

SENATE ECONOMICS REFERENCES COMMITTEE

Questions on Notice

The impacts of supermarket price decisions on the dairy industry
Melbourne, 6 October 2011

AUSTRALIAN DAIRY FARMERS

Question 1

Hansard Ref: p. 7 (Senator Xenophon)

Senator XENOPHON: We are hearing from the ACCC later on today. Has the evidence you presented today been given to the ACCC?

Mr Peake: I do not quite know these dates off the top of my head. We wrote directly to the ACCC raising a whole range of issues. ADF has received a response. So we can actually provide that response on notice.

Senator XENOPHON: Sure, if you could. The ACCC will be here to give evidence, and hopefully some of you will be around to hear that evidence. But a number of questions were put to the Mr Cassidy of the ACCC several months ago about what they were doing to investigate these concerns. They reached a conclusion that there were no breaches. To what extent has there been an ongoing dialogue between the ADF and individual dairy farmer groups with the ACCC? We are hearing from the new chairman, Mr Sims, today as well. What information has the ACCC been given by your groups on this?

Mr Griffin: We have had a couple of forms of correspondence with the ACCC but there has not been a strong dialogue between that organisation and ourselves.

Mr Toohey: In New South Wales we met with representatives from the ACCC early in the piece. I could give you that information that was forwarded on to them.

Senator XENOPHON: If it is possible to get that information before the ACCC gives evidence this afternoon, that might be useful. I would find it useful to put those things to the ACCC in terms of how active they have been, what levels of investigations they have carried out.

Answer

Attached is ADF's correspondence to the ACCC and the ACCC's response.

NSW Farmers met with the ACCC on 14 May to discuss the Australian Dairy Farmers Ltd application for revocation of authorisation A90966 and substitution of new authorisation A91263 regarding collective bargaining for dairy farmers. Specifically, the meeting was held to discuss the amendment of condition 1 within this authorisation which limited the ability of third parties to provide representation to more than one collective bargaining group. NSW Farmers was seeking a relaxation of the condition to allow for third parties to represent more than one collective bargaining group. Clarification was also sought on the activities that NSW Farmers and other farming bodies were permitted to undertake under the authorisation. These points were taken on board and were reflected in clarification in the final authorisation. While NSW Farmers raised the point of discounting milk prices the ACCC did not provide comment on this matter.

Question 2

Hansard Ref: p. 8 (Senator Xenophon)

Senator XENOPHON: My final line of questioning relates to this, and I think, Mr Griffin, in your comments in your opening statement you alluded to this. You have talked about the UK practices and you are saying that what we have seen with the Coles management are the sorts of practices that they have been pushing in the UK. But in the UK there is a code of practice.

Mr Griffin: That is right.

Senator XENOPHON: How long has that been in force for? How effective has it been—this is from your counterparts in the UK—in terms of ensuring a reasonable price and a reasonable supply chain?

Mr Griffin: I would have to take that on notice. It is only quite new and it has been instituted recently over there as a result of the issues that they have faced. I would have to take that on notice to give you the length of time that has actually been in place.

Answer:

The Groceries Supply Code of Practice (GSCOP) came into force on 4 February 2010 and applies to all retailers with an annual turnover of more than £1 billion in groceries in the UK (there are ten such retailers in the UK).

The United Kingdom Competition Commission (CC) found that one of the features that adversely affected competition in the market was the exercise of buyer power by certain grocery retailers with respect to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers.

The CC found that there was a detrimental effect on customers resulting from the adverse effect on competition and published its final report on 30 April 2008.

In the report the CC considered that a package of remedies consisting of the following key elements would be effective and proportionate in remedying the various features of the market identified as having an adverse effect on competition:

- (a) the establishment of a Groceries Supply Code of Practice (GSCOP); and
- (b) the establishment of a GSCOP Ombudsman to monitor and enforce compliance with the GSCOP.

The key issue the report raised was that some practices by big supermarkets were still having an anti-competitive effect, harming the long term interests of consumers

The new UK GSCOP was designed to improve the relationship between big retailers and their suppliers by preventing certain practices from occurring.

It is worth noting that eight of the current Coles senior executives have worked in the UK at retailers where the very practices originated that the UK CC deemed had an anti-competitive effect and harmed the long term interests of consumers. It should also be noted that retailer concentration in the UK is significantly less than in Australia.

