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Mr John Hawkins
Secretary
Senate Economics References Committee
Department of the Senate
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr Hawkins,

Further to our appearance before the inquiry into Access of Small Business to Finance, I attach a supplementary submission relating to anti-competitive price discrimination, as requested by Senator Eggleston.

Yours sincerely,

Ken Henrick
Chief Executive Officer

The need for reintroduction of a prohibition on anti-competitive price discrimination to the *Trade Practices Act 1974*

All OECD countries[1] except Australia and New Zealand have in place prohibitions on anti-competitive price discrimination.

Until 1995, Australia had such a prohibition, section 49 of the *Trade Practices Act.* That section was repealed on the recommendation of the Hilmer Committee in its report, *National Competition Policy*, in 1993.

Anti-competitive price discrimination is the sale of like product (or services) at different prices to different customers, giving one or more of those customers a price advantage over the others. The general tendency is to give large sellers an advantage over smaller competing sellers and large buyers an advantage over smaller competing buyers.

In the Australian context, where a number of industry sectors are highly concentrated, the risk is that a large buyer might intimidate a supplier with the purpose of extracting beneficial terms of trade which the supplier cannot afford to offer to smaller customers who compete with the large buyer.

Anti-competitive price discrimination will be likely lead to a substantial lessening of competition and/or concentration of a market (perhaps tending to create a monopoly) and to injure or destroy competitors or prevent the entry of new competitors.

As an example, Woolworths and Coles regularly have slabs of VB on special for $31. Fosters refuses to sell slabs of VB to independent liquor retailers for less than $36. The result is clearly anti-competitive, since independents are denied the opportunity to compete on equal terms and the tendency of the practice would be to shift greater and greater shares of the market to Woolworths and Coles over time.

In the banking sector, differential interest rates are charged by banks for small business loans secured by domestic mortgages, compared with loans for domestic mortgages only. The problem would appear to be banks' lack of expertise in evaluating small businesses, where in earlier times a local bank manager would be familiar with all of the small businesses with accounts at that branch and in a good position to make judgements about their viability.

However, the problem is not simply that small businesses cannot access finance at standard current rates. There is evidence that large businesses can use the market

[1] OECD member countries are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

power consequent upon their market share to demand and receive discriminatory interest rates.[2]

> A columnist in the *Sydney Morning Herald* writes:
>
> *Last year the owners of Melbourne Airport emerged from the global crisis with traffic figures intact and a new $1 billion credit line backed by every Australian major bank, plus a few overseas ones, at an average interest rate anyone else would kill for - 3.9 per cent.*
>
> *The airport's owner, Australia Pacific Airports Corporation, has also made after-tax profits in the vicinity of $150 for several years, which is not a bad return on between $450 million and $500 million a year in revenue.*
>
> *Like pretty much everyone of Australia's privatised airports, however, it is still gouging huge amounts from airport users in the form of vehicle parking and hire fees - not to mention finding new ways to force relatives and friends of airline passengers to fork over more.*

Clearly, while banks force small business to pay higher interest charges, they afford big business lower charges. Yet how exposed are banks to small business failures, compared to the failure, say, of a company the size of an HIH?

Nor are banks the only organisations giving big business preferential treatment[3]:

> *The Victorian Government, for example, has agreed to speed up the consideration of the first batch of applications, initially for 12* [Woolworths hardware] *sites in the state...*

What small business might dream of getting a the benefit of special treatment by a government agency? Such discriminatory treatment hands large companies clear competitive advantage, which, in any case they are big enough not to need.

The removal of the former s49 prohibition has also allowed shopping centre landlords to charge differential prices for leased retail space, with large anchor tenants leasing at cheaper rates. Retailers wishing to avoid paying high rents in shopping centres then find that strip-shop rents have also been inflated by the rents charged within shopping centres.

Economic theorists apparently find it difficult to distinguish whether discriminatory pricing, when it occurs, is merely evidence of competition in action or, on the contrary, the abuse of quasi-monopoly power.

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[2] "Airport flies into monopoly territory", Ian McIlwraith, *Sydney Morning Herald,* Business Day, p. 9, Friday 23 April 2010.

[3] "Bunnings path to beating rival may lie in doing it for you, not in do it yourself", Malcolm Maiden, *Sydney Morning Herald,* Business Day, pp9-9, Friday 23 April 2010.

Clearly, the test is in the effects of the price discrimination, which is why the former s49 and similar legislation in other OECD jurisdictions distinguishes "anti-competitive price discrimination", since some price discrimination might not be anti-competitive.

