

SENATE ECONOMICS REFERENCES COMMITTEE

Questions on Notice

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

AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

Question 1

Hansard Ref: pp. 33–34 (Senator Colbeck)

Senator COLBECK: Going back to the question on the advertisement, it quite clearly said \$2.47 down to \$2. Coles have since told us that the larger proportion of what they reduced in price was in fact from \$2.09 down to \$2. Did you have a look at that as part of this process?

Mr Bezzi: No we did not.

Senator COLBECK: Would it fall within your remit?

Mr Bezzi: It would, but we were focusing on the competition issues. We also looked more generally at the 'Down, Down' campaign. We have looked at that in the context of Woolworths' campaign and Coles' campaign. They have got similar campaigns. The Coles campaign we have looked at very closely and we have continued to monitor the prices for the products that are within the scope of the campaign. I think there are about 6,000 products within the scope of that campaign. Almost all of those products have remained at the low level since January. There have been some exceptions and we have taken the issue up with Coles, but essentially they do seem to have kept their prices down.

Senator COLBECK: In the context of that advertisement, what would trigger you looking at that specifically, other than in the broad context of the campaign?

Mr Bezzi: A number of things might trigger it. A complaint about it would. I do not think we have received a complaint about it from anyone and I am not sure that it was particularly drawn to our attention. Sometimes things are drawn to our attention by senators—

Senator COLBECK: I am drawing it to your attention now.

Mr Bezzi: Yes, and we can certainly have a look at it.

Mr Sims: Clearly we can when people misrepresent the extent of price reduction. We have had many cases—I am not talking supermarkets here; I am talking generally—where someone says it is X per cent off but the base is different to the one they are purporting. That is conduct we can have a look at.

Senator COLBECK: Fundamentally, I understand where Coles are at. They are trying to reshape their image in the market. They are trying to improve their competitiveness. So be it. That is part of the job and part of the role—value for shareholders and all that sort of stuff. The things that have got up my nose more than anything else through this process are things that I perceive to be misleading in respect of what they are saying or doing. They have put things before us where they will give us a clipped piece of information that provides a result that suits their argument. There is no question that they have a very well crafted campaign for this process. They have done the work so they can present evidence when things are questioned so that it gives the right impression. It is a very well prepared campaign. I give them credit for putting the background into it.

The reaction that I received when this first came to light was that there was a huge reduction in the price of milk. That became the discussion. The requests for comment from the media were about this huge reduction in the price of milk. Then we come to the nuts and bolts of the evidence that we got

from Mr McLeod the day he arrived. He said the greater proportion of what they were selling was in fact a reduction from \$2.09 to \$2. We got to the point of almost asking, 'What are we arguing about?' The advertisement said \$2.47 to \$2. What stirred my mind up was that in a previous inquiry they had told me that their gross margin on milk was 22.5 per cent including all their in-store costs. This was a 23 per cent reduction. You do the basic maths and say: 'They have told us their margin is 22. They are reducing it by 23. They must be selling it below cost.' They have said they are bearing that cost. That is their business to deal with that, but that strung a whole heap of other things together that brought us to where we are today. They are the things that really irritated me about what we were being told. We were given information that was designed to give a perception that supported their argument rather than the reality.

Mr Bezzi: Could I just clarify something I said? You indicated that there had been misrepresentations made to you in the course of this inquiry and you asked me whether—

Senator COLBECK: That was my perception, though what I was asking you was whether you had looked at that specific advertisement.

Mr Bezzi: I would have to take that on notice, but my recollection is that we did not. I just wanted to clarify that, when you asked whether we had jurisdiction, I think we may have had some discussions with you in the past about the limits of our capacity to deal with representations that might have been made in the course of Senate inquiries. We cannot go there.

Answer

The ACCC understands that Coles previously sold 2 litre home brand milk at two different price points being \$2.49 for lite and \$2.09 for full cream. These products were differentiated by branding, with the latter being marketed under the 'SmartBuy' range. At the same time as announcing its price reduction, Coles ceased selling milk under the SmartBuy range. Accordingly, Coles' reference to price reductions was promoted, at least in part, on the basis of the reduction from the higher priced label.

While the ACCC is not aware which particular advertisement Senator Colbeck referred to, the ACCC is familiar with a number of Coles' advertisements in which it described the price reductions. Having regard to the specific representations made and the circumstances described above, the ACCC did not identify representations it considered misleading or deceptive.