The UK CC considered that the GSCOP would be more effective with an ombudsman or adjudicator in place to enforce it, to act as a referee and police the new rules.

This was because many small suppliers were worried that raising disputes against retailers would jeopardise future commercial agreements with these companies.

Whilst the GSCOP came into force on 4 February 2010 the UK Government did not release a draft Bill to establish the Adjudicator until 24 May 2011. ADF understands the Bill is now making its way through the pre-legislative scrutiny process, which will involve committee review.

In its current form, the Grocery Code Adjudicator Bill establishes the Adjudicator and gives it power to investigate potential breaches of the GSCOP and arbitrate disputes between suppliers and large retailers. The Adjudicator is also required to report annually on compliance with the GSCOP.

5 August 2011



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Dear Mr Sims,

Re: ACCC investigation into Coles' milk price discounting

I am writing following the decision of the ACCC announced on 22 July 2011 that Coles' discounting of house brand milk is not predatory pricing.

ADF has major concerns regarding this decision, these include:

1. A lack of detail on the terms of reference used by the ACCC in conducting its inquiry into this matter. ADF would appreciate this information being made available so dairy farmers can understand the scope of the inquiry and possibly assist with further information.
2. The ADF would like confirmation on whether the ACCC inquiry looked at the entire value chain and the cost to Coles, including to the checkout, in relation to selling below cost and predatory pricing issues.
3. In the ACCC's media release of 22 July 2011 there was no mention of price impacts in regional or remote areas of Australia such as Darwin, Kununurra and Broome. ADF believes it is impossible for Coles to buy, transport, store and sell milk in these areas for \$1 per litre. ADF would appreciate further information from the ACCC on this issue, in particular in relation to s46(1AA) and acting with an anti-competitive purpose.
4. ADF also seeks further information on the issue of whether Coles has undertaken deceptive and misleading conduct by claiming in its advertising that they were not affecting dairy farmers. For a large group of Queensland dairy farmers affected almost immediately by Coles' actions this is clearly not true and they each stand to lose around \$8,000 this year due to the clear shift in sales to home brand milk.
 - o It should also be noted that despite claiming that their actions will not affect dairy farmers Coles has repeatedly refused to rule out dropping prices for processors and farmers in future contracts.
5. It would be useful to know the ACCC's perspective on Coles' 'Down, down and staying down' message in its advertising.
 - o ADF believes Coles has used false advertising and engaged in misleading and deceptive conduct as the average consumer would view their slogan 'staying down' as meaning a permanent discount - not for six months (or longer) with a large number of caveats as Coles has subsequently tried to claim.
 - o As Senator Colbeck pointed out at the Senate hearing into Coles marketing stunt on Tuesday 29 March after Coles executives had said 'staying down' meant for at least six months, "staying down to me is deceptive."
6. ADF also has concerns that Coles has consistently claimed it is absorbing the cost of the milk discounting yet evidence from independent sources appears to refute this. A recent Morgan Stanley research report indicated that "staples pricing continues to be cut while non-staples price have risen." It would be appreciated if the ACCC can inform the ADF and dairy farmers if the claim by Coles that it is absorbing the cost of the milk discounting was investigated and how this was undertaken. Other evidence and inconsistencies that the ADF would like to confirm the ACCC investigated include:

- In an interview on the 8th of March on 2GB radio with Alan Jones, Ian McLeod, Managing Director of Coles, when questioned about absorbing losses on discounted milk claimed that “No we’re not losing, we’re making four cents in the dollar.” This is completely inconsistent with the often stated claim by Coles that they are absorbing the cost of the milk discounting.
 - In the July edition of Food and Drink Business on page 10, Silvestro Morabito, CEO of IGA, stated that “IGA regularly surveys a sample of 2500 lines from its rivals and between 70 and 90 per cent of these products are in fact seeing a steady price increase.”
 - Recent reporting of comments by Wesfarmer’s CEO Richard Goyder in the Courier Mail of 29 July 2011 “Obviously if any product range has substantiated and necessary cost increases, we will look to see if we can absorb that and if we can’t, we will pass those on,” does not appear to support either the claim of ‘staying down’ or of absorbing the cost.
7. It would also be appreciated if the ACCC could indicate if it examined the impact of the current milk discounting on competition in the route trade market and future product innovation and choice in the drinking milk market.

