WOOLWORTHS LIMITED

INQUIRY INTO THE EFFECTIVENESS OFTHE TRADE PRACTICES ACT 1974 IN PROTECTING SMALL BUSINESS

SENATE ECONOMIC REFERENCES COMMITTEE

Submission by Woolworths Limited

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Woolworths Limited
ABN 88 000 014 675
540 George St,
Sydney NSW 2000
Telephone: (02) 9323 1534
Facsimile: (02) 9323 1596
Website: http://www.woolworthslimited.com.au

For information on this submission please contact:

Rohan Jeffs, Company Secretary

Woolworths Limited

Submission to the Senate Economic References Committee

To the Secretary,
Senate Economic References Committee
Room SG.64
Parliament House,
CANBERRA ACT 2600
E-mail: economics.sen@aph.gov.au

CONTENTS

EXECUTIVE SUMMARY

Woolworths is pleased to provide this submission to the Economics References Committee's inquiry into the effectiveness of the *Trade Practices Act 1974* ("**Act**") in protecting small business.

Woolworths' submission addresses the first four of the terms of reference, being:

(a) Whether **section 46 of the Act** deals effectively with abuses of market power by big businesses, and, if not, the implications of the inadequacy of section 46 for small businesses, consumers and the competitive process;

(b) Whether Part IVA of the Act deals effectively with unconscionable or unfair conduct in business transactions;

(c) Whether Part IVB of the Act operates effectively to promote better standards of business conduct, and, if not, what further use could be made of Part IVB of the Act in raising standards of business conduct through industry codes of conduct;

(d) Whether there are any other measures that can be implemented to assist small businesses in more effectively dealing with anti-competitive or unfair conduct.

Woolworths Limited submits that any review of the ongoing effectiveness of the Trade Practices Act must take account of both the underlying purpose of the Act and the current competitive situation in the Australian Food, Liquor and Grocery Market.

Legislative Objectives

Woolworths believes that the goal of trade practices legislation in a modern free market economy should be to promote efficiency and fairness in the interests of a strong and competitive economy and of consumers, who must be the ultimate beneficiaries of this legislation. We further believe that such legislation should be applied impartially to promote effective competition and

ensure a level playing field for all market participants. In a free market, all competitors must strive to meet consumers' demands. There is no immunity to any competitor, regardless of size or market share, from inefficiency and uncompetitiveness.

We note the significant changes that have occurred within the structure of the Australian economy and the increasing impact of global economic forces on Australian businesses over the past three decades. We acknowledge that trade practices legislation must keep pace with these changes.

As the economy evolves it is important to ensure that any amendments to trade practices legislation, while seeking to promote 'fairness' and consumer choice, do not inadvertently distort the operation of normal market forces or compromise healthy competitive activity by protecting or rewarding inefficient and incompetent behaviour. Such behaviour does not, in our opinion, improve the lot of the Australian consumer and ultimately will lead to Australia becoming uncompetitive globally.

The Australian Retail Sector

Australia has one of the best-balanced and most competitive food and grocery markets in the world and, on its own evidence, the independent grocery sector in Australia, while dynamic, continues to thrive. The latest Food Liquor and Grocery market research shows that the independent food retail operator sector is flourishing and now has more than 50% of the Food Liquor and Grocery market. New and successful retailers small and large, such as Aldi are entering the market.

Similarly, business failures are not, as is alleged, limited to smaller enterprises, but rather to inefficient business practices, with Franklins being a recent example of a large food retailer which failed to achieve the necessary cost efficiencies and faced major difficulties and ceased to exist in its current form, being acquired by a foreign operator.

Customer demand is the ultimate determinant of commercial performance. Legislative/regulatory support cannot be justified for businesses seeking

special treatment if their own customers show a lack of satisfaction with their offer – as a result of their being unwilling or unable to adapt to the economic realities of a modern competitive economy. Artificial protection of poor business practices will lead to consumers being the ultimate losers through higher prices, more limited choice and less convenience.

The arguments against any change to Section 46

Woolworths' submissions are summarised as follows:

Term of Reference (a)

In Woolworths' view, no case has been made out that section 46 is ineffective in dealing with abuses of market power affecting small business. The ACCC's loss of the *Boral* case does not on careful analysis reveal a structural problem with s.46.

In particular, s.46:

(a) is not limited to corporations who are monopolies (see, for example, the *Safeway* decision.

(b) can apply to oligopolies such as the cases referred to below; and

(c) is effective to deal with predatory pricing.

Woolworths opposes suggested reforms to section 46, such as:

(d) the establishment of "market share thresholds" for determining whether a corporation has substantial market power;

(e) the introduction of an "effects test";

(f) reversing the onus of proof; or

(g) the introduction of a new and distinct prohibition on predatory pricing into the Act. The introduction of a broad prohibition on below cost pricing would damage consumer interests and discourage corporations from competitive price discounting and sales.

Such reform proposals appear to be 'quick fixes' which have not been sufficiently analysed. They are more likely to deter competitive conduct and cause a chill on business activity.

A 'market share' test for market power would extend the operation of section 46 to prohibit conduct by many small and medium sized businesses, and increase compliance and legal costs to SMEs.

Woolworths supports the publication by the ACCC of revised s.46 guidelines (which should be non-binding - similar to the ACCC's Merger Guidelines) that outline its approach to prosecuting breaches of section 46.

Unconscionable Conduct

Woolworths submits that to date, there is no apparent need to further amend Part IVA of the Act (in particular section 51AC) to deal with unconscionable and unfair conduct. The provisions are a strong tool that can be used to protect small businesses in their dealings with large corporations.

Retail Industry Code

Woolworths' experience as a signatory to the Retail Grocery Industry Code of Conduct has been positive and Woolworths supports the Code. Woolworths submits that the recent initiative by the ACCC to review and approve more industry codes of conduct should be encouraged.

Other Reform Measures

Woolworths does not consider that a persuasive case has been made to otherwise strengthen the TPA for the benefit of small business. In Woolworths' experience most large businesses in Australia are familiar with and meet their obligations under the Act. Additional regulation will increase compliance costs and could damage efficient and competitive behaviour.

PART A: COMMERCIAL ARGUMENTS

WOOLWORTHS' CONTRIBUTION TO FOOD RETAIL COMPETITIVENESS

Employment and Career Opportunities

Woolworths employs around 145,000 Australians and is Australia's second largest private sector employer, offering employment ranging from long-term career opportunities (complete with training), to part-time and casual positions for those with other responsibilities such as study or family. In rural and regional Australia, Woolworths employs around 50,000 people, including 20,000 young people under 25 years of age.

Retail Food Margins – Australia/United Kingdom/United States/Europe

Woolworths also brings benefits to those who are not directly associated with the company through the delivery of high-quality, affordable food to families across Australia. In comparison to grocery retailers overseas, Woolworths' operates on very low retail margins. In the past year, Woolworths' EBIT (Earnings Before Interest and Tax) averaged around 3.5% (after tax), compared to similar large scale grocery/food retailers in the United Kingdom; United States and Europe which EBIT average is 6% (after tax). Woolworths also effectively subsidises freight costs to ensure that stores in non-metropolitan locations are able to offer the choice, quality and low prices expected by all Woolworths' customers.

Lower Costs/Lower Prices

Woolworths is continuing to push for lower costs across its stores through the "Project Refresh" initiative, and to pass on these benefits to customers through lower retail prices. Woolworths has over the past 4 years continually reduced its own costs (as a percentage of sales), and passed on these cost savings to customers. This has meant that retail prices are lower, so much so that Woolworths' gross profit has also continued to reduce from 27% 5 years ago to 25% in the last financial year. Growth in the company's net profit, and in the benefits to shareholders, have been achieved through operating efficiencies, thereby reducing costs and prices and increasing turnover.

Woolworths' 145,000 employees, 19 million customers a week and over 330,000 shareholders (around 70,000 of whom live in rural and regional Australia and 50,000 of whom are Woolworths employees) have all benefited from the efficiencies which Woolworths has achieved as it continues to drive down its costs and enhance its ability to compete in an increasingly global retail market.

Consumer Benefits of Volume Efficiency and Quality Improvements

Woolworths' market share, whilst modest in the context of a food, liquor and grocery market, enables it to pass on benefits for consumers and suppliers. Efficiency savings from volume buying flow through to consumers in the form of lower prices and investment in innovative products, service levels and improved food safety and quality. Volume orders allow suppliers to benefit from reduced financial risk and an improved ability to re-invest in their businesses. The efficiency savings also assist Woolworths in promoting the growth of particular product categories, in particular in primary producer areas which in turn benefits growers, through increased volumes.

Woolworths' business is absolutely customer driven, and to be successful it must continue to meet ever-changing customer needs. This includes ensuring that products meet customer requirements, particularly in areas such as range, safety, hygiene and quality. In relation to "fresh" food, Woolworths has set the industry standard by establishing quality specification requirements through its Woolworths Vendor Assurance System. These high standards are a reflection of customer demand for quality.

Fresh Food/Buying Code of Conduct

Australian supermarkets are a major channel of distribution through which Australian primary producers sell their products, and a significant source of funds that enable the primary sector to grow.

Fresh food is purchased by Woolworths through direct negotiations with primary producers (around 40%-50%) and through market agents, in established distribution centres such as the major produce markets, produce packhouses and saleyards that supply the entire market.

