S U B M I S S I O N

to the

Senate Economics Legislation Committee Inquiry into the Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill 2009

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Introduction

The National Association of Retail Grocers of Australia (NARGA) represents about 4500 independently owned and operated grocery stores in all States and Territories, accounting for about $18 billion of sales annually or about 20 per cent of the national grocery market. Independent grocery stores account for about 57 per cent of employees in the grocery sector on a full-time equivalent basis.

NARGA supports a competitive market for goods and services and believes that price discrimination legislation will assist with making the Australian marketplace more competitive.

The Trade Practices Act 1974 (TPA) does not contain specific provisions that address price discrimination[1] at either the wholesale supply level or the retail level. In that regard it is at odds with trade practices legislation in other OECD jurisdictions which deal comprehensively with terms of trade (including price) as demonstrated by the examples below:

- The UK *Competition Act 1998* makes agreements that prevent, restrict or distort competition illegal and in particular agreements which 'apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage'.

- Articles 81 and 82 of the EU Treaty also prohibit the application of dissimilar conditions to equivalent transactions.

- Price discrimination is prohibited under the US Robinson-Patman Act of 1936. (This law grew out of practices which allowed chain stores to purchase goods at lower prices than other retailers)

Whilst Section 45 of the TPA does, like its UK counterpart prohibit the making of a contract that would have or is likely to have the effect of substantially lessening competition, the provision of goods or services under dissimilar conditions is not listed as prohibited under this section, nor is there a history of use of this section (or any other section) to address the problem of price discrimination and its impact on competition.

Section 46 of the TPA deals with the misuse of market power. It is, however very difficult to prove market power has been misused. One of the ways market power can be misused is

[1] The TPA used to have an anti-price discrimination clause (Section 49) which was repealed following the Hilmer review of competition policy on the basis that the prohibited behavior was addressed through other provisions in the TPA. The question remains as to whether, in light of recent experience, this conclusion is correct.

for majors to demand a better price or terms of trade from suppliers or to charge a differential price to consumers (or a differential price in areas where there are smaller competitors). It would appear that a prohibition of price discrimination would be a simple way to address that way in which market power can be misused. Other jurisdictions appear to believe that such an approach is effective.

There have been previous occasions when the issue of price discrimination has been debated. Opponents of such a provision in the TPA suggest that a prohibition of price discrimination would result in loss of valid discounts for volume purchases etc. However this has not been the overseas experience. A purchaser of larger volumes of a particular product can legitimately be charged a lower price to the extent that there is a genuine reduction in the cost to the supplier of producing and delivering that larger volume of product. That is, the supplier can pass on all or part of the savings associated with any economy of scale that results from the production of larger volumes of a product – but no more than that.

The 'Blacktown Amendment' currently under review does not seek to go as far as a general prohibition on price discrimination. Instead it seeks to reduce the level of predation by larger companies against smaller competitors by requiring consistent prices across adjacent markets. Its origin lies within the petrol retailing sector where independent retailers are facing difficulties in competing with major chains and refiner/marketers that together make up over 90% of the petroleum retail market. Of course the problem of market concentration is much wider than the petroleum sector and pricing issues that affect that sector have their parallels elsewhere.

The TPA has clear provisions against cartel behaviour. In fact the ACCC has taken unsuccessful action against a small group of petrol retailers in Geelong for alleged cartel activity in that geographic market.

However, a corporation that controls hundreds of petrol outlets is free to charge whatever price suits their marketing or business strategy. Such prices can deviate substantially from a mean value. The entity is free to charge higher prices in areas where there is little or no competition and lower prices where there is competition or where the decision is made to target a particular competitor. Note that these prices need not be predatory as defined under the TPA in order for that competitor to be disadvantaged. This is because the larger entity, in the absence of a price discrimination prohibition, can access fuel at substantially lower prices than can the independent service station owner. The larger entity need not forego profits as any shortfall attributable to a particular site is easily compensated for by sites owned by the same entity that do not face competitive pressure.