The ADF is concerned that the ACCC has conducted a narrow inquiry that did not examine this serious issue with the thoroughness that it deserves. It would be appreciated if the ACCC could address the questions raised above and hopefully go some way to allaying the concerns of Australia’s dairy farmers, who feel their product is being fundamentally devalued in the market.

If you require further information on this issue or wish to seek clarification on any of the above please do not hesitate to contact Natalie Collard, ADF CEO,

Finally we would like to take this opportunity to congratulate you on your appointment as Chairman of the ACCC and wish you the best in the role in the future.

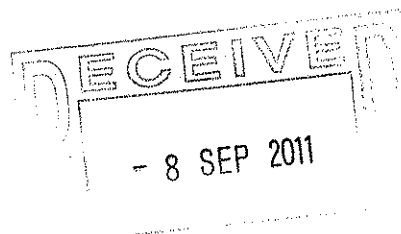
Yours sincerely,

Wesley Judd
ADF President



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6 September 2011

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Dear Mr Griffin,

Re: ACCC investigation into Coles' milk price discounting

Thank you for the letter of 5 August 2011 (the ADF letter) from Mr Judd, former President of Australian Dairy Farmers (ADF), addressed to Mr Rod Sims, Chairman of the Australian Competition and Consumer Commission. I have been asked to respond.

The ADF letter raises concerns and seeks clarification as to the ACCC's decision not to pursue matters raised with it concerning Coles' discounting of its house brand milk. The ADF letter also raises a number of issues relating to the Coles' 'down down' promotional campaign.

I will endeavour to clarify and answer the issues you have raised including the ACCC's role in enforcing the *Competition and Consumer Act 2010* (the Act).

Role of the ACCC

The ACCC's role as an independent statutory authority is to enforce the competition and fair trading provisions of the Act. The object of the Act is to enhance the welfare of all Australians through the promotion of competition and fair trading and the provision for consumer protection¹.

In enforcing the Act, the ACCC's responsibility is to ensure that markets, through competition and fair trading, operate efficiently and effectively to enhance the welfare of all Australians. As noted by the High Court '*Competition by its very nature is*

¹ Section 2 *Competition and Consumer Act 2010*

deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to "injure" each other in this way."² The object of section 46 of the Act is to protect competition in the interest of consumers by setting parameters to such 'injurious' conduct that only apply where corporations purposely abuse their market power.³

Dairy farmers operate in an open, deregulated market which is subject to competition. Since deregulation of the dairy industry, the ACCC has authorised various dairy farmer groups to collectively negotiate raw milk supply agreements with processors. The ACCC's role is not to re-regulate the market for drinking milk or other dairy products by setting prices that processors pay farmers for raw milk, setting prices that processors sell their drinking milk to supermarkets or setting prices that supermarkets can sell their drinking milk to consumers.

The ACCC does not set nor approve prices for goods or services in open, competitive markets. Businesses are free to compete by setting their own pricing strategies as long as their conduct in setting and implementing their pricing strategies does not contravene the Act. The scope of the ACCC's enquiries into the conduct of Coles was therefore limited to the allegations of 'predatory pricing' under section 46(1) and 46(1AA) of the Act.

Misuse of market power / selling below cost for a proscribed purpose

Section 46 of the Act concerns the misuse of market power by corporations. Section 46(1) and 46(1AA) deal with conduct that is commonly described in competition matters as 'predatory pricing'. The Act does not define predatory pricing.

Section 46(1AA) provides that a corporation that has a *substantial share of a market* must not supply, or offer to supply, goods or services for a *sustained period* at a *price that is less than the relevant cost to the corporation* of supplying such goods or services for the *purpose* (emphasis added in italics) of:

- substantially damaging or eliminating a competitor;
- preventing the entry of a competitor into that market or any other market;
- or
- preventing or deterring a person from engaging in competitive conduct in that or any other market.

It is not a contravention of section 46(1) or 46(1AA) of the Act for a corporation to have a substantial degree of market power or to have a substantial share of a market. Conduct will only contravene section 46 of the Act when all of the following elements are able to be established:

- the corporation has a *substantial degree of market power or substantial share of a market*
- the corporation supplies goods or services *below relevant cost* for a *sustained period*, and
- it does so for any or all of the anticompetitive *purposes* as described above.