Question 2

Hansard Ref: pp. 36–37 (Senator Xenophon)

Senator XENOPHON: Perhaps I am getting a bit frustrated here, Mr Sims. Isn't it relevant to find out whether the price is below cost? Isn't that something that is a reasonable inquiry for the ACCC to make in the context of looking at these issues. Purpose may be able to be inferred by virtue of below cost pricing.

Mr Sims: I do not think that you would infer purpose out of below cost pricing. You would infer purpose out of what the effect of the behaviour was. I think that it turns very much on that. If you just simply start selling goods below cost, is that a problem? It very much depends on whether what you are doing is for the purpose of damaging competition or it has the effect of damaging competition. If it does neither, then I am not sure what the public policy issue is there.

Senator XENOPHON: Isn't there a public policy issue if it is below cost? That may or may not be a building block in a case.

Mr Sims: Absolutely: it is a building block. But if you know that you have stumbled at one of the foundation bricks then you have a problem. Let me ask my colleagues as to where they got to on that issue. I may ease your frustration.

Senator XENOPHON: Difficult, but thank you.

Mr Cassidy: Your generic question, if I can call it that, about relevant costs—

Senator XENOPHON: It is not a home brand question; it is a generic question.

Mr Cassidy: I am sorry: I did not mean it in that way! It sets up a little bit what you quite roughly called full cost—in other words, the cost of the product, the cost of transporting it, some contribution towards the overhead costs of the firm involved. Speaking generally here, if we were to take a case where someone was using predatory pricing and we got to court and the firm said, 'Hang on a moment: your calculation of cost has not included this and that,' we would probably be back out of the court again fairly quickly. So there needs to be a full cost or a total cost concept.

Senator XENOPHON: So in addition to the wholesale cost, there is the cost of transport, delivery, storage, refrigerating et cetera.

Mr Cassidy: Yes, that is right. With that in mind, and I know you have raised the issue of whether we checked the cost of selling fresh milk in Darwin and—

Senator XENOPHON: Kununurra.

Mr Cassidy: a few other far flung places—and I say that without intending any offence to anyone who might live in those places—the answer is that we did not go to the point of checking at each individual geographic locality, basically because of the reason that the chairman has mentioned, which is that from the evidence that we had we could see that we were not going to get a purpose in terms of section 46. There was, if you like, a commonsense approach taken by us in terms of the resources that we would put in to establishing one leg in certain geographic areas when we basically knew that we did not have the required other elements.

Senator XENOPHON: So it is fair to say that in this case, because of what you and the chairman have said about the whole issue of purpose, there has not been a formal inquiry or a forensic examination of whether this was below the relevant cost or not.

Mr Cassidy: We spent a fair bit of effort on it, certainly in capital cities, regional centres and so on and so forth.

Senator XENOPHON: Was a conclusion reached as to whether it was below?

Mr Cassidy: Yes. We were confident that in many areas—in fact, we would say most areas—it was not selling below cost. But what I am saying is that if we get to geographically extreme areas, if I can call them that, we would not guarantee that it was not selling below cost. But then, if we did not, they would have the required other elements of the offence.

Mr Sims: We just expect markets to operate as well.

Mr Bezzi: We looked at the actual cost that they had, which included the distribution costs. There was a range of distribution costs, including refrigeration, transport and storage. The distribution figures are claimed to be confidential, so I will not read them out, but they went from a very small amount in metropolitan areas to a much larger amount in the remote areas. If you include the distribution costs in all those areas, except in very remote areas, it was very clear at the date of our analysis that they were not selling below cost. But it was not so clear for the remote areas.

Senator XENOPHON: Again, you did not take it further because of the purpose issue?

Mr Bezzi: We did not take it further. When you also look at it on a national basis, right across the country, they were not selling below cost.

Senator XENOPHON: But that is not the way you define markets under the act, so that is irrelevant.

Mr Bezzi: No, it is not. So we looked at it both ways.

Senator XENOPHON: Could you provide that to the committee—whether it is on an open basis or a confidential basis. I would find that quite useful. I can understand if there are commercial-in-confidence issues where that could be the basis of the analysis.

Mr Cassidy: We will first take that on notice and see what we can do to give you a feel for the geographic dimensions in terms of the cost price issue.

Answer

In major regional and metropolitan areas Coles was not selling its house brand milk below cost. In more remote areas, particularly in northern Australia, the ACCC can not guarantee that it is not possible that Coles was selling below cost. However, pricing at or below cost is not in itself unlawful. 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 *Competition and Consumer Act 2010* was the absence of any anti competitive purpose.