All Woolworths' buyers are required to operate to a strict internal Code of Conduct to ensure that prices and conditions of supply are fairly negotiated. If disputes do arise, Woolworths' internal dispute resolution procedures have been established to ensure that Woolworths' Fair Trading Policy and Procedures have been followed. A copy of Woolworths' Policies and Procedures is attached. Annexure H. The supplier may also refer the dispute to the Retail Ombudsman under the Retail Grocery Industry Code of Conduct.

By developing partnerships with suppliers, Woolworths has been able to reduce the volume of imported fresh products sold in its supermarkets to less than 5%. This figure continues to fall as Woolworths implements an aggressive import replacement program.

The Food Retail Market Share Debate

The food and grocery retail industry in Australia has been the subject of much scrutiny in recent years concerning market share and the conduct of the major supermarket operators.

Definitions of the size of the retail food market and who holds what share, continue to be misrepresented, particularly by interest groups seeking to exaggerate the market position of the major food retailers. Independent experts (Dimasi Strategic Research, ABS and AC Nielsen) have endorsed the most accurate measure of market share should include sales across the entire food, liquor and grocery (FLG) market. In this FLG market, according to world standards, the independents' sector share is the highest at around 50%, with Woolworths at around 28% and Coles/Bi Lo at around 22%.

The distinction between any grocery/scan data based market share statistics and the truly representative FLG market shares, is highlighted by the fact that the often quoted grocery retail market statistics only cover around 35%-40% of the products sold in a major supermarket, while the FLG definition covers over 90%.

THE INDEPENDENT RETAIL INDUSTRY

Wholesalers to Independents/Small Businesses

The independent retail sector has undergone significant rationalisation and consolidation over the past 18 months, largely prompted by Australian Independent Wholesalers Pty Limited ('AIW'), a wholly owned subsidiary of Woolworths Limited, ceasing operations during 2002. The transfer of business of a major Victorian retail banner group, FoodWorks, to Metcash Trading Limited ('Metcash') rendered AIW's future operations unsustainable.

This has essentially left Metcash as the only major wholesaler to independents along the Australian eastern seaboard and South Australia. However, the sale of AIW's Queensland operation to a group of independent retailers and their banner group, saw the birth of Australian Retail Logistix Limited as a competitor to Metcash in that State. Those independents did not wish Metcash to have a monopoly. However, Metcash remains -- by a wide margin -- the leading wholesaler in Queensland.

In Tasmania, the wholesaler is Statewide Independent Wholesalers Limited ('SIW'), which is owned 60% by Woolworths and 40% by Tasmanian independent retailers.

In Western Australia, Foodland Limited acts as wholesaler to the independent retailers.

Apart from ARL in Queensland, Metcash has an effective monopoly along the eastern seaboard and in South Australia. As wholesaler to the independent food retail businesses (over 4,500), Metcash negotiates directly with suppliers (except for the 70 Franklin stores which negotiate directly). Metcash endeavours to provide the best cost prices to its customers but because Metcash is a publicly listed company (although majority foreign-owned) shareholders expect a return on their funds. Metcash's sales, market share and profit growth in the last three years has been remarkable.

The table below charts the significant growth of Metcash the wholesaler:-

Source: Metcash Annual Reports

IGA Distribution	FYE 30/04/2001	FYE 30/04/2002	FYE 30/04/2003
Share of Australian supermarket sales (ACNielsen)	11.2%	13.4%	16.1%
Sales growth	$2.43b (+16.9%)	$2.97b (+22.3%) *	$3.70b (+25.4%)**
Number of IGA stores	1,036	1,101	1,138***
Group EBITDA****	$97.6m (+17%)	$117.5m (+20%)	$152.7m (+30%)

* same store growth of 8.8 %

** same store growth of 7.3%

*** excludes 70 Franklin stores, 180 FoodWorks stores and more than 500 AUR stores.

**** includes Australian Liquor Marketers & Campbells Cash & Carry.

NARGA presents itself publicly as a lobby group representing independent grocery retailers. It appears, however, from the 1998 Joint Parliamentary Inquiry into Retail, that over 80% of NARGA's funding has come from Metcash. *(Hansard, Monday 12 July 1999 JOINT-Select RS1045)*

NARGA's current campaign for changes to the misuse of market power provisions of the TPA is premised on their claims that 'big business' is using "*their multi-billion dollar positions of power to crush smaller opponents and wipe out competition* (NARGA Press Release, 28 March 2003). The NARGA position is inconsistent, however, with that of its apparent principal financial backer, Metcash, which has recently stated "*independents have done brilliantly, in terms of increasing their market share" Mr A Reitzer, CEO, Metcash Ltd [ABC Business Breakfast 23 May, 2003]* in sectors including grocery and liquor retailing. The table above supports that statement.

Comparisons of Retail Concentration Levels

Many markets in Australia have a limited number of participants but remain highly competitive**.** In these markets, Australian operators must be able to

generate sufficient economies of scale to be able to provide world class standards. While there will always be opportunities for innovative specialist operators, a sufficient share of the retail market is required to enable efficient and internationally competitive domestic retailers to survive.

International comparisons of market concentration levels should take into account factors such as market size and geographic spread, as well as other factors including consumer behaviour, preferences, cost structures, regulatory considerations and their relative level of efficiency all of which can affect market structure and behaviour.

The Increasing Trend of Retail Globalisation and Concentration

The increase in concentration levels seen in Australia's food retail sector over the past 5 -10 years is not limited to Australia. Increasing growth of major food retailers at the expense of the smaller independent operators is occurring at the same or greater rate in most overseas countries. Worldwide consumers are demanding more choice of quality products and services at retail prices which are considerably lower, in relative terms, than 5-10 years ago.

The drive by major food retailers across the world, for increased efficiencies in their logistics and distribution systems, has meant that those retailers willing to invest in these areas benefit from a lower cost structure, enabling them to continually 'invest' these cost savings and efficiencies into lower retail prices, making them increasingly more competitive than those retailers unwilling to make this commitment.

The consumer is the beneficiary of these strategic developments in retail logistics, and they can only suffer should any regulatory regime penalise a business for investing in future efficiencies.

Australia needs to ensure that its Australian-owned retailers remain internationally competitive. In the context of global retail expansion, it is worth noting that both Metcash and Franklins are already owned by overseas interests and that Aldi, a large privately owned international food retailer, has

established a strong and expanding retail base in Australia and intends to continue to expand, without the demands of Australian public shareholders.

By world standards, Australia's major food retailers are considered to be relatively small. In the latest "World's 100 Largest Retailers Ranked by Sales" list, Woolworths is ranked 50th.

Supermarket industry concentration across the globe will continue to grow; the stores will be fewer, bigger and better. However, whilst Woolworths is at world class levels in terms of its standards of quality, range and the price of its "offer" to consumers, its operating efficiencies are not yet at world class levels. To achieve this requires considerable investment. Woolworths needs to continue to strive for efficiency, domestically, to enable it to compete with the larger overseas chains in their drive for domestic market expansion.

Any regulatory intervention that has the effect of inhibiting domestic retailer market dynamism runs the risk of reducing the competitiveness of players such as Woolworths, and encourages the further growth of international operators in the Australian retail market at the expense of the Australian-owned and operated retailers.

In order for Australian companies to attain efficiencies necessary to meet a competitive world market, there needs to be a competitive and growing domestic market. The placing of artificial regulatory restrictions on consumer-based market growth reduces domestic competitiveness. These restrictions would remove the incentive for companies to be innovative, to improve service levels and efficiencies, and to offer a high quality, broad range of products and services at consistently lower prices.

The Independent Food Retailers and Competitive Pricing

Food retailers in Australia operate in a demanding market with rapidly increasing consumer expectations of price and service levels, together with low population growth, low inflation and increased competitiveness. There has been significant new market entry by specialist food retailers that have been able to successfully develop niche markets. Woolworths constantly faces

competition, not only from its traditional supermarket rivals, but from convenience stores, service stations and "fresh food" specialists such as bakeries, seafood and health food stores, delicatessens, meat and fruit and vegetable retailers, as well as other specialist franchise chains.

In addition to this new competition, intense rivalry between the major domestic food retailers is the driving force of increased service levels and lower prices for metropolitan, regional and rural consumers across Australia.

Australia's Current Competitive Safeguards

Suggestions that there is a need for further regulation to protect competition implies that current competitive safeguards are inadequate. This is not substantiated. The Trade Practices Act (TPA) is administered by the Australian Competition and Consumer Commission (ACCC). Growth by acquisition is addressed by Section 50 of the Act, while concerns over organic growth are adequately covered by the restrictive trade practices provisions in Part IV of the Act, including in particular, section 46 which prohibits the misuse of market power.

The following section examines the provisions of the TPA most applicable to retail concentration and market power.

Growth through Acquisitions

The increase in market share through mergers or acquisition is subject to scrutiny by the ACCC. Section 50 of the TPA prohibits mergers or acquisitions where they have or are likely to have the effect of substantially lessening competition in a substantial market.

Assessment of competition starts with a definition of the market. Market definition is an economic and legal concept, however, determining the boundaries of a market is purely a factual issue. The factors which are likely to impact on the outcome include ability for new entrants, at all levels, sensitivity to price change, the product's peculiar characteristics, distinct customers and increasingly, industry perception of the market parameters.

