose and argue should be either removed or amended.

Supported Recommendations:

- Section 46 – Introduction of Effects test
- Section 46 - Onus of Proof
- Discount Fuel Dockets
- Liquor retailing
- Price signalling
- Resale Price Maintenance

Additional Recommendations:

- Mandatory Merger Notification
- Planning & Zoning Laws

Opposed Recommendations:

- Market concentration findings
- Section 46 to be subject to a "Substantial lessening of competition"
- Retail trading hours

The following submission explains in more detail our response to the draft Panel report.

Summary of Recommendations

AURL Recommendation 1: Market Concentration

The final report should recognise the high level of concentration in the Supermarket industry and the anti-competitive effect this is having on consumers, suppliers and smaller competitors.

AURL Recommendation 2: Section 46 - 'Effects Test'

AURL support the inclusion of an effects test into Section 46 of the Act.

AURL Recommendation 3: Section 46 - 'Focus'

Section 46 should not be amended so that it requires anti-competitive behaviour to “substantially lessens competition in a market” before it can be prosecuted. The Act must maintain a prohibition on conduct where a firm with a substantial degree of power in a market takes advantage of that power with the purpose or effect of eliminating or substantially damaging a competitor, irrespective of whether it substantially lessens competition in a market or not.

AURL Recommendation 4: Section 46 - 'Defence Provisions'

AURL support the proposed defence to Section 46 and that the onus of defending the conduct lies with the firm engaging in that conduct. However, the wording of the defence should be amended to require that both conditions of the defence must apply in order to satisfy the defence, and that a corporation with a substantial degree of market power is excluded from this defence.

AURL Recommendation 5: Section 46 – 'Predatory Pricing'

Maintain a specific provision that prohibits predatory pricing. The provision should not be subject to proving that it would “substantially lessen competition in a market”. The provision should also be subject to an effects test (as is proposed by the Panel for Section 46 of the Act).

AURL Recommendation 6: Discount Fuel Dockets

The current court-enforceable undertakings from Woolworths and Coles limiting the extent of fuel discounts to four cents per litre should be retained.

AURL Recommendation 7: Liquor Retailing

Include a specific recommendation requiring for an immediate review of State based liquor legislation to ensure that this unnecessary restriction on competition is removed.

AURL Recommendation 8: Price Signalling

Support legislative changes that prevent price signalling where it has the purpose or effect of substantially lessening competition.

AURL Recommendation 9: Resale Price Maintenance

Support the Panel's recommendation to retain the prohibition on resale price maintenance.

AURL Recommendation 10: Retail Trading Hours

AURL oppose the blanket deregulation of retail trading hours and support the current State based mechanisms already in place to review and assess retail trading hours.

AURL Recommendation 11: Pre-merger/acquisition Notification

There should be an amendment to the CCA to introduce a mandatory merger notification requirement for all mergers and acquisitions that take place in specific highly concentrated industries, including the supermarket industry. The mandatory merger notification requirement would apply to participants in industries prescribed by regulations. It would require participants in those industries to notify the ACCC of a merger or acquisition at least 6 weeks prior to completion where the merged firm would have a post merger market share of greater than 20 per cent in the relevant market(s).

In addition, where the ACCC has reviewed a merger/acquisition through the mandatory pre-notification process recommended above and it is deemed that further investigation is warranted then a 'suspensory' clause should apply to prevent the parties from completing the transaction before clearance is granted.

AURL Recommendation 12: Planning and Zoning

State and local Planning Provisions should promote the following additional principles:

- Create a hierarchy of sustainable retail centres.
- Facilitate opportunities for viable smaller retail centres in order to create, diversity, competition and healthier 'walkable' communities, as opposed to larger car based centres.
- New centres to be based on need, viability and market sustainability.

Response to Draft Recommendations

1. Market Concentration

AURL wish to challenge the Panel's conclusion on the level of concentration in the Australian supermarket industry.