The ACCC's own report on the petroleum sector[2] highlighted the problems associated with wholesales supplies of petrol:

> *'in practice wholesale prices available to customers in Australia vary considerably and are affected by numerous factors, the most important of which is the volume sought to be purchased; discounts and favourable terms are likely to be more generally available to larger players than smaller ones[3] – regional difference in bargaining strength and proximity to refineries and seaboard terminals can also affect negotiations.'*
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> and
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> *'the exclusive supply arrangements between the supermarkets, Coles Express and Woolworths and respective suppliers, Shell and Caltex, have diminished the supply options for many independent resellers' (p.126)*[4]

The following statement on page 125 of the same report gives some indication of the price advantage enjoyed by the major chains:

> '*When discounts are taken into account, the actual gross margin obtained by the refiner-marketers varies within a range of around 1 and 3 cpl. The ACCC received evidence that, on a net basis, these margins may at times be negative...'*

It would appear from the above that smaller resellers have a lot to fear from 'competition' from the majors. The majors appear to have a substantial price advantage on top of which they can adjust prices across the outlets they control to apply competitive pressure as and where they choose.

Given the above, it also appears that the ACCC does not know at what price the majors are purchasing their fuel supplies so are not in a position to determine whether at any time the behaviour of the major in relation to a particular competitor is predatory as defined under the TPA. Under such circumstances, the 'Blacktown Amendment' is one way of levelling the playing field.

It would also help reduce price confusion for motorists. If the major chains were to be required to supply fuel at a consistent price within a region, motorists would find it easier to

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[2] Petrol prices and Australian Consumers – Report of the ACCC inquiry into the price of unleaded petrol, December 2007

[3] This results in a 'waterbed effect' where prices to smaller resellers have to increase to pay for the favorable terms enjoyed by the majors. The resulting reduced competitive pressure on the majors allows these to increase their average price and margin.

[4] Given the problems the ACCC has identified with independents' ability to access wholesale supplies at competitive prices it is surprising that the ACCC did not recommend amending the TPA to outlaw price discrimination.

make a direct comparison between different chains. This would reduce the current complexity of the purchasing decision and enhance competition.

It should be noted here that under current arrangements the price of fuel offered within the one chain can vary substantially within a relatively small area. Two examples are offered. A drive down the Princes Highway in the south of Sydney will show a series of petrol prices from the same retailer – steadily increasing as the driver goes further south. Price differentials vary depending on the current mean petrol price but differentials of several cents per litre are common.

The second example is two outlets owned by the same retailer situated almost opposite each other in Parramatta road in Sydney. Prices differentials approaching ten cents per litre have been observed.

The ACCC petrol inquiry noted that the retail margin for unleaded petrol was, on average, 4.9 cpl in 2006-07 (p.139)[5]. If we now accept that a significant proportion of consumers take advantage of the 4c (or more) 'shopper docket' discount, does this mean that the price being paid is, on average, close to the wholesale price?

Given the wide range of prices at which fuel is offered by the two major chain operators, there must be situations when prices offered are at the low end of the band, they are, when discounts are taken into account, below relevant cost. As this situation continues over an extended period of time and as the lower prices offered would be in areas where there are other competitors, this behaviour could be considered as predatory.

Given the complexity of the petroleum market, it would not be possible for a small competitor to determine whether the price at which fuel is being offered by a large chain retailer nearby is predatory. They would simply get the standard ACCC response which is that they (the small competitor) have no way of knowing what the major's purchase price is. The question then is: does the ACCC know? And if it does not, how can it take action against any instances of predatory pricing?

It should be noted here that even after the TPA was amended via the 'Birdsville Amendment' to make it easier to bring cases of predatory pricing to court, no action has been taken by the ACCC on predatory prices. This suggests one of the following conclusions:

- no examples of predatory pricing consistent with the Birdsville amendment are being reported to the ACCC; or

[5] The ACCC also noted that retail margins are increasing. This is typical of a market that is becoming increasingly concentrated. A similar trend is evident in the retail grocery sector. Margin increases in these two important sectors impact the CPI and, indirectly, result in the RBA's need to set higher interest rates 'to combat inflation'.