The ACCC's Merger Guidelines state that following completion of the first stage (defining the relevant market), concentration levels are determined and applied against thresholds. The ACCC will use these as a guide only for deciding to continue through a process of rigorous analysis in order to determine whether there is likely to be a substantial lessening of competition.

The ACCC has continued to strictly enforce Section 50, requesting substantial evidence of public benefits in cases where competition may be affected, prior to permitting certain mergers.

Woolworths' Supermarket Acquisitions

In new locations where Woolworths wishes to establish a store, we prefer to construct a new supermarket rather than acquire an existing supermarket business. Acquisition tends to be a more costly option. In addition to the purchase cost, most acquired stores require extensive refurbishment in order to meet Woolworths' standards.

Pricing Behaviours

From time to time there are suggestions that the size of the supermarkets, both in range and number of stores, might lead to 'predatory pricing' in particular areas. These suggestions are unfounded and unsubstantiated.

Woolworths' Pricing Policy

Woolworths' pricing policy in supermarkets is to sell competitively. Woolworths' prices are determined by the market and our ability to reduce our costs of operating through investment in efficiency enhancing technology in logistics and store operations. These reduced costs have meant lower prices to customers and have provided shareholders with adequate return on their investment.

In the absence of efficiency improvements and reduced operating costs, Woolworths would not be able to achieve the world class standards necessary to remain an independent Australian retail operator.

Competitive Price Checking

To maintain a competitive pricing policy Woolworths has a monitoring program of major competitors' prices. A similar monitoring exercise is also maintained by Woolworths' competitors for the same purpose.

In addition to the monitoring of prices at individual stores to ensure that they are competitive on key products, store Managers are empowered to lower prices in their local area on certain items to match major competitors.

Price Comparisons

Woolworths' policy is to sell at the lowest price structure which it can sustain dependent upon cost and a reasonable return.

'***Predatory Pricing'***

Woolworths' prices competitively and within the boundaries of the TPA. Pricing can be challenged under section 46 of the TPA if it can be shown to be 'predatory'.

Predatory pricing is normally understood as a strategy whereby a business may temporarily sell its products below its average net variable cost in order to drive competitors out of a market. The business then aims to recoup its losses through increased "monopoly" pricing.

Predatory pricing requires the business to have a substantial degree of power in a market, using that power for the purposes of deterring or damaging competitors from competing by deliberately selling below its own cost base, or otherwise pricing in a way designed to eliminate a competitor.

It should be clearly understood that, with the benefits of technological and volume based efficiencies, some businesses will have a lower net variable cost than their competitors. It is not predatory pricing to sell at prices which reflect such cost structure, despite the fact that such cost may be below or even materially below the cost structure of its competitors.

Because much normal competitive behaviour involves responding and reducing a businesses' prices to meet competition, it is not thought of as "predatory" for any competitor in a market (no matter what their respective size), to reduce its prices to match prices of another competitor.

Further, the fact that, in some locations, a business reduces its prices to meet localised competition, but does not reduce its prices to the same extent in other locations where the same level of competition is not encountered, is not regarded as contrary to the Act or a matter for criticism. Localised 'hot spots' of competition do and will occur in many markets for many reasons. Consumers are astute enough to be aware of these issues. Consumers often seek out such low prices, even if they are not available at the closest and most convenient locations to where the consumers reside. An example can be seen in the extent of price cutting in petrol in parts of the Sydney metropolitan region, where prices vary widely from suburb to suburb, due to localised competition.

Predatory pricing can be difficult to distinguish from strong competitive behaviour. Economic theory has not provided a clear definition of what is meant by selling products at prices below "cost". Low prices in most instances are good for consumers and section 46 is designed to protect the interest of consumers (see High Court in *Queensland Wire),* not competitors who are unable to compete as successfully, as their rivals.

Our submission, therefore corrects some of the assumptions and misrepresentation of the facts and puts the issue of retail competition in the context of Australia's unique blend of distance and small population – in a global economy where efficiency and cost effectiveness is needed to continue to deliver lower prices and meet the needs of the Australian consumer.

PART B: THE LEGAL ANALYSIS

A. Term of Reference (a): Section 46 of the Trade Practices Act

What was Parliament's intended purpose for the current form of section 46?

A.1 In 1986, section 46 was amended to promote an efficient and competitive environment for firms large and small. It was not intended to be a protective shield for small business.

A.2 In the Attorney General's second reading speech for the 1986 amendments to the Act, the then government of the day made clear a number of purposes about the reform to section 46:

> *"...A competitive economy requires an appropriate mix of efficient businesses, both large and small".*
>
> *"The Government attaches great importance to ensure that the Act is effectively and appropriately achieving its dual aims of promoting efficiency through competition, and thereby ensuring goods are provided to the consumer at the cheapest price, and providing consumers and business people with an appropriate measure of protection against unscrupulous traders".*
>
> *"The Trade Practices Act lays down rules designed to preserve an environment in which the forces of competition can be effective and, at the same time, to protect consumers and reputable businesses from practices which are unfair".*
>
> *"...Beyond that the Act does not seek to regulate the way in which firms carry on their business".*
>
> *"An effective provision controlling misuse of market power is most important to ensure that small businesses are given a measure of protection from the predatory actions of powerful competitors..."*

"Section 46 in its proposed form which will be described as misuse of market power rather than monopolisation. It is not aimed at size or at competitive behaviour as such of strong businesses. What is being aimed at is the misuse by a business of its market power."[1]

A.3 It is an overstatement for some commentators to suggest that the 'focus' of section 46 is small business. The focus of the section is to encourage efficient businesses, large and small and to prohibit misuse of substantial market power for anti-competitive purposes. To that end the government's intention was to see that small businesses should be protected from larger but less efficient competitors. Equally, small business was not to be protected from large, efficient competitors. The Attorney General declared that section 46 is not to be aimed at competitive behaviour of strong businesses.

A.4 It is this critical distinction that needs to be borne in mind in considering all of the current proposals for reform and criticisms of the *Boral* decision.

Determining market power by reference to market shares

A.5 There are several fundamental problems with a suggestion of the Fair Trading Coalition ("**FTC**") to include a deeming provision in section 46 based on market share.

A.6 Nowhere in the world is market share regarded as a satisfactory test of market power.

[1] See Hansard, 19 March 1986.

A.7 The FTC draft is:

> "*Without limiting the generality of this section, a corporation shall be deemed to have a substantial degree of market power where:*
>
> *the combined market share of the four (or fewer) largest firms is 75% or more and the corporation supplies at least 15% of the relevant market; or*
>
> *the corporation supplies 15% or more of the relevant market.* "

Comparison with US HHI Index

A.8 The FTC proposal would legislate an administrative guide used in the US: the Herfindahl-Hirschman Index ("**HHI**"). However, the attempt to introduce this index in Australia is problematic for three reasons:

(a) First, the HHI is not law in the US - it is only an administrative guide.

(b) Second, it is a merger guide and is not used in the US for misuse of market power monopolisation cases.

(c) Third, the US economy is many times larger than that of Australia and markets are accordingly larger, thus presumptions about market shares in a very different economy cannot be simply replicated in Australia.

Market share is not market power

A.9 Fundamentally, Woolworths is opposed to the FTC's proposal because market share cannot conclusively establish the existence of market power. Market share may be a short run phenomenon which

may be easily eroded by the entry of new competitors or by the response of existing competitors.

A.10 It is well recognised, by the terms of section 46 itself, as well as by the Courts and by economists, that market power depends on a large number of factors but most importantly, absence of constraint, not market share. Market share can, on occasion, provide a useful indication, but it can never be determinative of whether a particular corporation has substantial market power. The critical issue is the absence of constraint on a firm from actions of its competitors, customers and suppliers: see section 46 (3).

A.11 The courts[2] have set out a number of major factors to be considered in determining whether a corporation has substantial market power. These include:

(a) the ability of a firm to raise prices above the supply cost (the minimum cost an efficient firm would incur in producing produce) without rivals taking away customers in due time;

(b) the extent to which the firm's conduct in the market is constrained by that of competitors or potential competitors, suppliers or customers;

(c) the market share of the firm;

[2] Market share on its own is not determinative of market power. In *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13, the High Court applied section 46(3), stating:
"market power means capacity to behave in a certain way (which might include setting prices, granting or refusing supply, arranging systems of distribution), persistently, free from the constraints of competition."

In the High Court's decision in *Boral*, Gleeson CJ and Callinan J stated (at para 137):
"a large market share may, or may not, give power. (per Mason CJ and Wilson J in Queensland Wire) The presence or absence of barriers to enter into the market will ordinarily be viable. Vertical integration may be a factor."

(d) the existence of vertical integration;

(e) the extent to which it is rational or possible for new entrants to enter the market - the extent of barriers to entry.

A.12 The ACCC recognises the limited usefulness of market share as a proxy for market power. In its publication, *Rural industry and the Trade Practices Act: a guideline for rural producers*, December 1997, it states (page 17):

> "*a firm with a large domestic market share may not have market power if it is subject to considerable import competition*."

Boral and Universal cases

A.13 Perhaps underlying the FTC's proposal is a concern that the effect of the High Court's decision in *Boral* and the Full Federal Court's decision in *Universal* is that few firms will be found to have substantial market power. Indeed, the FTC states that its proposed amendment would "*allow oligopolies as well as dominant firms to be "captured" by section 46- which is what was intended by the Parliament in 1986*". These views are wrong.