“Australia’s grocery market is concentrated, but not uniquely so (see Box 13.1 below). While concentration is relevant, it is not determinative of the level of competition in a market. A concentrated market with significant barriers to entry may be conducive to weak competition, but competition between supermarkets in Australia appears to have intensified in recent years following Wesfarmers’ acquisition of Coles and the expansion of ALDI and Costco; consequently, few concerns have been raised about prices charged to consumers by supermarkets.”
(P. 181, Draft Panel Report).

The evidence presented in our original submission shows that:

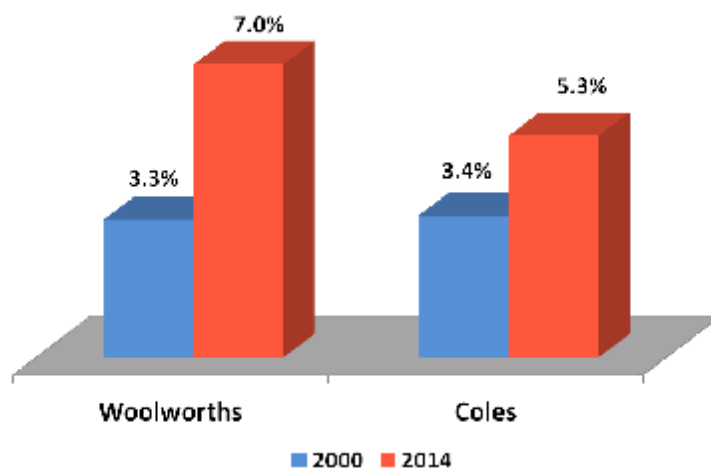
- Coles and Woolworths hold a 73% share of the Australian supermarket industry.
- Coles and Woolworths combined share of the market has grown from 35% in 1975 to 73% currently, and increasing.
- Over the last 4 years Coles and Woolworths have been growing at a rate faster than the Industry growth rate (ie their market share continues to grow).
- This growth continues despite the entry and growth of Aldi and Costco. The entry of these competitors is not making the industry more competitive, rather Coles and Woolworths continue to grow their market share.
- Over the last 12 months Woolworths has raised prices on more than twice as many of its products than it has lowered.
- Over the last decade Coles and Woolworths have continued to increase their EBIT Margin.
- In particular, Woolworth’s EBIT margin has more than doubled, from 3.3% in 2000 to 7.0% in 2014.

It is our opinion that the market share table included on page 182 of the Panel’s Draft Report is misleading. Unless the market definition is consistent for each country it is not possible to compare concentration levels. For example:

- With regards to Australia, the figures do not represent the supermarket industry. Rather it is a representation of the much wider food industry, and in our opinion incorrectly includes specialty retailers such as bakeries, butchers and convenience stores. This clearly diminishes and misrepresents the actual market share held by Coles and Woolworths in the supermarket industry.

The Australian supermarket industry is concentrated and becoming more so. The consumer pays for this uncompetitiveness by supporting ever increasing profit margins at Coles and Woolworths. The evidence is clear that as the dominance of these two players increases their ability to extract higher profits and higher margins improves – and they are more than willing to take advantage of this. As a consequence of these conditions:

- There is less imperative for Coles / Woolworths to reduce grocery prices (due to a reduced need to reinvest in price).
- There is less motivation on behalf of Coles / Woolworths to invest in innovation.
- It increases the bargaining power gulf between suppliers and Coles / Woolworths – setting up the environment for unfair and unconscionable conduct.
- It further erodes the confidence of other market participants, in particular small businesses, from investing and pursuing innovation.



Source: Citi Research, Trends in the Australian Grocery Sector, The increasing reliance on margin, 1 August 2013. Coles and Woolworths financial reports 2013/14

These trends were identified by USB Investment Research in November 2011:

“Globally Australian retailers earn some of the highest margins in the world. In FY11, the WOW supermarket business recorded EBIT margins of 6.6%, well ahead of the 4.2% global average and lags only Walmart’s US operations at 7.7%.