- the ACCC does not have sufficient power to act; or
- the ACCC has been deciding for itself that all complaints brought before it are invalid; or
- the ACCC is not interested in taking forward any cases of alleged predation to let the court decide whether predatory pricing took place.

The advantage of the 'Blacktown Amendment' is that it is one way of reducing the potential for predatory behaviour that does not have to rely on any decision of the ACCC to act.

Of course at the top end of the price range charged by the majors, consumers are being taken advantage of – a case of price gouging, because if the major chains can retail profitably at the lower price being charged in one location they are clearly overcharging in locations in the same region where prices are higher.
Petrol 'shopper dockets' are also used by the major chains to gain an unfair advantage over smaller retailers. Whilst the standard discount offered by the majors is 4 cpl, Coles offers an additional 2 cpl in conjunction with a small purchase made in the convenience outlet associated with each service station and both Coles and Woolworths have offered discounts as high as 40cpl conditional upon grocery purchases. Both routinely give higher levels of discount in association with campaigns to increase sales through associated liquor outlets.

The fact that both Woolworths and Coles had to initially apply for ACCC authorisation for these schemes confirms that they are seen as anti-competitive under third line forcing provisions in the TPA[6]. It is notable that similar schemes have not been authorised in equivalent jurisdictions.

In order to give an authorisation to Woolworths and Coles for their 'shopper dockets' arrangements the ACCC had to determine that the anti-competitive effect of the schemes was warranted in light of an overall community benefit. The ACCC judged that the consumer benefit associated with the schemes was a lower petrol price. However no detailed analysis of the pricing effects of the schemes appears to have been undertaken. A person with adequate knowledge of the operation of retail markets would understand that any continuous discount given would need to be funded from price increases elsewhere. In our view the discount initially came from increasing grocery margins, but lately has more than likely been supported by increased fuel margins.

The ACCC has also not explained that not all consumers benefit from these shopper docket arrangements. Shoppers who do not benefit are those who do not have a car (many of whom are otherwise disadvantaged) or those that buy their fuel elsewhere. These groups have still borne the cost associated with the provision of the discount to others.

[6] Amendments to S.47 of the TPA came into effect in January 2007 which allowed related companies to be exempted from third line forcing prohibitions.

The question that remains for the ACCC is how petrol prices have fared in the longer term under the influence of the 'shopper docket' schemes. Our concern is that they have given consumers the appearance of lower prices whilst prices and margins have, on the average, increased.

A second concern is that the 'shopper docket' schemes allow the majors to advertise a price on their price boards that is 4 cpl lower than the actual pump price – a factor that gives them the semblance of being price competitive and having a competitive advantage over independents.[7]

Changes to S.47 of the TPA that came into effect in January 2007 cement this advantage into law. What the TPA now in effects says is that exclusive dealing is permissible if you are a large conglomerate, and not if you are a small player. Given that the larger entity is more than likely to also have market power and the capacity to cross-subsidise from related entities, this would appear to be an unfair advantage. We believe that these amendments need to be repealed and that the 'shopper docket' schemes need to be disallowed so that each entity in the petrol market is seen to compete transparently and on equivalent terms.

Conclusions

- NARGA supports the 'Blacktown Amendment' in that it is a mechanism that is likely to reduce the level of predation(and price gouging) in concentrated markets;
- NARGA suggests that consideration be given to further amending the Trade Practices Act to outlaw price discrimination at every level;[8]
- NARGA recommends the repeal of recent amendments to S.47 of the TPA to ensure that exclusive dealing remains illegal even when it takes place between related entities;
- NARGA recommends that the 'shopper docket' schemes be discontinued to improve price transparency and competition.

[7] State legislation controls the information that must be displayed on price boards. This legislation requires that the retail price be displayed. It is possible that the dominant display of a discounted price which is not the retail price is illegal.

[8] This would address the problem of wholesale pricing to petrol independents.