A.14 Woolworths submits that nothing in the *Boral* or *Universal* or other decisions means that section 46 would not apply to oligopolistic firms. The recent decision of the Full Federal Court in Safeway shows that a firm with a market share under 20% can be found guilty under section 46 of the Act[3].

[3] See Annexure A for a summary of the salient facts of the Safeway case. Safeway and the ACCC are both seeking leave to appeal the decision to the High Court

A.15 In the following cases since the 1986 amendments to section 46, corporations that were not monopolies were found to have a substantial degree of market power:

ACCC v Australian Safeway Stores Pty Ltd (2003) 198 ALR 657;

Melway Publishing Pty Ltd v Robert Hicks Pty Ltd [2001] HCA 13;

John S Hayes & Associates Pty Ltd v Kimberly-Clarke Australia Pty Ltd (1994) ATPR 41-318;

Petty v Penfold Wines Pty Ltd (1993) ATPR 41 - 263;

General Newspapers Pty Limited & Ors v Australian and Overseas Telecommunications Corporation Limited (1993) ATPR 41-215

TPC v CSR Ltd (1991) ATPR 41-076;

Cadbury Schweppes Pty Ltd v Kenman Developments Pty Ltd & Ors (1991) ATPR 41-116;

O'Keeffe Nominees Pty Ltd v BP Australia Ltd (1990) ATPR 41-057;

TPC v Carlton & United Breweries Ltd (1990) 24 FCR 532;

Mark Lyons Pty Ltd v Bursill Sports Gear Pty Ltd (1987) 75 ALR 581;

Williams v Papersave Pty Ltd (1987) 16 FCR 69.

A.16 The decisions in *Boral* and *Universal* both related to actions of companies in strongly competitive markets, not in oligopolies where co-ordination replaced competition. Indeed, in *Universal*, the trial judge held that the following factors demonstrated the level of competition in the market:

(a) the 2 defendant music companies competed with each other and with other record companies, including three other major companies;

(b) there were distributors other than major record companies, some with substantial resources;

(c) there was competition from wholesalers, importers and overseas exporters;

(d) none of the major record companies had demonstrated an ability to raise prices and maintain them above the level of other suppliers (large or small);

(e) large retailers had, and exercised, countervailing market power;

(f) there was no finding that competition in the market was ever successfully excluded, or that there was vertical integration or super profits.

A.17 This was clearly a highly competitive market. (Interestingly, while the 2 music companies did not have substantial market power, their actions against smaller retailers were still found to breach section 47 of the Act. This highlights the fact that section 46 is only one tool available to the ACCC and small businesses in dealing with anti-competitive conduct. The fact that a corporation is not caught by section 46 does not mean that it can act with impunity towards small businesses, as the decision - and over $2 million in fines - in *Universal* clearly demonstrates).

A.18 In *Universal*, the full Federal Court (at paragraph 160) expressly noted that the concept of a coordinated oligopoly or 'conscious parallelism' of the major firms was neither pleaded nor argued by the ACCC. If the facts had supported such an allegation there is every reason the ACCC would have included these in this case.

A.19 Similarly, Gaudron, Gummow and Hayne JJ in *Boral* (at paragraph 176) stated:

> *"The ACCC did not contend that the CMP market in Melbourne was an oligopoly"*.

A.20 More relevantly, in *ACCC v Qantas Airways Ltd* [2003] FCA 125 Gyles J stated (at paragraph 17):

> *"In my opinion, there is no defect in the pleading which is clear enough to strike it out or otherwise stay or dismiss the proceedings. There is no doubt that the decision in Boral, taken together with Melway Publishing Pty Ltd v Robert Hicks Pty Ltd [2001] 205 CLR 1, has clarified a number of aspects of the operation of section 46. Those decisions have not, however, dealt with the operation of section 46 where there is sometimes called an oligopoly (or, in the present case, a duopoly) or the related question as to the precise difference in operation between the earlier fall of section 46, which spoke of a corporation that was in a position "substantially to control the market", compared with the present description "that has a substantial degree of power in the market". There is no doubt that the 1986 amendment was intended to lower the threshold to give section 46 work to do in situations short of dominance of control."* (emphasis added)

A.21 Based on these remarks, it is wrong to suggest that, notwithstanding the decisions in *Boral* and *Universal*, section 46 will, as presently drafted, not catch firms who operate in an oligopolistic market, as well as monopolies.

A.22 Of course, nothing in the foregoing should be taken to suggest the scope of section 46 is limited to collusive or co-ordinated oligopolies.

A reference to an oligopoly is simply a reference to a market which is dominated by a few large suppliers. Such a market can feature strong competition between the largest competitors (Cournot and Bertrand models of competitive oligopolies). It can also feature strong, smaller competitors.

A.23 An oligopoly may therefore contain, in addition to larger suppliers who are caught by section 46, smaller suppliers who will not be so caught. Section 46, then, can serve as a useful tool in protecting small businesses in such a market.

A.24 In this sense, the concerns of the FTC, and others, may be based on a misunderstanding of the scope of the section. The amendments designed to bring smaller corporations within the ambit of section 46 are not required and are not desirable.

Other Defects with the FTC Proposal

A.25 Under the FTC's proposal, the first "threshold" in subsection (a) of its draft is rendered irrelevant by the operation of the second threshold in subsection (b). Essentially, the FTC proposal would mean that any corporation with a 15% market share would be deemed to have substantial market power, regardless of the structure of the market[4].

A.26 However, regardless of whether the second threshold is amended, the first threshold (which would deem a corporation to have substantial market power with a market share of only 15%, if the

[4] If the FTC is attempting to replicate the ACCC's guidelines for assessment of mergers (to which it refers earlier in its submission), the second threshold should be amended to refer to a market share of 40%.

CR4 is 75% or more) would be detrimental to small businesses and to competitive activity generally. Small firms in regional Australia would be forced to comply with s.46 under such a reform.

A.27 Moreover, calculation of market shares is rarely straight forward, so that the section would be difficult to apply. Market definition is a matter of judgment in many cases and is rarely free from controversy. Markets are defined in terms of products, geographic dimensions and functional levels and change over times, sometimes rapidly. This is recognised in the ACCC Merger Guidelines.

A.28 Further, the FTC suggestion is limited to 'suppliers' whereas section 46 currently applies to buyers as well.

15% Threshold - Section 46 would apply to small businesses

A.29 Under the FTC proposal, many small businesses and new entrants to markets would unexpectedly find themselves caught by such an expanded section 46. For example, in a market with a near-monopoly provider, a new entrant who enters the market and quickly establishes itself with a 15% market share would find itself subject to section 46, even though its only competitor had an 85% market share.

A.30 If current Australian industry sectors were analysed to determine which corporations would be deemed to have substantial market power by operation of the FTC's proposed thresholds, how many SMEs would be caught? A very large number of small and medium sized businesses would have a 15% market share. For example,

two competing hardware stores in a regional town may both be caught by the new section. Such an amendment would certainly not serve to protect their interests.

A.31 Determining that a corporation automatically has a substantial degree of market power if it has a 15% market share would be unprecedented in international competition law, and could damage Australian firms' ability to compete offshore.

A.32 Even the European Union, which has a strong competition regulator and regime has adopted Regulation (EC) No. 2790/1999, "The Block Exemption Regulation" which provides a safe harbour for vertical agreements entered into by companies with market shares not exceeding 30%. In other words, the European Commission has determined that vertical restraints imposed by corporations with a market share of less than 30% are not subject to Article 81 of the EC Treaty, which prohibits certain anti-competitive vertical restraints. The implication of the Block Exemption Regulation is that European corporations with less than 30% market share are unlikely to be in a position to unilaterally lessen competition in a market.

A.33 If corporations with a market share of 15% are required to act with the level of caution required to comply with section 46, this will, in Woolworths' submission, cause a substantial chill on competitive activity and a restraint on the freedom of small and medium sized businesses to compete aggressively.

No need for a specific provision dealing with predatory pricing

A.34 Woolworths does not support the introduction of a provision into the Act (whether by way of amending section 46 or otherwise) which directly prohibits the practice of "predatory pricing", by pricing below 'cost' or other means.

A.35 Woolworths prices competitively and within the boundaries of the TPA. Pricing can currently be challenged under section 46 of the TPA if it can be shown to be a taking advantage of substantial power for a prescribed purpose.

A.36 Predatory pricing is normally understood as a strategy whereby a business may temporarily sell its products below its variable cost in order to drive competitors out of the market. The business then aims to recoup its losses between increased "monopoly" pricing.

How common is predatory pricing?

A.37 In most markets, below-cost pricing as a predatory business strategy is generally risky and irrational because of the uncertainty of recouping losses through latter price increases. In order for a predatory pricing scheme to be successful, two future events have to take place: First, the victim(s) of the alleged predation would have to exit and second, the predator would then have to generate profits in excess of its initial losses (recoupment)[5].

[5] Jonathan B Baker, *Predatory pricing after Brooke Group: An economic perspective*, 62 Antitrust LJ 585 (1994).

The US experience with predatory pricing

A.38 The United States Courts have a long history of deciding predatory pricing cases. Their experience with such cases is therefore instructive. The US Supreme Court has observed "*that there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful*"[6].