Question 3

Hansard Ref: p. 38 (Senator Xenophon)

Senator XENOPHON: Has the ACCC examined the UK market and what happened there in relation to supermarkets and drinking milk to assist in the ACCC's investigation? I am not holding this against them but the current management of Coles have got a long history of a deep involvement in the UK market. I do not know whether that would be relevant. I am just saying that they have come from that market where there was a certain lack of competitiveness; is that something that the ACCC looked at?

Mr Cassidy: We are aware of what has happened in the UK both in terms of what happened in the market, including in relation to milk, and in terms of what the UK government has subsequently done.

Senator XENOPHON: But have you been in contact with your equivalent number with the regulator in the UK about these matters?

Mr Bezzi: We have had discussions with the UK OFT and in fact some staff from the Competition Commission about grocery issues more generally. But I cannot tell you that we have specifically had discussions with them in the context of this investigation. We have certainly had ongoing discussions with them about—

Senator XENOPHON: Perhaps you might want to take that on notice.

Answer

In the context of the investigation of Coles' discounting of house brand milk, the ACCC did not have discussions with the UK OFT. However, as disclosed at the hearing, the ACCC has been in contact with the UK OFT over time about grocery issues generally.

Question 4

Hansard Ref: p. 39 (Senator Xenophon)

Senator XENOPHON: Can you take on notice the issue of the whole supply chain, which Senator Colbeck has raised, being affected. That is what dairy farmers are concerned about and are saying that someone is going to cop it in the end. There is evidence out of Queensland that a number of dairy farmers have left the farm directly as a result of this and some for other reasons such as natural disasters. That has been a factor and there is a concern that that will grow.

Answer

The ACCC found that Coles' purpose in reducing the price of its house brand milk and other staple food products was to compete with other supermarkets and not for an anti-competitive purpose. Therefore, issues concerning competition and its effect in the route market and the supply chain were not factors that required assessment as to whether the conduct by Coles in reducing its prices contravened section 46 of the Act.

Question 5

Hansard Ref: p. 41 (Senator Bushby)

CHAIR: Just following up firstly on the section 49 issue discussion you were having, I take your point. The purpose of this inquiry, which is the drop to \$1 per litre, may not have triggered any of those issues. I am just playing devil's advocate here a little bit while you are in front of us. Certainly the evidence we had this morning was about a broader level of price discrimination that is not based on scale or volume or those sorts of things between Coles and Woolworths and other competitors in the milk market. The proposition that was raised is that this is occurring and, I guess, that in the context of this inquiry that has an impact on the competitive environment within the retail milk market, which, when you overlay the reduction to \$1 a litre over the top of it, is causing a problem. I presume that is not the direction you have looked at it from. You have looked at it specifically from the \$1 a litre for milk type of issue, not from the existing issues that occur and potential alleged competitive problems that already exist in the market.

Mr Cassidy: Certainly from the point of view of the \$1 a litre issue. But more generally—and this is not the first time, of course, that section 49 has been raised—each time we look at it and think about the law, we come to a position where, for price discrimination to be effective (in other words, to be, say, anticompetitive), you end up needing either the firm involved to have market power or more than one firm involved and, therefore, having an anticompetitive agreement. Now, misuse of market power is covered by section 46 of the act and anticompetitive agreements are covered by section 45, so you end up looking at conduct, or potential conduct, and saying, 'Righto, this may be anticompetitive price discrimination, but it falls within the ambit of either section 46 or section 45.'

CHAIR: Are you talking about section 49 when you say it was of no use?

Mr Cassidy: Yes.

CHAIR: I was thinking about what we heard this morning. The allegation was that the processors are selling to Coles and Woolworths at a price that is substantially lower and not wholly accounted for by volume, freight and other relevant factors, and therefore section 49 would assist them in a more general sense within the milk market to compete with the big guys; and that, when you overlay the \$1 a litre thing, it just complicates it and makes it even worse for them. They were not raising it in the context of the \$1 a litre being the catalyst but more that there is a general problem.

Mr Cassidy: I think there are two answers to that. Firstly, it is perhaps something we will need to take on notice and give you a confidential response to. But, on the basis of the evidence we have, I am not sure whether that proposition is factually right to start with, in terms of price at which milk is being sold to various retailers by the processors—

Senator XENOPHON: Mr Cassidy, do you want to go in camera? Is that what you are suggesting?

Mr Cassidy: No, I think we can do it by giving you a confidential answer on notice—

Senator XENOPHON: Sure. You probably need to get that information as well; you would not have it here.

