# NARGA

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Department of the Senate
PO Box 6100
Parliament House
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By email to: economics.sen@aph.gov.au

Dear Mr Hawkins,

## Senate Economics References Committee: Inquiry into the impacts of supermarket price decisions on the dairy Industry

On the 22nd of July the Australian Competition and Consumer Commission (ACCC) issued a media release[1] outlining the outcome of its investigations into the milk pricing practices of Coles supermarkets. Although a detailed report of the ACCC's investigation is not on the public record, suggesting a lack of transparency, the little detail available in the media release raises a number of questions:

- The emphasis of the ACCC investigation appears to have been on whether or not Coles was engaged in predatory pricing. It clearly was not. Proving predatory pricing is extremely difficult as the complainant or the regulator has to show that:
  - The price charged was below relevant cost (as yet undefined due to the absence of any guidelines from the ACCC and the lack of case law);
  - The entity has to have a substantial share of the market;
  - The activity has to have been undertaken for an 'sustained period' (undefined); and
  - The activity had an anti-competitive purpose.

    Note also that we have argued in the past that it is possible for an entity to sell a product at a price substantially lower than that of a competitor and for that price not to be 'below relevant cost' simply because of the low price that a larger company can demand in the absence of an enforced prohibition on anti-competitive price discrimination. This is the case with current prices for private label milk. Both Coles and Woolworths still make a profit on their sales of private label milk, even though competitors have difficulty in matching them on price without making a loss.

[1] Coles discounting of house brand milk is not predatory pricing, ACCC, 22 July 2011.

- The ACCC media release says that '*Section 46(1) prohibits businesses that have substantial market power from taking advantage of that power for the purpose of (a)eliminating or substantially damaging a competitor, (b) preventing the entry of a person into a market and/or (c) deterring or preventing a person from engaging in competitive conduct in a market.*'

  Whilst it may be clear that competitors of Coles have been damaged – those that did not have access to low price milk -saw a substantial shift in business away from them to the major chains – it is difficult to demonstrate purpose.

  Again, the absence of case law does not help.

  It may be time to adopt the New Zealand approach to this part of competition law which states that purpose may be inferred[2].

  > "**36B Purposes may be inferred**
  > The existence of any of the purposes specified in section 36
  > or section 36A, as the case may be, may be inferred from the
  > conduct of any relevant person or from any other relevant circumstances

- The ACCC did not present any detail of whether compliance with Section 46(1) had been assessed.

- The ACCC did not, in its media release, advise as to whether compliance with Section 45 of the Act, by both the supplier and the chain had been assessed.

  We note here that Section 45 deals with contracts that restrict dealings or affect competition. Section 45, unlike Section 46(1) has an 'effects test'.

  We would suggest that the supply of milk by dairy processors to the major chains at prices substantially lower than those available to competitors of those chains is likely to have the effect of substantially lessening competition, given that in the grocery market milk is a major customer traffic generator[3].

  We understand that there are arguments that the supply of low price product is pro-competitive. These are based on the concept of marginal costs. We would suggest that it is unusual, if not unsustainable for a processor to supply a substantial proportion of its production at 'marginal cost', and that therefore there must be other explanations for their doing so. The excessive market power of the major chains would be one such explanation.

  The lower price paid by the major chains must be compensated for by higher prices paid by other retail outlets for what is basically an identical product – a 'water bed effect'.

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[2] Competition Amendment Act 2001, New Zealand

[3] '…City consumers have lapped up the price war with branded sales plummeting as much as 26.2% since it erupted. Of the reduced-fat varieties, Coles and Woolworths have increased their combined market share by 64%'. Northern Star, 23 August 2011.

> Competitors paying the higher prices are then at a competitive disadvantage to the major chains. That is not a pro-competitive outcome.

On 15 August the ABC rural news reported that NSW farmers who supply the Dairy Farmers Milk Co-operative faced a cut to their milk contracts of 27 per cent. One farmer quoted translated this into a loss of income of $160,000, a need to cull 400 cows and on-farm job losses.

The milk volume downturn is due to a decision by Woolworths to shift its private label milk contract from National Foods to Parmalat.

The above case demonstrates that the major chains, through their purchasing arrangements, control a large proportion of the outputs of each farm sector and that their purchasing decisions have a major impact on those sectors.

The dominant influence that the major chains have is outlined in a report prepared for NARGA by Accenture Australia[4] (copy attached).

The question that must be asked is whether the major chains are too big, or have too large an influence on markets for the proper functioning of those markets.

Recent media reports of comments made by major suppliers to the chains support such a conclusion.

The Sydney Morning Herald business section recently reported[5] comments from the HJ Heinz CFO: '*The reality is that with two key customers there has become an inhospitable environment for grocery manufacturers. With it being such a difficult market, we're going to take the measures....to address that. We've seem our margins squeezed as the pressure comes on.'* The SMH goes on to say that Heinz is 'the latest supplier to take a swipe at the perceived concentration of power in the hands of the two leading retailers....Heinz criticism represents a rare public outburst as suppliers typically keep their grumbles to themselves rather than risk having their product removed from shelves.'

Heinz have taken the decision to close a local manufacturing plant and switch production to New Zealand.

The SMH article quoted above also reported that the $167 million loss incurred by Goodman Fielder last financial year was in large part due to the loss of a private label contract and the bread price cuts being pursued by the major chains.

It would appear that the major chains have become so dominant that their purchasing behaviour now has a major impact on their suppliers and on those in the farming sector that supply their inputs. A retail grocery market composed of a larger number of smaller entities would not have such impacts.

We suggest that to date, the Competition and Consumer Act 2010, in its various earlier forms, has been unable to prevent the current level of concentration in the retail grocery sector and to control the evident market power they command. For too long the two

[4] The challenge to feed a growing nation, Accenture Australia, November 2010
[5] Sydney Morning Herald Business Day, 30 August 2011, P.1

elephants in the grocery room – and the damage to competition they do - have been ignored by a regulator unwilling to enforce the Act or to test its limits.

We also suggest that the re-introduction into the Act of a specific prohibition of anti-competitive price discrimination would give suppliers the capacity to resist pressure from the major chains to accede to unrealistic pricing demands, thereby helping to retain a competitive level playing field for goods supplied to the retail sector and denting the buyer power of the major chains.

Please let me know if you need any further details on the matters we have raised.

Yours sincerely,

Ken Henrick
**Chief Executive Officer**