A.39 Even in the United States, predatory pricing cases are difficult to prove: See, for example the recent prosecution by the Department of Justice, of American Airlines[7], where the Department's case failed because it failed to demonstrate that American Airlines was pricing below its variable costs.

Difficulties of cost-based test

A.40 Woolworths does not support an amendment to the Act to prohibit selling "below costs of production".

A.41 Such a proposal ignores the fact that there are often good reasons for a corporation to sell below cost. For example, a corporation that is having an end of year clearance sale may sell below its costs, or a corporation that is entering a market may sell below costs for a time to entice customers to try their product.

A.42 US case law suggests that predatory pricing can be inferred or presumed (but subject to explanation) when the prices are lower than the corporation's average variable or 'avoidable' cost

[6] *Matsushita Elec Indus Co v Zenith Radio Corp* 475 US 574 (1986); *Brooke Group Limited v Brown & Williamson Tobacco Corp* 509 US 209 (1993).

[7] *US v AMR Corporation*, 3 July 2003

(measuring variable costs over the defendant's entire market output). The decision in *AMR Corporation* confirms that, 'marginal cost' is the appropriate cost measure but because it is so difficult to measure, 'average variable' or 'avoidable cost' is used.

A.43 In many cases, it is extremely difficult to measure a firm's average variable cost or marginal cost. Indeed, even measuring average product costs, or total costs, is fraught with significant difficulties and compliance costs for firms that do not possess sophisticated product costing or activity based costing systems (which many Australian firms do not possess).

A.44 There is in any event, significant debate about the correct measure of costs to use for the purposes of calculating "below cost pricing". Woolworths submits that the appropriate measure will vary from industry to industry, as the Court determined in *US v AMR Corporation*.

A.45 Further, not all corporations use the same methods to measure their costs. An attempt to standardise these methods would be impossible.

A.46 A direct prohibition on below cost pricing would require all corporations to closely monitor their costs (average, total, avoidable, variable and marginal) on an ongoing basis. This would result in unprecedented compliance costs for businesses, as well as deterring competitive price cutting.

A.47 Most businesses, including Woolworths, do not make their day-to-day business decisions by reference to their variable costs. Indeed, calculation of the appropriate measure of costs for a particular product and during a particular time is an extremely complex task, requiring the use of highly sophisticated activity-based-costing systems, the maintenance of sophistication of business and accounting systems and the lengthy and expensive involvement of expert cost accountants. Even then, there is invariably more than one method for measuring, apportioning and calculating costs. Court cases under this provision often become long and complex disputes between competing expert accountants.

A.48 A provision in the Act that seeks to prohibit below-cost pricing would therefore be rife with major difficulties.

A.49 It should be clearly understood that with the benefits of technological and volume based efficiencies, some businesses will have a lower variable cost than their competitors. It is not predatory pricing to sell at prices which reflect such cost structure, despite the fact that such cost may be below or even materially below the cost structure of its competitors.

The need for caution with prohibiting predatory pricing

A.50 Because much normal competitive behaviour involves responding to, and reducing a business' prices to meet, competition, in most cases, it is not 'predatory' for a competitor in the market, no matter what its size, to reduce its prices to match prices of another competitor in order to defend its business.

A.51 Further, the fact that, in some locations, a business reduces its prices to meet localised competition but does not reduce its prices to the same extent in other locations where the same level of competition is not encountered, should not be prohibited or discouraged under the Act. Localised "hot spots" of competition do and will occur in many markets for many reasons. Customers are astute enough to be aware of these issues. Customers often seek out such low prices, even if they are not available at the closest and most convenient locations to where the consumers reside. An example can be seen in the extent of price cutting in petrol in parts of the Sydney metropolitan region, where prices vary widely from suburb to suburb due to strong localised competition.

A.52 Numerous commentators and court decisions state that great caution is required in predatory pricing cases because "*the costs of an erroneous finding are high*"[8]. Because "*the mechanism by which a firm engages in predatory pricing - lowering prices - is the same mechanism by which a firm stimulates competition*", mistaken inferences may deter the very conduct the competition laws were created to protect[9].

A.53 Predatory pricing can be difficult to distinguish from strong competitive behaviour. Low prices in most instances are very positive for consumers. The dilemma was set out clearly by Wilcox J in *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1991) 30 FCR 385:

[8] *Brooke Group*, 509 US at 227

"The special difficulty about a case of predatory pricing is that, although this practice is just as anti competitive as exclusive dealing and tying arrangements, its existence may be more difficult to prove. Once the facts are uncovered, the true nature and purpose of an exclusive dealing or tying arrangement becomes readily apparent. But the outward manifestation of a decision to engage in predatory pricing is a lowering of prices, an action which, on its face is pro competitive. The factor which turns mere pricing cutting into predatory pricing is the purpose for which it is undertaken.....

Traders commonly fix prices with the intention of diverting to themselves custom which would otherwise flow to their competitors. In doing so, they realise that, if they are successful, the result will be to damage - in extreme cases, even to eliminate - those competitors. Such conduct is the very stuff of competition, the result which parts IV seeks to achieve. It would be surprising if parliament intended to prescribe competitive conduct when undertaken by our company with sufficient resources to compete effectively. Something more must be required.....?"

"Substantial financial resources"

A.54 Woolworths does not support any amendment to the Act to prohibit below cost pricing by firms with "substantial financial resources". The notion of a firm possessing substantial financial resources will

[9] *Cargill Inc v Monfort of Colo* 479 US 104 (1986)

affect many small and medium sized businesses across Australia. Furthermore, such a proposal would be contrary to the intent of s.46 meant to prevent large firms competing efficiently.

A.55 In the trade practices context, "substantial" has been held by the Courts to mean not insignificant. This law could be applied to small firms with net assets of, say, as low as $500,000 or more.

Section 46 is effective in dealing with predatory pricing

A.56 Section 46 of the TPA will, as presently drafted, catch instances of true predatory pricing by corporations with substantial market power.

A.57 This is clear from the *Boral* decision, which stands for no more than the proposition that in a highly competitive price war, no firm may possess substantial market power.

A.58 Indeed, Gleeson CJ and Callinan J stated (at 129):

> *"If one begins with the fact that a firm is a monopolist, or is in a controlling or dominant position in the market, then, by hypothesis, such a firm has an ability to raise prices without fear of losing business. If such a firm reduces its prices, especially if it reduces them below variable cost, then it may be easier to attribute to the firm an anti competitive objective and to categorise its behaviour as predatory."*

A.59 McHugh J expressly left open the possibility that section 46 could deal with instances of predatory pricing, so long as the predator was able to recoup its losses.

A.60 *Boral* was held to have no market power; it did not increase its market share; its prices were regularly undercut and customers drove prices down and down.

An effects test for section 46?

A.61 Woolworths does not support proposals for the amendment of section 46 of the Act to introduce an effects test. The following formulation has been suggested:

> *"A corporation that has a substantial degree of market power in a market shall not take advantage of that power for the purpose, or with the effect or likely effect of:*
>
> *(a) eliminating or substantially damaging a competitor in a market;*
>
> *(b) preventing the injury of a person into a market; or*
>
> *(c) deterring or preventing a person from engaging in competitive conduct in a market."*

A.62 Although there are variations with the precise wording of the proposed amendment, these amendments are generally referred to as an "effects test".

A.63 The introduction of an effects test has been considered in a number of reviews of the Act over the past 25 years.

(a) the Trade Practices Consultative Committee (the Blunt Committee), 1979;

(b) the House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffiths Committee), 1989;

(c) the Senate Standing Committee on legal and constitutional affairs (the Cooney Committee), 1991;

(d) the Independent Committee of Enquiry (the Hilmer Committee), 1993;

(e) the House of Representatives Standing Committee on Industry, Science and Technology (the Reid Committee), 1996/97;

(f) the Joint Select Committee on the Retailing Sector (the Baird Committee), 1999;

(g) the House of Representatives Standing Committee on Economics, Finance and Public Administration (the Economics Committee), 2001; and

(h) the Trade Practices Act Review Committee (Dawson Committee), 2003.

A.64 The reasons for that rejection have been consistently recognised. They were well articulated by the Dawson Committee Report, which stated:

> *"An effects test, which would disregard purpose, would make it even more difficult to draw a distinction between pro-competitive and anti-competitive behaviour than is*

currently the position under section 46 where purpose may be called in aid."

and

"The introduction of an effects test would be likely to extend the application of section 46 to legitimate business conduct and discourage competition."

and

"It is also relevant to note that the operation of an effects test would not necessarily be confined to large corporations, but could extend to small business as well. An effects test could, in the view of the Committee, discourage legitimate competitive practices by small business having the effect of injuring a competitor or discouraging a potential competitor, in the same way as with larger businesses."

A.65 Woolworths makes only one additional comment to the References Committee. The FTC, in its submission to the References Committee has proposed an effects test, as well as the introduction of a defence for "pro-competitive behaviour". According to the FTC, this test is designed to provide a statutory defence under section 46 for conduct that, *in the longer term does not lessen competition in any market and does not eliminate or substantially damage a competitor*.