Hilmer argued that s49 was unnecessary because it had been of little assistance to small business and because s46 (misuse of market power) would catch such conduct. However, s46 was rendered largely ineffective by the High Court's 2003 decision in the *Boral Besser Masonry v ACCC* case.

The "difficulties" Hilmer found[4] in s49 were spurious:

> *There are considerable practical difficulties with s.49. It is not clear what degree of similarity is required for goods to be regarded as being "of like grade and quality"; it is not clear what might constitute "reasonable" allowances for differences in cost; and it is not clear whether, when meeting a competitor's price, the goods must bear the same degree of similarity to the competitor's goods as is required by the phrase "of like grade and quality". The cost defence does not necessarily correspond with those factors which firms would monitor or consider significant.*

None of these matters is in practice difficult to establish and no other OECD country has noticed such "difficulties". For example, the similarities across the supply of the entire range of tens of thousands of branded, packaged grocery product liness are manifest.

Anti-competitive price discrimination is entirely irrelevant to "meeting a competitor's price", contrary to Hilmer's suggestion; it is about the prices at which a supplier sells a particular product to different customers. Hilmer was clearly confused about the intent and coverage of s49 and his opinions are therefore of no account, despite the fact that his recommendation led to the repeal of the section.

Other, earlier, critics of s49 had also argued for its abolition, including reviews by Swanson (1976) and Blunt (1979). Since s49 was legislated only in 1974, such early attempts to have it repealed before even a single case had been taken to court are, at best, highly curious.

Both these reviews, however, were based on theories and assumptions about the operation of competitive markets. Swanson, Blunt and Hilmer were not considering s49 in the context of its capacity to prevent the development of concentrated markets, such as we have in Australia now in the grocery, banking, telecommunications, petroleum and air transport industries, for example.

The prevention of market concentration is at the heart of the Robinson-Patman Act, the relevant legislation in the United States, and s49 was directly based on it.

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[4] *National Competition Policy: Report by the Independent Committee of Inquiry,* AGPS, Canberra, August 1993, p. 77.

Notably, the United States does not suffer the consequences of market concentration (the top two US grocery retailers, Wal-Mart and Kroger, jointly have only 20 per cent of their domestic market , while Woolworths and Coles have just under 80 per cent of the Australian market) and 15 years after the abolition of s49 Australia has a worrying number of concentrated markets. The ACCC found the Australian grocery industry, for example, to be only "workably competitive". "Workably" is the ACCC's euphemism for "not very".

Hilmer argued that[5]:

> *The provision is contrary to the objective of economic efficiency and has not been of assistance to small business. The Committee does not believe that it is the role of the competitive conduct rules to protect any particular sector of society, and does not believe that the competition rules should be used to achieve objectives contrary to economic efficiency.*

First, so far as we can determine, only one s49 case was ever taken to court, none by the Commonwealth agencies responsible for administration of the *Trade Practices Act.* Had they taken more cases over the twenty one years in which s49 applied, the result might have been quite different. It is sophistical to argue that s49 was of little assistance to small business when s49 was tested in court only once because of lack of purpose by the relevant regulators.

In any case, much of the *Trade Practices Act* is of little or no assistance to small business - even those parts which are intended to be so - particularly when such laws are still not applied by the regulators responsible for them. Should all such sections be repealed?

The costs and time required to take a case to court and see it appealed all the way to the High Court are prohibitive for small businesses. Currently, only the ACCC has the taxpayer-provided funding to do so, but generally demurs from acting. While recent changes to the *Trade Practices Act* have given small business relatively affordable access to the Federal Court, many small businesses remain unable to afford any legal action. In any case, even if successful in the Federal Court, small businesses would be stymied by the costs of any appeal to the High Court.

Hilmer's concern with "economic efficiency" as an over-riding goal is fatuous. Economic efficiency is regularly ignored by governments of all persuasions for a wide variety of commendable (or not) reasons. And if we accept Hilmer's argument that it is not "*the role of the competitive conduct rules to protect any particular sector of society"*, much of our consumer protection law would be null and void. Consumers, after all, are supposed to be the beneficiaries of the activities of the Australian Competition and *Consumer* Commission.

[5] ibid., p. 74

Hilmer's approach to economic efficiency reminds one of the adage that "to a man with a hammer, everything looks like a nail." There are other considerations besides economic efficiency. In any case, it is not "economically efficient" to hand massive competitive advantage to large companies to the detriment of smaller competitors which are then expected to carry lead in the saddle while the regulator accuses them of being inefficient.