² *Queensland Wire Industries Pty Ltd v Broken Hills Pty Co Ltd* (1989) 167 CLR 177

³ Gleeson CJ and Callinan J in *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374 "The purpose of the statute is to promote competition; and successful competition is bound to cause damage to some competitors."

Concern that a large company like Coles may be selling below cost for a sustained period is cause for the ACCC to consider allegations of predatory pricing. However, for such allegations to be sustained each of the elements referred to above needs to be established and an ACCC assessment looks to obtain information to address each of those elements.

Selling below cost

In the ADF letter and the ADF's earlier submission to the ACCC of 23 May 2011⁴, reference is made to the impact of Coles decision to sell its house brand fresh milk at \$1 per litre, a level the ADF considers to be below the cost of supply in regional and remote areas of Australia, particularly where milk is sourced from the drinking milk markets of New South Wales, Queensland and Western Australia.

In considering the matters raised, in addition to obtaining information from the ADF, the ACCC also gathered and reviewed sensitive commercial-in-confidence information from other market participants concerning the costs of supplying drinking milk to consumers. As further noted in the ACCC's media release, enquiries showed that there was a significant variation between the respective costs of supply and operating margins among supermarket operators in retailing their house brand milk to particular geographic regions throughout Australia.

The ACCC enquiries support the view that the major impact of Coles reduction of its house brand milk prices has been the erosion of its profit margins previously enjoyed for house brand milk. As you suggest, the extent to which those margins come close to below cost of supply vary from region to region. As noted above and further discussed below, pricing at or even below cost is not in itself illegal.

Proscribed purpose

As discussed above, it is incorrect to simplify 'predatory pricing' to encompass all instances where a corporation with substantial market power or a substantial share of a market sells goods or services below its cost of supply.

Heavy discounting can often be indicative of 'competitive pricing' in 'jockeying for sales' from competitors – in this instance other supermarket competitors.

Taking into account that competition is deliberate and ruthless, conduct under section 46 of the Act is limited in its application to those instances where the conduct has an anti competitive purpose of eliminating or substantially damaging a competitor, preventing competitive entry or preventing or deterring a person from engaging in competitive conduct. As noted in the ACCC's media release, a key factor in forming its view that Coles conduct did not contravene section 46 of the Act was the absence of any anti competitive purpose as described above.

Purpose is to be ascertained subjectively, rather than objectively, in the sense that what is to be ascertained is the intent of the corporation engaging in the relevant conduct. Information available to the ACCC did not support the existence of an anti-competitive purpose. ACCC enquiries revealed that Coles' purpose or intention in reducing the price of its house brand milk was to increase its market share by taking sales from its supermarket competitors, in particular, Woolworths. This is consistent

⁴ Australian Dairy Farmers Ltd letter of 23 May 2011

with reports of Coles' market performance and competition between the major grocery retailers.

"The stronger Coles sales performance has brought more customers back into their stores...Published quarterly sales results from the major grocery retailers show a period of Coles' ascendancy in underlying sales growth – and therefore a gain in grocery market share."

*"... while the volume of promotional discounts has reduced in 2010/11, the depth of discounting has increased, as the major chains battle for the perception of 'retailer with the cheapest groceries'."*⁵

The ACCC concluded that the evidence available to it supported the view that the purpose for Coles' price discounting of its house brand milk and other staple food products (as part of its price reduction campaign) was to compete with other supermarkets and not for an anti-competitive purpose. It concluded that Coles' conduct was unlikely to constitute a contravention of section 46 of the Act.

Taking into account the above, issues concerning competition in the route market and/or future product innovation were not factors that required assessment as to whether the conduct contravened section 46 of the Act.

It is also clear that the effect of this competition amongst major grocery retailers is that consumers in metropolitan and regional areas have benefited from a reduced national price for house brand milk.

Misleading or Deceptive Conduct

The ACCC has obtained information from various market participants concerning representations made by Coles and other supermarkets in relation to current price reduction campaigns. In particular, the ACCC has been keen to consider representations that go to the extent to which prices may remain reduced. The ACCC continues to monitor these matters. To date we have not seen evidence of misleading or deceptive conduct in relation to the Coles price reduction campaign.

Thank you once again for your letter and assistance in the ACCC inquiries concerning this matter.

Yours sincerely

Marcus Bezzi
Executive General Manager
Enforcement and Compliance

⁵ Dairy 2011 Situation & Outlook, Current Market Conditions, page 29