A.66 In Woolworths' view, by proposing the defence, the FTC necessarily recognises that an effects test under section 46 may prohibit conduct

which has a long term pro-competitive effect. That the FTC proposes this defence, in Woolworths' view, demonstrates that the introduction of an effects test will stifle the very competition that section 46, and Part IV of the Act, seek to encourage.

Another proposed amendment to section 46: Reversing the onus of proof?

A.67 In previous enquiries, various other amendments to section 46 have been proposed. One of these proposals was to reverse the onus of proving purpose under section 46.

A.68 Woolworths agrees with the Dawson Committee's reasons for rejecting a reversal of the onus of proof:

> "(it would) *discourage corporations from engaging in competitive conduct for fear of being unable to discharge the reverse onus. It is likely that greater caution would be taken to avoid litigation under section 46, which would discourage rather than encourage competitive behaviour*".

ACCC Guidelines for section 46?

A.69 Woolworths **supports** suggestions that the ACCC should issue guidelines on section 46. Whether the Courts would be required to take into consideration when determining whether a corporation has breached section 46(1) is a matter for debate - the Courts will be guided by proper principles, and of course the ACCC is a party to many section 46 cases.

A.70 Woolworths would welcome the publication by the ACCC of new guidelines that indicate the approach that it will take to prosecuting breaches of section 46. The ACCC's Merger Guidelines are a good example of a publication that assists businesses to know their rights and obligations under the Act.

A.71 Woolworths submits that it is not appropriate for the ACCC, through guidelines or otherwise, to determine whether a particular corporation has committed an offence in breach of section 46. Given the heavy sanctions and remedies available, the role of determining whether a corporation has breached section 46 must be left to the courts. The ACCC should not be permitted, by the publication of guidelines, to alter the scope or ambit of section 46.

B. Term of reference (b): Unconscionable Conduct

B.1 Section 51AC is a strong protection for small business. The section provides a useful check-list of factors that the court must take into account in determining whether particular conduct by a larger corporation is unconscionable.

B.2 Woolworths considers that there is no evidence that section 51AC is not working well to ensure that small businesses are well protected in their dealings with larger businesses.

B.3 In particular, the increase of the transaction limit under section 51AC from $1 million to $3 million on 1 July 2000 (*Trade Practices Amendment Regulations (No.2) 2000*) is likely to be effective in protecting more small businesses in their dealings with larger corporations.

B.4 For its part, Woolworths has adopted its own compliance procedures in its dealings with suppliers so as to not engage in unconscionable conduct. It deals with its suppliers fairly and openly.

B.5 Although the Dawson Committee did not make any recommendation to section 51AC (the section was outside its terms of reference), it did state:

> *"The committee would add that there may be some uncertainty about the operation of Part IVA. Section 51AC was only added in 1998 and applies only prospectively so that its scope has, perhaps, not yet been fully explored.*

The committee suggests the ACCC consider issuing guidelines concerning its approach to Part IVA.

B.6 Woolworths would support further guidelines by the ACCC on the application of section 51AC.

C. Term of reference (c): Industry Codes

C.1 The 1999 report of the Joint Select Committee on the Retailing Sector: "*Fair Market or Market Failure*?" recommended that a retail grocery code of conduct be developed.

C.2 In accordance with the Committee's recommendation, the Retail Grocery Industry Code of Conduct ("**Retail Code**") was established in September 2000. It is a voluntary code of conduct for the retail grocery industry which is not intended to be declared as either a prescribed voluntary or mandatory code under Part IVB of the Act.

C.3 Woolworths takes its obligations under the Retail Code very seriously.

C.4 Woolworths welcomes the recent initiative by the ACCC to introduce a system of endorsing voluntary industry codes of conduct. Woolworths suggests that active ACCC involvement in promoting industry codes will be particularly effective in protecting the interest of small businesses and ensuring a competitive and fair market place for consumers.

C.5 In Woolworths' experience, the Retail Code has played a huge role in ensuring the fair and equitable operation of the retail grocery industry. This has been to the substantial benefit of small businesses.

C.6 Woolworths, and other participants in the retail grocery industry, has therefore had a very positive experience with its own industry code.

C.7 Woolworths does not consider that any amendments are required to Part IVB, but that the References Committee should give its support and encouragement to the recent ACCC initiative to develop and approve more industry codes.

D. Term of reference (d): Other amendments to the Act

D.1 Woolworths does not consider that any other measures are required to strengthen the TPA for the benefit of small business.

D.2 Large businesses in Australia are generally very familiar with their obligations under the Act. Woolworths, for example, has a detailed trade practices compliance program, which includes training and procedures to ensure that Woolworths treats its smaller suppliers and competitors fairly and equitably.

D.3 Woolworths' experience is that the existing level of trade practices regulation in Australia is very high. Woolworths seeks trade practices legal sign-off on all of its significant commercial decisions, and on many of its day to day activities. Additional trade practices regulation will result in increased compliance costs which will ultimately be passed on in the form of higher prices.

D.4 Increased regulation will also serve to discourage legitimate competitive behaviour. This would be contrary to the stated aim of the Act: *to enhance the welfare of Australians through the promotion of competition and fair trading and provision of consumer protection*.

PART C: ANNEXURES

ANNEXURE A: THE SAFEWAY CASE

Full Court finding

On 30 June 2003, the majority of the Full Court of the Federal Court of Australia (Justices Heerey and Sackville) found that Safeway had breached section 46 in four separate incidents involving dealings with suppliers of plant baked bread (Buttercup, Tip Top and Sunicrust) in particular locations in Victoria in 1994 and 1995. The majority found that Safeway had not breached section 46 in five other incidents which also involved dealings with the plant bakers in particular locations in Victoria in 1994-1995.

The Trial Judge, Justice Goldberg, and one of the Judges hearing the appeal, Justice Emmett, held that Safeway had not breached section 46, but for different reasons.

Factual background

The case was about Safeway's power in the wholesale market as a buyer of bread. The Court at first instance found that the retail market for bread at the relevant times was highly competitive and that Safeway did not possess any significant degree of market power as a retail seller of bread, because of the strong competition from other retailers and small businesses, including hot bread stores. The ACCC did not challenge this finding.

At that time, Safeway purchased between 21% and 25% of the total plant baked bread in Victoria, which was about half of the total bread sold at retail (the other half was the product of hot bread stores). At relevant times Safeway's market share as a wholesale acquirer of bread was about 16% (trial judgment, para 1061).

All Judges agreed that:

> Safeway was not able to reduce the cost price at which it purchased bread from plant bakers below competitive levels;
>
> Safeway was not able to raise the cost of the supply of bread to its retail competitors;

Safeway had no ability to raise retail prices;

Safeway was not able to obtain persistently better buying terms than independent supermarkets; and

Safeway was not able to influence or affect the terms of trade throughout the wholesale market.

Full Court's finding of substantial market power

The trial judge, Justice Goldberg, found that Safeway did possess a substantial degree of power but had not taken advantage of that power in the conduct under challenge. On the appeal Justice Emmett was not satisfied that Safeway's power at the relevant times was "substantial".

The majority in the Full Court Appeal, Justices Heerey and Sackville, disagreed with the basis on which Justice Goldberg had found that Safeway possessed substantial market power. However, they still held that Safeway had a substantial degree of market power. In the view of the majority Judges, Safeway's power (applying the High Court's decision in *Boral*) rested upon:

- its significant share of purchases of the output of the 3 plant bakers;
- the excess capacity of the plant bakers at the time;
- Safeway's ability to delete the plant baker's products from a particular supermarket and substitute those products with other suppliers products;
- barriers to entry to the wholesale market at the relevant time. (The later entry of Aldi was not considered relevant).

The majority found that, due to Safeway's actions, one of the plant bakers, Tip Top, had raised the price of its bread to certain competitors in the incidents involved in the case.

Conduct which did not breach section 46

The proceedings concerned 10 incidents in which Safeway deleted a particular plant baker's bread from a particular supermarket in a specific location in Victoria for a limited period of time during 1994-1995. The duration

of each deletion ranged from a period of a few days to several months. Safeway deleted bread in only 1 to 3 stores in each incident.

In five of the incidents, the relevant supplier had given one of Safeway's competitors a lower cost price for its bread than the price that it was charging Safeway for its branded bread. When Safeway's request for a matching reduction was refused, Safeway deleted the products of the relevant supplier and brought in a "fighting brand" of bread at a lower cost to match the competition it faced. The trial judge found that Safeway was requesting a discount, or "case deal", from the supplier/plant baker, in order to enable Safeway to match discounted prices offered by a competing retail store selling bread against Safeway. The trial judge did find that Safeway possessed, in all of these incidents, a substantial degree of market power, but held the power was not exercised.

On appeal the Full Court accepted that in these five incidents there had been no breach of section 46 because there was no taking advantage of power and Safeway had not acted for an anti-competitive purpose.

Conduct which did breach section 46

The incidents where the majority of the Full Federal Court found that Safeway had contravened section 46 were four incidents where Safeway had failed to establish that, before deleting the products of the relevant supplier, it had requested a matching discount in order to compete with lower prices offered to a Safeway competitor by that supplier. The Court held that deletion of products in those circumstances was not competitive conduct and that an anti-competitive purpose should be inferred.