The fact that Australian supermarkets have higher margins is unusual given the challenges associated with the scale of operations, and logistics. However, these challenges appear to have been overcome by the benefits of market concentration with the top 3 retailers (including MTS) holding a combined market share of ~87% vs the global average of ~60%.

The benefits of market share concentration are 3-fold:

- (1) Less competitive grocery prices – The impact of a resurgent competitor in Coles has been evident in the past 2 years, driving deflation in the overall grocery market. MTS has commented that the level of product sold on promotion has more than doubled, up from 20% 2yrs ago to ~50% today.*
- (2) Lower levels of innovation – Reduced levels of competition have driven lower levels of innovation and costs with respect to marketing, loyalty and private label development compared to offshore peers.*
- (3) Pressure on suppliers – the concentration of market share at the retail level affords WOW and Coles to demand more attractive trading terms from their suppliers.”*

“USB View:– concentration of market share in Australia allows local retailers to benefit from:

- (i) Significant operating leverage and*
- (ii) Less need to reinvest in price.”*

The Australian supermarket industry has characteristics that exacerbate anticompetitive behaviour, in particular a highly concentrated market, a small number of businesses with substantial market power and high barriers to entry (eg significant sunk costs, large economies of scale, a saturated geographic market, limited product differentiation and restricted access to suitable sites). These conditions result in a lack of competitive tension in the market, increasing the risk that businesses with substantial market power do not compete effectively on price.

To counteract this the Australian supermarket industry needs a strong independent supermarket sector. The reforms that we have recommended are intended to create the conditions to foster a healthy and prosperous independent supermarket sector through appropriate controls over anti-competitive behaviour and the removal of current legislation that create an unfair advantage for the major supermarket chains. A prosperous and competitive independent supermarket sector is in the best interest of Australian consumers.

AURL Recommendation 1: Market Concentration

The final report should recognise the high level of concentration in the Supermarket industry and the anti-competitive effect this is having on consumers, suppliers and smaller competitors.

2. Misuse of Market Power (Section 46)

There are four parts to the Panels Draft Recommendation 25 that we wish to comment on:

1. The inclusion of an effects test
2. A change of focus from impacts on a competitor to a more broader test: “*of substantially lessening competition in that or any other market*”
3. A defence to prevent inadvertently capturing pro-competitive conduct
4. Predatory Pricing

1. Effects Test

AURL are in full support of the inclusion of an effects test into Section 46 of the Act.

As discussed in our initial submission, this change is required for the following reasons:

- An effects test will better capture and deter anticompetitive behaviour.
- It is too difficult to prevent or prosecute anticompetitive behaviour when it is necessary to prove a firm had that purpose.

AURL Recommendation 2: Section 46 - ‘Effects Test’

AURL support the inclusion of an effects test into Section 46 of the Act.

2. Focus

We have a concern about the proposed change of focus to Section 46. Currently Section 46 captures action by a firm that is deemed to be anti-competitive, whether or not it substantially lessens competition in a market. However, the proposed change could allow such anti-competitive behaviour to be permitted.

For example, a firm which has the purpose of engaging in ‘Predatory Pricing’ and which results in severe impacts on another firm would not be caught by the new Section 46 where that action did not result in a ‘substantial lessening of competition’. Importantly, under the current provisions of Section 46 and 46 (1AA) such activity would and should be prohibited.

The proposed changes to Section 46 would have the undesired and unintended effect of legitimising a variety of anti-competitive behaviour that should remain prohibited.

AURL Recommendation 3: Section 46 - 'Focus'

Section 46 should not be amended so that it requires anti-competitive behaviour to “substantially lessens competition in a market” before it can be prosecuted. The Act must maintain a prohibition on conduct where a firm with a substantial degree of power in a market takes advantage of that power with the purpose or effect of eliminating or substantially damaging a competitor, irrespective of whether it substantially lessens competition in a market or not.