Prohibitions on anti-competitive price discrimination *do not prohibit* lower prices based on economies of scale, but require that the seller should be able to demonstrate genuine economies of scale proportionate to the discounts.

Economies of scale, however, are not infinite. Indeed, in practical terms economies of scale can expire quite rapidly. In other OECD jurisdictions, a supplier offering a discriminatory price to a large customer must be able show that the larger discount offered to a large customer does not exceed the savings in selling or handling cost that the larger order has made possible. Nevertheless, wholesalers and retailers typically order in standard quantities per order, such as by pallet or truck load, even if competitor A might order twice as much as competitor B over the course of a year. Economies of scale do not necessarily arise in that context.

While it is possible to argue, as Hilmer did, that there are similarities with s46, there seems to have been no valid reason for the repeal of s49.

Further, the ACCC noted in its grocery pricing inquiry report that Justice Keely found in the Federal Court that conduct in breach of s49 of the Trade Practices Act might also be in breach of other sections of the Act[6]. In *Cool & Sons v O'Brien Glass Industries*, Justice Keely found that both ss47 and 49 had been breached. Given that decision, it is difficult to argue, as Hilmer did, that s49 was ineffectual and that conduct relevant under s49 would be caught by s46 (misuse of market power).

In any case, s46 itself has been rendered largely ineffectual by the High Court decision in the *Boral Besser Masonry* case. The ACCC has never used s46 to pursue any case involving alleged anti-competitive price discrimination, nor did its predecessor, the Trade Practices Commission, ever take a s49 case to court from 1974 to 1995.

In other jurisdictions, where anti-competitive price discrimination occurs, both buyer and seller are liable. A prohibition on anti-competitive price discrimination is thus a protection for a weaker party which might be intimidated by a stronger party to engage in anti-competitive price discrimination.

That such conduct occurs was indicated by the ACCC in its grocery price inquiry report, where it noted[7]:

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[6] Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, July 2008, p. 440

[7] op. cit., p. 325

> *The inquiry was provided with little evidence to substantiate allegations of buyer power being exercised in an anti-competitive or unconscionable manner.* ***Having said that, however, there were some complaints of buying power being exercised where the complainant appeared to be genuinely reluctant to give information to the ACCC out of concern about retribution if detail were provided to the ACCC and investigated.***

Our emphasis.

The ACCC noted later in the same report[8]:

> *Unless a supplier of a product has a powerful brand (or is able to build such a brand) which the MSCs* [that is, Woolworths and Coles] *perceive as important to a category, the terms that can be negotiated with the MSC will tend to favour the MSC and from the supplier's perspective may erode over time. This broad, but not universal, trend is reflected in the ACCC's analysis of supply terms over time.* ***Further, in some case, the MSCs were able to shift costs to suppliers and effectively unilaterally alter the terms on which goods are supplied, even after delivery.***

Our emphasis.

In the United States, the relevant legislation is the *Robinson-Patman Act,* the primary objective of which is to protect competition by avoiding the development of market concentration or monopolies. Section 2(a) of the Robinson-Patman Act[9] says:

> *That it shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality...where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit or such discrimination or with customers of either of them.*

Former Congressman Wright Patman, one of the co-authors of the Act, made the point that once anti-competitive price discrimination has occurred, the competitor who has suffered the discrimination is unlikely to be able to remain competitive in relation to that product or service, even if he accepts a lower profit margin.

Patman summarised the issue thus:

> *If we had to provide a single statement as to the economic tests of an objectionable price discrimination, we would have to say that it is a discrimination that has a substantial tendency to divide the market shares in*

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[8] op. cit., p. 383

[9] Patman, W., *Complete Guide to the Robinson-Patman Act,* Prentice-Hall, Englewood Cliffs, NJ, 1963 p. 11

ways different from the division that would take place if efficiency were the sole determinant of this question.[10]

Anti-competitive price discrimination may arise in a number of ways. In the Australian grocery market it is likely to be in the form of demands from a supermarket chain to a supplier to accept a lower price for a product than the price at which he sells that product to his competitor(s) or to provide equivalent benefits through bundled terms, such that the supermarket chain effectively enjoys a pricing advantage at that point in the supply chain. From that point on, the competitive advantage is unlikely to be eroded and the consequences for smaller competitors can be dire.