Answer

The information available to the ACCC confirms that milk is supplied by processors to supermarket retailers at a variety of prices, including prices below that paid by Coles and Woolworths.

Question 6

Hansard Ref: p. 43 (Senator Xenophon)

Senator XENOPHON: Okay. You may want to take my next question on notice. Your predecessor said on 8 March 2011 on the Sky business channel in relation to this whole milk price war:

But I do think we've actually got to start looking at others in the supply chain, and treat with a healthy scepticism some of these protestations about concerns of the farmer, when it may well be that the primary concern is for these major corporations' bottom line, their profits.

He was talking about the processors. My question to you, perhaps on notice, is: given the evidence we have heard today from National Foods in their submission, and what has transpired since March, do you share the healthy scepticism of your predecessor?

Mr Sims: Scepticism in relation to?

Senator XENOPHON: In relation to saying that these protestations are about processors, rather than dairy farmers, keeping their bottom line.

Mr Sims: The protestations coming from the processors?

Senator XENOPHON: Yes. He said, and this was on the Sky business channel:

But I do think we've actually got to start looking at others in the supply chain, and treat with a healthy scepticism some of these protestations about concerns of the farmer, when it may well be that the primary concern is for these major corporations' bottom line, their profits.

Mr Cassidy: We will take it on notice, because obviously we need to look at what has been said from today—

Answer

Whatever may have happened to processors' profit margins since the beginning of the \$1 per litre of milk campaign in January doesn't alter the proposition that some participants in the milk supply chain have been more concerned with their profit margins than with the impact of the campaign on farmers or consumers.

Question 7

Written (Senator Xenophon)

Has the ACCC investigated the impact of Coles' actions on farmers under Parmalat's Pauls Daily Access Scheme in Queensland; particularly following the Queensland Dairy farmers' Organisations formal letter of complaint dated 24 February 2011 that raised this issue?

Answer

The ACCC considered the Parmalat arrangements as part of the investigation of the alleged predatory pricing by Coles.

Question 8

Written (Senator Xenophon)

Has the ACCC investigated Coles' advertising claims in relation to price reductions on home brand milk products, particularly in relation to the amount of product affected by the larger discounting of 33% versus the amount of product affected by the smaller discounted amounts as advertised in Coles' initial press release of 26 January 2011?

Answer

Please refer to the ACCC's answer to Question 1.

Question 9

Written (Senator Xenophon)

Who does the ACCC view as Coles' competitors?

Answer

In relation to supermarket retailing the ACCC views Coles' competitors as other supermarket retailers. On one level this includes major supermarket chains such as Woolworths. On a different level, this includes smaller supermarket retailers such as Aldi and IGA stores.

Question 10

Written (Senator Xenophon)

Does the ACCC view Coles home brand products as a competitor to processor-branded products which sell on the same shelves in Coles stores?

Answer

Yes. In general house brand and processor branded products are substitutable with each other.

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The impacts of supermarket price decisions on the dairy industry

Melbourne, 6 October 2011

Additional Questions on Notice to the ACCC from Senator Xenophon

1. In ascertaining Coles' purpose in reducing the price of home brand milk, did the ACCC ask Coles to produce all internal emails, memos or other documents in relation to the actual decision to reduce the price of home brand milk?

Answer

The ACCC requested from Coles documents as to the decisions made within Coles to reduce the price of Coles house brand milk.

2. Did Coles provide internal memos, emails or documents to the ACCC or did Coles simply brief or write to the ACCC regarding the reasons for Coles' decision?

Answer

Coles provided internal documents to the ACCC.

3. Isn't the problem at the processor level that the processor level is highly concentrated as a result of the ACCC having allowed processors to merge or make acquisitions to a point where there just a few left?

Answer

The ACCC administers section 50 of the *Competition and Consumer Act 2010* (CCA) which prohibits mergers and acquisitions that have the effect, or are likely to have the effect of substantially lessening competition in a market.

In cases where the ACCC has had concerns that proposed mergers between dairy processors were likely to raise competition concerns pursuant to section 50 of the CCA it has taken appropriate action.

In particular, in 2008 the ACCC examined National Foods' acquisition of Dairy Farmers. In that matter, the ACCC conducted a public review and formed the view that the proposed acquisition would raise competition concerns in certain regions of New South Wales and South Australia where the merger parties both had a strong presence in processing. Concerns were also identified in relation to the manufacture and supply of fresh white milk, and flavoured milk in NSW and South Australia. To address the ACCC's concerns, the merger parties provided a section 87B undertaking to divest milk processing facilities, depots, brands and supply agreements in each of the relevant states. The businesses were divested to Parmalat, which had no presence in milk processing in the relevant areas.