Conduct which did breach section 45

In one incident, Tip Top itself competed directly against Safeway through a retail outlet it operated at Preston Markets. Safeway had deleted Tip Top bread from its Preston supermarket near the markets because Safeway was uncompetitive on the lower prices charged by Tip Top at its retail outlet for Tip Top bread. The Full Court found that an arrangement had been reached between a Safeway store manager and Tip Top to increase the price charged

by Tip Top at its retail market stall. There was no breach of section 46 in this conduct but rather a breach of the price fixing provisions of section 45 of the Act.

Special leave applications

Safeway is seeking special leave to appeal to the High Court of Australia against the majority decision of the Federal Court that Safeway breached section 46 in these 4 incidents (and section 45 in the Preston Market incident). The ACCC is seeking special leave to appeal against the Federal Court decision in the five other incidents in the case where the Full Court ruled that Safeway had not breached section 46.

ANNEXURE B: JOINT SELECT COMMITTEE ON THE REATILING SECTOR (1999)

Joint Select Committee on the Retailing Sector
Fair Market or Market Failure
Extracts from Committee Report, August 1999

Despite the growth of the major chains, consumers appear to be benefiting from the competitive forces of the current market structure. The evidence revealed that, since 1986, prices have fallen on average for baskets of foods and individual foods at supermarkets. Although there are some exceptions, the Committee accepts that economics of scale and scope have driven prices down in major supermarkets across Australia. Furthermore, surveys have revealed that there has been a shift in shopping habits from late in the week (Thursday to Friday) to Sunday. As a consequence, the ability of supermarkets or other stores to open on a weekend is a factor welcomed by many consumers. **(p.vii)**

By its recommendations, the Committee does not seek to invoke protectionist measures for small independent retailers. Rather, it provides for measures, which it believes, will enhance competition in the market place. **(p.vii)**

High levels of efficiency, superior technology and buying power has lead the Committee to conclude that consumers are voting with their feet, deciding to frequent the supermarkets because of their price, range of products, extended trading hours, and the convenience of one-stop-shopping. **(p.viii)**

The Committee heard compelling evidence that a market cap would be unworkable, and would effectively regulate the consumer. **(p.viii)**

Australian Competition and Consumer Commission (ACCC) Chairman, Professor Allan Fels believes that, in at least some cases, some areas or some product markets, a market cap would mean that Australian consumers may be condemned to being supplied by inefficient, high cost operators. Professor Fels also pointed out that there are significant mechanical problems associated with a market cap. He said that there are problems about defining it, and there are problems about policing it. **(p.viii)**

The evidence also revealed that there are some independent retailers who feel that, at some stage of their business career, they would like to be able to see out to a major chain. The imposition of a market cap would have the likely effect of preventing them from doing so, with a consequent reduction in the value of their stores. **(p.viii)**

In line with the market cap proposal, the Committee did not find a compelling case for divestiture of stores in the current market structure.

However, as the major chains continue to grow, the Committee considers that there may be some merit in considering divestiture as a safeguard to unchecked growth, when levels of concentration are seen to impact negatively on competitive market forces, in particular markets. **(p.ix)**

The Committee believes that the evidence clearly reveals a need to address the issue of predatory pricing, with a recommendation that the ACCC be given wider powers to bring representative actions, and to seek damages on behalf of third parties under Part IV of the Trade Practices Act. **(p.ix)**

The Committee also devoted a significant amount of time examining the merits of replacing the current "purpose" test in section 46 of the Trade Practices Act with a "reverse onus of proof" test. Compelling arguments were presented from proponents on either side of the debate, leaving the Committee unconvinced that such a measure would be appropriate at this stage. However, the Committee believes that a "reverse onus of proof" test may well be appropriate should the core recommendations prove to be ineffective in preventing predatory conduct. The Committee therefore leaves this issue open for review when the Committee is re-constituted in three years time. **(p.ix)**

In order to compete with the "big two", Franklins and the independent sector needed greater scale to keep their prices down. **(p.10)**

Small and independent retailers rely on wholesale volumes to compete with the major chains, although some are not convinced that a strong and competitive independent wholesale sector would, by itself, ensure their survival. For example, many shoppers from small country towns now choose to travel to nearby regional centres to buy their groceries from large, modern and well-stocked supermarkets. **(p.19)**

Andrew Reitzer, CEO of Davids: "You try to put pressure on that manufacturer and then he turns around and says. "The turnover you guys are doing as independent is marginal. I am not prepared to invest. I am not prepared to give you marketing money and I don't want to be part of your TV advertising. It is worthless because the volume you are going to do as a result of it is nothing". I think we are very close to that in this country at the moment." **(p.59)**

The Committee therefore sought the views of Professor Allan Fels, Chairman of the ACCC, on the merits of a reverse onus of proof test. Professor Fels said: There may be scope for some further strengthening of section 46 in terms of that kid of thing; that, if the effect can be shown, then there is a reverse onus of proof on purpose. That would essentially keep it to purpose. There is a problem at the moment with the test, in that the Commission or private litigants have to embark on a cops and robbers type search for purpose in particular cases. They are just not going to succeed in that, even though one has a fair idea that the purpose is anti-competitive. So there is a case for reversing the

onus without departing from the underlying notion that, in the end, it would be a purpose test." **(p.100)**

The merits of supplementing the present "purpose" test of section 46 with an "effects" test were also considered during the course of the inquiry. One view is that an "effects" test would not address the central issue of how to distinguish between socially detrimental and socially beneficial conduct. In order to avoid frivolous and capricious actions, any such change to section 46 might require only the ACCC or the Minister to bring actions in highly concentrated markets. Once proved, in order to protect private rights, damages claims would be open to affected parties. In conjunction with this, it was also considered that it may be appropriate to provide for authorization in respect of conduct, which is likely to breach the "effect" provisions, but not the "purpose" provisions (where the anti-competitive conduct would have been intentional and thus ought not be able to be authorized). However, the Committee is of the view that such far reaching changes to the law may create much uncertainty in issues dealing with misuse of market power. *(p.100)*

Further consideration was given to recommending a reversal of the onus of proof, whilst maintaining the current "purpose" test in section 46. For example, if the ACCC could establish that a firm, which has a substantial degree of market power, has used that power, the firm would bear the onus of proving that it did not have one of the requisite purposes. Another alternative would be to remove "purpose" as an element, but make the absence of purpose of defence. This would involve the firm, which has used its market power, to be presumed to have used it for an anti-competitive purpose, but with such a presumption able to be rebutted. **(p.100-1)**

The Committee recognizes that technological change has had an important impact on recent developments in the retailing sector, as both retailers and wholesalers exploit new means of achieving lower inventories, a wider range of goods, higher product turnover and faster receipt of goods. New technologies such as self-scanning are also on the horizon. **(p.126)**

Enterprises are increasingly using technology to learn more about their customers in order to optimise their sales. Better information has, for example, allowed firms to match inventories closer to customer needs, and thus reduce the need for mark-downs and discount sales. **(p.126)**

ANNEXURE C: WOOLWORTHS LIMITED RESPONSE TO JOINT SELECT COMMITTEE (1999)

Woolworths Limited
Delivering Choice for all Australian Consumers
Extracts from the Submission to the Joint Select Committee on the Retailing Sector, March 1999

Woolworths delivers real benefits to consumers, communities, small business and the Australian economy. **(p.5)**

Woolworths delivers substantial, measurable and vital benefits to consumers, local communities, small business and the Australian economy as a whole. These benefits include significant employment, investment, small business generation and community support. **(p.5)**

A proper examination of the reasons for small business failures in the retail sector portrays a different position than presented by some interest groups. The cessation rate (businesses no longer existing) for small business in the retail sector is actually below the average for all industries. In order to assist the survival of small businesses, it is important to understand the specific causes of their failure. According to the ABS, major reasons include lack of capital, lack of business ability, excessive finance costs and economic conditions. *(p.8)*

The failure to adapt to changing consumer demands, in conjunction with these internal mismanagement issues, provides a good indication of the reasons for the decline of many of the small independent retailers. It also provides a focus on the areas in which assistance should be directed. **(p.8)**

Woolworths' business is consumer driven, and to be successful the ever-changing consumer needs have to be met. This includes ensuring that products meet consumer requirements, particularly in areas such as range, safety, hygiene and quality. In relation to "fresh" food, Woolworths has set the industry standard by establishing quality specification requirements through its Woolworths Vendor Quality Management System (WVQMS), which are merely a reflection of consumer demands. **(p.9)**

The introduction of WVQMS serves to ensure food safety and quality, which are essential for achieving international competitiveness. Woolworths market size allows it to maximise the opportunities presented by its quality management systems to benefit its suppliers. In particular, through working with suppliers and industry bodies Woolworths has been successfully expanding the supply base for growers of produce and meat. This is the result of its efforts in the area of varietal development, import replacement programmes and taking advantage of export market programmes. For the last 6 months alone,

Woolworths has been responsible for $29 million of export sales. **(p.9)**

Woolworths is a successful Australian owned company that has been successfully serving its customers across Australia for over 75 years through its commitment to convenience, quality, value and service. In a highly competitive retail food industry Woolworths has, and continues to deliver substantial real benefits to consumers, communities, small business and the Australian economy. These benefits include employment for over 110,000 Australians and significant investment in rural areas. **(p.10)**