3. Defence Provisions

AURL support the introduction of a defence provision so that Section 46 does not inadvertently capture pro-competitive conduct. Further AURL supports that the onus of proving the defence lies with the firm engaging in the conduct.

“To mitigate concerns about over-capture, the Panel proposes that a defence be introduced so that the primary prohibition would not apply if the conduct in question:

- would be a rational business decision or strategy by a corporation that did not have a substantial degree of power in the market; and*
- the effect or likely effect of the conduct is to benefit the long-term interests of consumers.” (Panel Report, Recommendation 25)*

However, the wording of the defence raises a number of questions:

- Does the defence require both points to be satisfied? AURL is of the view that it should.
- Does it assume that a corporation with a substantial degree of market power is excluded from this defence? AURL is of the view that it should.

AURL Recommendation 4: Section 46 - 'Defence Provisions'

AURL support the proposed defence to Section 46 and that the onus of defending the conduct lies with the firm engaging in that conduct. However, the wording of the defence should be amended to require that both conditions of the defence must apply in order to satisfy the defence, and that a corporation with a substantial degree of market power is excluded from this defence.

4. Predatory Pricing

Section 46 (1AA) of the Act prohibits a firm with a substantial market share from the purpose of predatory pricing (ie selling a product at below cost for a sustained period with the intent of damaging a competitor). This provision is not currently subject to the proviso that such behaviour would substantially lessen competition in a market.

However, the Panel recommends deleting this Section, and replacing it with the revised Section 46 provisions (as discussed above). Under the new Section 46 the prohibition on predatory pricing would require a substantial lessening of competition in a market.

Any change that would allow a firm to use predatory pricing when there is no substantial lessening of competition in a market is opposed outright. Under no circumstances should predatory pricing be condoned and accepted as robust competition between two firms.

AURL Recommendation 5: Section 46 – ‘Predatory Pricing’

Maintain a specific provision that prohibits predatory pricing. The provision should not be subject to proving that it would “substantially lessen competition in a market”. The provision should also be subject to an effects test (as is proposed by the Panel for Section 46 of the Act).

3. Discount Fuel Dockets

The current court-enforceable undertakings from Woolworths and Coles limit the extent of fuel discounts from supermarket purchases to four cents per litre.

AURL support the position of the Panel that these undertakings should be maintained.

“The Panel has heard submissions on this issue but at present is not persuaded that consumers are made worse off by, rather than benefitting from, the availability of discounts at their current levels. The Panel notes the undertakings accepted by the ACCC and the availability of the misuse of market power provisions of the CCA should future competition concerns emerge in this context.” (P. 186, Draft Report)

AURL Recommendation 6: Discount Fuel Dockets

The current court-enforceable undertakings from Woolworths and Coles limiting the extent of fuel discounts to four cents per litre should be retained.

4. Liquor Retailing

AURL welcomes the Panels recommendation that “**..preventing supermarkets from selling liquor be prioritised as part of the renewed round of regulatory review proposed at Draft Recommendation 11...**” (P. 68, Draft Report).

In a number of States, liquor legislation severely restricts competition and needs to be addressed as a matter of priority. As discussed in our original submission issues regarding health, safety and the responsible service of alcohol do not preclude deregulation, as they can all be managed by appropriate State based legislation (eg the Victorian Liquor Control Reform Act 1998). To this extent we request the inclusion of a specific recommendation regarding liquor legislation reform, in a similar way that retail trading hours has been addressed in the Draft Report as a matter of priority. In our opinion the more general recommendation (Draft Recommendation 11 – Regulation Review) is not considered specific enough.

AURL Recommendation 7: Liquor Retailing

Include a specific recommendation requiring for an immediate review of State based liquor legislation to ensure that this unnecessary restriction on competition is removed.