In 2010, the ACCC examined Murray Goulburn's proposed acquisition of Warrnambool Cheese and Butter Factory (WCB). The ACCC identified a number of preliminary concerns in relation to this proposed transaction, particularly in relation to potential increased market concentration at the

processor level in Victoria, south east South Australia and central South Australia. The ACCC issued a Statement of Issues in relation to this matter. Murray Goulburn withdrew its proposal to acquire WCB prior to the ACCC forming a concluded view on the matter.

However, the ACCC has not intervened in acquisitions relating to processors which it considered were not likely to breach section 50. For example, in 2007 the ACCC considered the acquisition of National Foods by the Kirin Group. In that matter, the ACCC took the view that the acquisition was unlikely to result in a substantial lessening of competition due to the limited overlap between the operations of National Foods and Kirin in Australia.

It is also relevant that in its 2008 grocery inquiry report the ACCC found that in most regions of Australia there are a number of processors to which farmers can supply their milk.

4. What value does collective bargaining have if the larger party refuses to bargain with the collective bargaining group, but chooses to negotiate with individual farmers?

Answer

The ACCC has recognised a number of public benefits as being likely to arise as a result of collective bargaining by small businesses, including dairy farmers. In the ACCC's recent decision in response to the collective bargaining proposal put forward by Australian Dairy Farmers Limited the ACCC considered that the following public benefits were likely to result:

- efficiency improvements by providing dairy farmers with a greater opportunity to have effective input into the terms and conditions of their supply contracts, in part by aggregating their bargaining power
- transaction cost savings, for example by consolidating elements of the professional advice obtained by farmers as part of the negotiation process
- addressing information asymmetries, for example by improving the availability of market information and resources for use by farmers in the negotiation process
- enhancing dynamic efficiencies through new marketing opportunities (through aggregating milk supply).

Some of these benefits may still arise in circumstances where the target of the negotiation elects not to participate in the collective bargaining process. In particular farmers would still be able to collectively address some of their information needs (delivering transaction cost savings and reducing information asymmetries). In some circumstances the ability to engage in collective bargaining has allowed dairy farmers to aggregate their milk volumes and successfully seek out alternative purchasers.

5. Would it be misleading if a supermarket advertised heavily that it had reduced the price of 6,000 products, but in reality it had also increased the price on the other 15,000 products or more in the supermarket?

Answer

In addition to considering the accuracy of the representations the Courts will also consider the overall impression of the representations. The ACCC when assessing such matters needs to consider all the relevant circumstances as to whether the representations are misleading and deceptive.

6. Does the ACCC agree that misleading conduct under the Australian Consumer Law can occur through silence or half truths, so isn't it potentially misleading if Coles is heavily advertising the discounting of 6,000 products, but Coles is silent on increases on the other 15,000 products or more?

Answer

The Courts have found that conduct by silence can be misleading and deceptive. Whether silence is misleading or deceptive is dependent upon all the relevant circumstances being taken into account including any specific representations made.

7. Isn't the "staying down" slogan, especially when the signage is seen across the supermarket, creating the impression of a discount across the supermarket product range?

Answer

It is not possible for the ACCC to form a view that the use of this slogan in itself is likely to mislead and deceive. Consistent with previous answers we are required to consider all the circumstances including the context in which the slogan is made.

8. There have been very few court cases in relation to mergers, but why hasn't that stopped the ACCC issuing merger guidelines?

Answer

The ACCC issues guidelines on the analytical framework it applies when examining mergers and acquisitions under section 50 of the CCA. The Merger Guidelines were first issued in 1992 and have been revised periodically. They were last revised in 2008.

Mergers, by their nature, involve structural changes to businesses and the economy. Accordingly, unlike other anti-competitive conduct provisions under the CCA, the ACCC provides an opportunity for parties to seek the ACCC's views on whether a proposed acquisition is likely to raise competition issues pursuant to section 50 prior to a transaction occurring. The Merger Guidelines are an integral part of the informal merger review process, providing guidance to parties about the issues the ACCC will consider when examining a merger. The Merger Guidelines also assist parties to determine whether they should apply to the ACCC for informal clearance.

The Merger Guidelines do not have any legal force in determining whether a merger is likely to contravene the CCA—final determination of the issues is a matter for the courts. While there have been few court cases in relation to mergers, the substantial lessening of competition test applied under section 50 is well recognised internationally and applied in many jurisdictions, including the United States.