Australia has one of the most comprehensive pieces of competition legislation in the world. Claims for industry-specific competition regulation, such as market share caps, are therefore made without proper justification. Blanket regulation that protects small retailers from competition would lessen the incentive to compete, leading to reduced innovation, efficiency, service levels and higher prices. It would also lead to a reduction in the level of benefits that Woolworths provides to the Australian community. In order to provide effective assistance to small business without damaging the competitiveness of the Australian retail market, Government should focus on the causes of small business failures such as a lack of financial management skills, access to capital and excessive red tape. **(p.10)**

ANNEXURE D: ACCC REPORT ON REDUCING FUEL PRICE VARIABILITY (2001)

Australian Competition & Consumer Commission
Reducing Fuel Price Variability
Discussion Paper, June 2001

The lack of price flexibility and the wide availability of prices may encourage price collusion among the majors. **(p.28)**

Regulating prices could lead to average prices being higher than they otherwise would have been in the absence of the price regulation. This may arise because regulators may allow for margins, which may be higher than those that would be determined in a competitive marketplace. *(p.30)*

This option may limit or remove the ability for retailers to compete on price, meaning that they would have to compete on other factors (such as service) to attract customers. Depending on the level of the price cap, it may also allow inefficient operators to continue. *(p.30)*

ANNEXURE E: ACT INDEPENDENT COMPETITION & REGULATROY COMMISSION INQUIRY INTO MOTOR VEHICLE FUEL PRICES (2001)

ACT Independent Competition & Regulatory Commission
Inquiry into Motor Vehicle Fuel Prices
Summary Report, September 2001

The multiplicity of fuel-supply arrangements and control of the various retail outlets leads the Commission to the view that competitive tension is at work within the market such that the majors cannot currently control prices. **(p.3)**

Evidence suggests that these cycles are not caused by an attempt by oil companies to gain monopoly profits, but instead caused by competitive price discounting cycles. Evidence for this is the low profitability of the industry and the fact that the troughs of the cycle often see fuel sold at or below wholesale cost. *(p.5)*

The Commission is of the view that none of these new regulatory actions, if introduced only in the ACT, would have long-term net benefits for ACT consumers. As the domestic industry component of the fuel market appears to be efficient and is relatively small by comparison to the total retail price of fuel, there is little scope for prices to be reduced by regulatory action that focuses upon the domestic industry component. Removal of the short-term price fluctuations caused by competitive price cycles risks reducing competition and thus raising average prices. **(p.10)**

ANNEXURE F: ACCC REPORT TO THE SENATE ON PRICES PAID TO SUPPLIERS BY RETAILERS (2002)

Australian Competition & Consumer Commission
Prices paid to suppliers by retailers in the Australian grocery industry
Report to the Senate, September 2002

Buyer power is present in the Australian grocery market but, on the data received, the suppliers do not favour any single buyer. (p.2)

The Commission has not reached the view that there has been a breach of the law. In addition, this inquiry has not concluded that the extent of process difference apparent in the front-end (or upstream) part of the supply chain for groceries is likely to breach the competition provisions of the Act at this stage. (p.2)

From the data obtained, the price differences that are apparent do not give rise to concerns about public benefit issues. (p.2)

Extract from ACCC media release (of 30 September 2002) about the above report: Major retailers such as Woolworths and Coles have buyer power and while they may obtain better wholesale prices more often than the independent wholesalers, the market does not appear to exhibit anti-competitive conduct.

ANNEXURE G: WOOLWORTHS LIMITED RESPONSE TO ACCC INFORMATION REQUEST RE SENATE REPORT (2001)

Extract from Woolworths Limited response to Australian Competition and Consumer Commission:

Woolworths Limited
Response to ACCC Information Request relating to the Report to the Senate
November 2001

Suppliers offer support to ensure that sales of their products are note lost. This may be at the same time or for a period soon after the competitive activity. The support is not conditional on selling at a certain price, but it is understood by Woolworths to be provided in order to assist Woolworths in selling competitively. **(p.11-12)**

We are opposed to any artificial price mechanisms but support the Retail Grocery Code of Conduct as a voluntary monitoring process. One assumes that the key guiding principle is the achievement of the lowest prices and best service for the population of Australia thereby raising living standards. Retailers prosper, survive or fail based upon their ability to deliver convenience range, quality and service without reliance on price as the only major competitive advantage. **(p.13)**

The cost, inconvenience, inaccuracy and non-comparability of pricing data across all industry participants outweigh any perceived public benefits. See CQ 8 for public benefit. Artificial controls raise prices to consumers and lower living standards. **(p.13)**

Prices in Woolworths Supermarkets are the responsibility of Business Managers based in the Shared Services office at Yennora Sydney. Any options for store managers to move individual prices are strictly limited to a specific list of products which they can only match in price and must report to the responsible Business Manager. **(p.14)**

Woolworths pricing policy, whilst strictly confidential, does take into account the pricing of its retail competitors and within various limits local store managers have discretion to adjust pricing to protect Woolworths competitive position. **(p.14)**

Woolworths

Fair Trading Policy

Woolworths' policy is to deal fairly and honestly with all vendors, irrespective of their size, the nature of their product or the amount of business that they do. Woolworths is willing to negotiate terms and conditions of supply with vendors to meet mutual needs and ongoing relationships.

Woolworths strongly encourages its vendors to take sufficient time and opportunity to:

- consider the proposed terms and conditions of supply to Woolworths
- obtain independent advice, and
- assess the benefits and costs of doing business with Woolworths,

before entering into any trading arrangement.

Woolworths supports the voluntary Retail Grocery Industry Code of Conduct (the **"Retail Code"**).

The Retail Code encourages:

- fair and equitable trading practices,
- open communication to avoid disputes,
- simple dispute resolution mechanisms.

WOOLWORTHS LIMITED
A.C.N. 000 014 675

DISPUTE RESOLUTION

Woolworths is a high-performance company with hundreds of dedicated and satisfied suppliers who have never had to use the dispute scheme we have developed. Just knowing it's there encourages the resolution of incidents before they become issues.

Woolworths has a process model to resolve disputes quickly and fairly. The first step for a trading partner to take in resolving a dispute is to make your Business Manager or Senior Business Manager aware of your issues and give them the opportunity to address them.

Scope of Woolworths' Scheme
This scheme applies to any complaint or dispute which is raised by any Supplier about its dealings with Woolworths' Supermarkets Division.

What kinds of complaints?
Suppliers may raise any concern they may have about their current or recent dealings with Woolworths' Supermarkets Division.

Woolworths' Supplier Relationship Team
Woolworths has established a Supplier Relationship Team to action complaints under these schemes with suppliers.

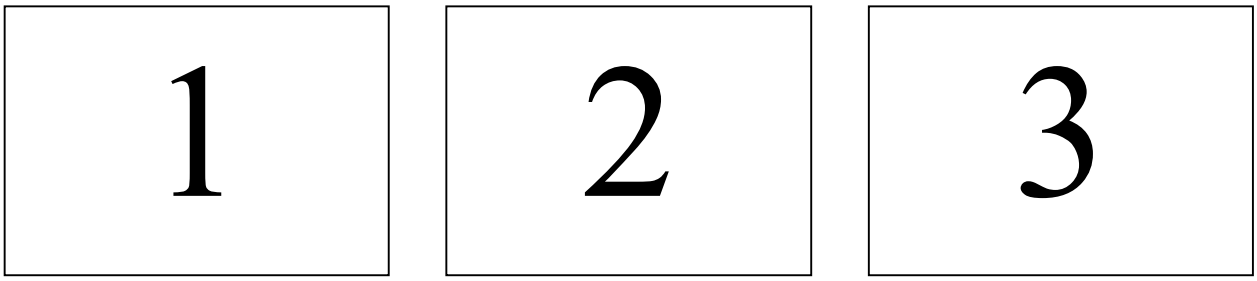
Members of the Team
Mr B Brookes – Chief General Manager, Buying and Marketing, Woolworths Supermarkets;

Mr R Jeffs – General Manager, Corporate Services / Company Secretary, Woolworths Limited;

Mr S Bate - General Manager, Fresh Foods Buying and Marketing, Woolworths Supermarkets;

Mr S Eames – Business Manager, Trade Relations, Woolworths Supermarkets

Woolworths Procedures



Stage 1

The Supplier Relationship Team will review the complaint and contact the supplier within FIVE working days to acknowledge the receipt of the complaint.

The team will endeavour to resolve all complaints after TEN working days.

After giving notice to Woolworths the supplier may refer the dispute to stage 2.

Stage 2

In stage two Mr R Jeffs will assume responsibility for handling and resolution of the complaint.

The function of Mr Jeffs and his group will be to seek an expedited resolution of the dispute to the satisfaction of the supplier as soon as possible.

Mr Jeffs will report to the Chief Executive Officer of Woolworths, Mr R Corbett, on all matters referred to him which have not been resolved to the satisfaction of the supplier.

Stage 3

Mr Corbett will contact the supplier following a review of all the issues raised in the course of the dispute.

Every effort will be made to resolve the supplier's complaint within a reasonable period after its referral to Mr Corbett.

Without Prejudice

Participation by Woolworths and the suppliers in this scheme will be on a basis that is "without prejudice" to either party's strict legal position.

For assistance or information about the scheme, suppliers should in the first instance contact:

Mr Scott Eames
Woolworths Supplier Group
Woolworths Supermarkets
Locked Bag 11, Fairfield NSW 2165
Phone 02 9892 7133
Email seames@woolworths.com.au