In the banking sector it is likely to be in the offer of advantageous interest rates or other loan terms, discriminating between classes of borrower, as we have seen earlier.

Until repealed, s49 read in part:

49(1) [Prohibited Conduct] *A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to:*

(a) The prices charged for goods
(b) Any discounts, allowances, rebates or credits given or allowed in relation to the supply of goods;
(c) The provision of services in respect of the goods; or
(d) The making of payments for services provided in respect of the goods;

If the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods....

The rest of the section provided limited exemptions and defences.

The former s49, we note, relied on a "substantial lessening of competition" test which has clearly failed in relation to other issues, such as creeping acquisitions. We do not suggest the reintroduction of s49 as it formerly stood.

Simpler and more direct legislation applies in the United Kingdom. The UK *Competition Act 1998,* Chapter 1, s2(2)(d) prohibits agreements, etc., which "apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage". We think a "competitive disadvantage" test would be preferable, but there may be other options also.

[10] ibid., p. 54.

The Hilmer committee's report admitted that:

> ... *price discrimination can be anti-competitive where it enables a firm to entrench its position of market power by creating strong buyer-seller ties and thus raising barriers to the entry of new competitors. Extreme forms of price discrimination can amount to predatory pricing.*[11]

Indeed, anti-competitive price discrimination sets the scene for predatory pricing of a type not caught by the current predatory pricing provisions of the *Trade Practices Act* - the "Birdsville amendment" - but which is recognised in the literature as "above cost predation".

In the Australian context, the beneficiary of anti-competitive price discrimination - a buyer with sufficient market power to extract a discriminatory price advantage from a supplier, for example - has the capacity to lower prices (using the extra margin gained from the price discrimination) to a level its competitors are unable to match, without actually having to sell "below relevant cost" (that is, at a loss) which the Act prohibits if it is conducted for a "sustained period of time" for the purpose of injuring or eliminating a competitor or preventing the entry of a new competitor.

While this might deliver a short-term pricing benefit to consumers, prices will rise once competitors have been eliminated. Woolworths admitted in evidence to the ACCC's grocery price inquiry that its prices varied from place to place, depending on, among other things, the level of competition in the local market.

Clearly, Hilmer's committee did not consider the duopsonistic circumstances of today's retail grocery sector or the other industry sectors which are now highly concentrated. From the year the Hilmer report was published, 1993, until now, Woolworths and Coles have increased their joint market share from about 50 per cent to just under 80 per cent. That circumstance puts it outside any experience of market behaviour available to Hilmer and his committee at that time and it is now at a level which they could not have contemplated. Similar market concentration has occurred in other industry sectors, underlining the failure of the ACCC's stated goal of "protecting competition, not competitors".

Despite National Competition Policy, in 2008 the ACCC found the retail grocery industry to be only "workably competitive" (a term which has no status in competition law literature) and that Coles and Woolworths had a lack of incentives to compete strongly on price.[12] Indeed, competition seems to have diminished in a number of markets since National Competition Policy was adopted.

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[11] *op. cit.*, pp. 74-75

[12] op. cit., p. xvi

An industry sector is either competitive in the way it operates, or it is not. In a competitive market, sellers will compete to improve products and supply them at the lowest possible cost.

A perfectly competitive market is one in which profits are high enough to pay costs and deliver net profits just high enough to persuade investors that their funds are not better off in a savings account or some other investment.

Clearly, the ability of Woolworths, for example, to deliver double digit profit *increases*, as it has done in recent years, is at least partly due to the hyper-concentration of the Australian grocery market and the disproportionate market power which derives from that concentration.

The assumptions of the Hilmer committee and more recently the ACCC inquiry into the grocery retailing sector are based on academic theories of competition which assume "normal" competition, but which largely do not apply in some industry sectors in Australia because of the hyper-concentration of markets. When markets are hyper-concentrated, competition theory doesn't work. As the law is currently based on competition theory - that is, on functioning competitive markets - and at least some markets are not functioning as competitively as they should, the legislation needs to be amended to take account of that.

For example, the Act could be amended specifically to deal with competition in hyper-concentrated markets. Indeed, partly as a result of National Competition Policy, there are now a number of industry sectors - banking, telecommunications, air transport, petroleum, grocery retailing - which are concentrated to the point where market-sharing, rather than competition, seems to be the predominant feature, or have government-annointed monopolies, such as major airports.

We believe the reintroduction of a prohibition against anti-competitive price discrimination would go a long way towards returning the Australian food and grocery market to a more competitive context.