5. Price Signalling

AURL agree that the regular exchange or disclosure of price information between two firms can harm the competitive process through the co-ordination of pricing decisions. We agree that price signalling should be prevented where it has the purpose or effect of substantially lessening competition.

Panel Draft Recommendation 24 – Price Signalling

The 'price signalling' provisions of Division 1A of the CCA are not fit for purpose in their current form and should be repealed.

Section 45 should be extended to cover concerted practices which have the purpose, or would have or be likely to have the effect, of substantially lessening competition.

AURL Recommendation 8: Price Signalling

Support legislative changes that prevent price signalling where it has the purpose or effect of substantially lessening competition.

6. Resale Price Maintenance

AURL agree that resale price maintenance, whereby a supplier imposes a restriction on a retailer that a product supplied will not be advertised for sale below a price specified by the supplier, is anti-competitive and not in the best interest of Australian consumers.

Panel Draft Recommendation 29 — Resale price maintenance

The prohibition on resale price maintenance (RPM) should be retained in its current form as a per se prohibition, but the notification process should be extended to include resale price maintenance.

The prohibition should also be amended to include an exemption for RPM conduct between related bodies corporate, as is the case under sections 45 and 47.

AURL Recommendation 9: Resale Price Maintenance

Support the Panel's recommendation to retain the prohibition on resale price maintenance.

7. Retail Trading Hours

AURL note the following recommendation from the Panel's draft report:

Panel Draft Recommendation 51 — Retail trading hours

The Panel notes the generally beneficial effect for consumers of deregulation of retail trading hours to date and the growth of online competition in some retail markets. The Panel recommends that remaining restrictions on retail trading hours be removed. To the extent that jurisdictions choose to retain restrictions, these should be strictly limited to Christmas Day, Good Friday and the morning of ANZAC Day.

It is our view that the State Governments of SA, WA and Queensland already have appropriate mechanisms for reviewing and assessing retail trading hours. Importantly the interest of the consumer and the welfare of Australians are already taken into regard when retail trading hours are reviewed by these jurisdictions.

In Queensland the Queensland Industrial Relations Commission (QIRC) is charged with this responsibility. Organisations, such as Coles and Woolworths can and regularly do apply to the QIRC for an extension to trading hours in particular localities. Importantly the QIRC in making its decision will consider the interests of the public, consumers and businesses.

More specifically, Section 26 of the Queensland Trading (Allowable Hours) Act 1990 requires the QIRC to take into consideration the following matters:

- "(a) the locality, or part thereof, in which the non-exempt shop or class of non-exempt shop is situated;*
- (b) the needs of the tourist industry or other industry in such locality or part;*
- (c) the needs of an expanding tourist industry;*
- (d) the needs of an expanding population;*
- (e) the public interest, consumers' interest, and business interest (whether small, medium or large);***
- (f) the alleviation of traffic congestion;*
- (g) the likely impact of the order on employment;*
- (h) the view of any local government in whose area the order is likely to have an impact;*
- (i) such other matters as the industrial commission considers relevant."*

On this basis we believe that the determinations of the QIRC are made in the interest of consumers and a blanket removal of retail trading hours restrictions would not necessarily be in the interest of these communities.

In SA a major review of retail trading hours was undertaken in 2007. Importantly, this review took into account the views of the business sector and the community. The report found that *"While it is a primary duty of governments to grow their communities' economies it is not their only duty. Governments also have a duty to nurture and preserve their social and community fabric and institutions"*.

AURL Recommendation 10: Retail Trading Hours

AURL oppose the blanket deregulation of retail trading hours and support the current State based mechanisms already in place to review and assess retail trading hours.

8. Mandatory Merger Notification

AURL note that the draft report fails to consider our earlier recommendation for mandatory merger notification.

AURL submits that there should be a mandatory merger notification requirement in the CCA for participants in concentrated industries such as the supermarket industry. In addition, in circumstances where the ACCC has reviewed an acquisition through the mandatory notification process and considers that further investigation is required, a 'suspensory' clause should apply to prevent the parties from completing the transaction while a merger clearance process is undertaken.

AURL Recommendation 11: Pre-merger/acquisition Notification

There should be an amendment to the CCA to introduce a mandatory merger notification requirement for all mergers and acquisitions that take place in specific highly concentrated industries, including the supermarket industry. The mandatory merger notification requirement would apply to participants in industries prescribed by regulations. It would require participants in those industries to notify the ACCC of a merger or acquisition at least 6 weeks prior to completion where the merged firm would have a post merger market share of greater than 20 per cent in the relevant market(s).

In addition, where the ACCC has reviewed a merger/acquisition through the mandatory pre-notification process recommended above and it is deemed that further investigation is warranted then a 'suspensory' clause should apply to prevent the parties from completing the transaction before clearance is granted.

9. Planning and Zoning Laws

AURL note the following recommendation from the Panel's draft report:

Panel Draft Panel Recommendation 10 — Planning and zoning

All governments should include competition principles in the objectives of planning and zoning legislation so that they are given due weight in decision-making.

The principles should include:

- a focus on the long-term interests of consumers generally (beyond purely local concerns);
- ensuring arrangements do not explicitly or implicitly favour incumbent operators;
- internal review processes that can be triggered by new entrants to a local market; and
- reducing the cost, complexity and time taken to challenge existing regulations.

AURL is of the view that Planning and Zoning laws must also provide the necessary environment for business investment. Unless the business community is prepared to invest then competition objectives become largely redundant. In order to invest the business community, as well as lending institutions, are looking for a return on investment as well as a level of certainty over future planning decisions.

It is also important that planning systems does not create the conditions for unnecessary duplication and obsolescence. Significant private and public money is invested in our communities through public infrastructure and services. These should not be discarded or used in a sub-optimal fashion on the basis of unfettered development.

In *Metricon Qld v Tweed Shire Council* [2008] NSWLEC 1453 the judge noted:

“Moreover, a planning policy such as the protection of existing centres is not worth much if it is changed each time a plan is reviewed. People make investment decisions on the basis of such policies, and their investment horizon is usually beyond ten years.”

AURL is not recommending that individual competitor impacts should be taken into account in planning decisions. However, as discussed above, planning policies and legislation should provide direction and certainty over what is permitted and what isn't, and must take into regard the needs and welfare of consumers as well as the business community. We therefore recommend the following additional planning principles:

- State and Local Government planning strategies and policies should aim to create a network of sustainable retail centres.

Conclusion

AURL is concerned that current competition laws do not adequately address anticompetitive behaviour and the misuse of market power in the Australian supermarket industry.

This industry is highly concentrated, with two very large and dominant parties. In order for the industry to operate efficiently and effectively it is vital that we have a prosperous and growing independent supermarket sector. The independent supermarket sector should have the legislative support to provide the necessary competitive tension in the industry so as to drive benefits for Australian consumers, including prices, service levels and choice.

AURL is therefore seeking amendments to the CCA and other State based legislation in order to eliminate misuses of market power, anticompetitive activities, and establish a fair and competitive marketplace. The recommended changes will also provide the ACCC with the necessary tools to help achieve the general aims of Australia's National Competition Policy and the CCA.

Without legislative change the concentration in the supermarket industry is expected to worsen, and coupled with other structural issues and high barriers to entry, the conditions for anticompetitive behaviour, unconscionable conduct and the misuse of market power in this industry will continue to flourish.

AURL thanks the Federal Government and members of the Panel for this opportunity to comment on the draft recommendations. We hope that our concerns and suggested remedies will be favourably considered by the Panel and eventually lead to much needed competition policy reform.

Should the members of the Panel have any queries on any issue contained in this submission, AURL would be happy to provide further details.

Yours faithfully,

A handwritten signature in blue ink, appearing to read "Rick Wight", written over a light blue circular stamp.

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