

WOOLWORTHS LIMITED

SUPPLEMENTARY SUBMISSION

TO THE SENATE ECONOMIC REFERENCES COMMITTEE INTO THE INQUIRY INTO THE EFFECTIVENESS OF THE TRADE PRACTICES ACT 1974 IN PROTECTING SMALL BUSINESS

Woolworths wishes to make the Supplementary Submission following the Australian Competition & Consumer Commission's submission dated 8 September 2003

16 SEPTEMBER 2003

For information on this Supplementary Submission please contact:

Contact: Rohan Jeffs
Company Secretary
Phone: (02) 9323 1534
E-mail: rjeffs@woolworths.com.au

WOOLWORTHS LIMITED

EXECUTIVE SUMMARY

- The ACCC recommended amendments, on practical application, may in certain circumstances, lead to unintended consequences and result in business uncertainty.
- Some of the proposals may also lead to judicial value judgments from Courts such as when particular “conduct” of itself is proposed as proving the existence of substantial market power, rather than a careful economic analysis of market structure.
- The ACCC amendments would tend to eliminate from Section 46 the determination of whether the power which a firm has enjoyed has actually *been engaged*. It would tend to over-simplify the Section 46 to issues of ‘power’ and ‘purpose’ only. This would also have unintended consequences in potentially deterring pro-competitive conduct.
- Further, the ACCC recommendation that Section 46 be amended to clarify that the ‘business *rationale*’ for the relevant conduct is not critical to determining whether a corporation has ‘taken advantage of its substantial market power’, runs directly contrary to the most recent Full Federal Court judgement in the *Safeway* Case.
- The business *rationale* for particular conduct must remain integral to determining whether the corporation has misused its market power for an anti-competitive and not pro-competitive purposes. This is a simple matter of protecting legitimate commercial activities.
- The ACCC recommendations on predatory pricing ignores both the economic *rationale* for recoupment and the relevant American law which holds that recoupment is necessary under broadly accepted economic analysis.
- The ACCC’s proposed amendment to Section 46 to clarify that this provision applies to any use of substantial market power with a prescribed purpose, irrespective of whether the relevant conduct takes place in the same market where the power exists, is likely to deter market innovation as it means that a corporation’s conduct in a market in which it has *no* substantial market power would be caught by Section 46, regardless of whether or not there is a causal link.
- The ACCC’s proposed amendment to encompass the concept of ‘coordinated market power’ in the absence of an explicit agreement between competitors ignores the fact that parallel conduct, without any understanding or agreement, may be a legitimate business strategy. A relevant example would be a corporation simply following the action of a price leader.

WOOLWORTHS LIMITED

- There is no good reason why the ACCC's very broad discretionary power to access documents and other potential evidentiary material, through the issue of Section 155 notices, should be available to it during litigation but outside the normal rights granted to parties in court processes.
- The ACCC's suggestion that a new provision should be added to the Act to address illegitimate conduct designed to *achieve* substantial market power would have the impact of making it more difficult for corporations to expand, enter new markets and compete on their merits to gain market share. Such a provision could actually deter small businesses from growing. There is no "gap" in section 46 as suggested by the ACCC, because the section rightly assumes that small firms, including small business, may and should be able to engage in more aggressive conduct than large firms which possess market power, and there is simply no warrant to widen the section to catch every firm, including those which aspire to be successful but who do not have substantial market power.
- Woolworths has concerns that the inclusion in section 51AC of the practice of using a unilateral contract variation clause as an example of conduct which may be 'unconscionable', is oversimplistic, and ignores examples of where this type of clause is unexceptional. The ACCC appears not to have considered all applications of such a clause and nor considered the contract law rule that in cases of a unilateral price rise, the other party has an implied right to terminate the agreement if it does not accept the change - see the Peters v Champion Case in the High Court - (1928) 41 CLR 316. There are wider circumstances that need to be considered before this suggestion should be considered to be adopted.

The removal of the \$3 million limit in s.51AC should remain a small business protection and not become a remedy resorted to generally between larger firms.

- In summary while the ACCC's proposed amendments appear reasonable at first glance, a detailed analysis suggests they may have far reaching consequences in Australian commercial life, particularly as they would apply in retailing. Woolworths urges the Committee to consider these proposals very carefully in the light of the arguments outlined above.

WOOLWORTHS LIMITED

ACCC Submission: section 46

Market power

1. The ACCC considers that the decisions in *Boral* and *Universal* have narrowed the scope of section 46. In particular, they consider that there is a need to clarify that the section applies to corporations who do not have monopoly power, or a dominant market position.
2. To achieve this, the ACCC has recommended that section 46 should be amended to clarify the following principles:
 - (a) the threshold of "substantial degree of power in a market" is lower than the former threshold of substantial control;
 - (b) substantial market power does not require a corporation to have an absolute freedom from constraint - it is sufficient if the corporation is not constrained to a significant extent by competitors or suppliers;
 - (c) more than one corporation can have a substantial degree of power in a market;
 - (d) evidence of a corporation's behaviour in the market is relevant to a determination of substantial market power.
3. In our view, it could be strongly argued that such clarification is not necessary (evidenced by the fact that Safeway was held to have market power with only 20% market share) and may only serve to confuse the section.
4. Amendment (d) proposed above appears to "put the cart before the horse" and to reintroduce the Finkelstein J test that one should infer "power" from "conduct" regardless of market structure. Assessing whether market power exists by reference to the impugned conduct could possibly lead to a broad range of idiosyncratic judicial "value judgments" as to whether particular conduct suggests a firm has "market power" without conventional economic analysis of the firm's position.
5. Indeed, Gleeson CJ and Callinan J emphasised the danger of this over reliance on purpose and conduct in the *Boral* decision as follows:

"The purposes proscribed by s 46 include the purpose of eliminating or damaging a competitor. Where the conduct that is alleged to contravene s 46 is price-cutting, the objective will ordinarily be to take business away from competitors. If the objective is achieved, competitors will necessarily be damaged. If it is achieved to a sufficient extent, one or more of them may be eliminated. That is inherent in the competitive process. The purpose of the statute is to promote competition; and successful competition is bound to cause damage to some competitors.

It follows that, where the conduct alleged to contravene s 46 is competitive pricing, it is especially dangerous to proceed too quickly from a finding about purpose to a conclusion about taking advantage of market power. Indeed, in such a case, a

WOOLWORTHS LIMITED

process of reasoning that commences with a finding of a purpose of eliminating or damaging a competitor, and then draws the inference that a firm with that objective must have, and be exercising, a substantial degree of power in a market, is likely to be flawed. Firms do not need market power in order to put their prices down; and firms that engage in price-cutting, with or without market power, cause damage to their competitors.

To "Take advantage" of substantial market power

6. The ACCC has recommended that section 46 should be amended to provide further clarification as to the "take advantage" element of the provision - and we suggest, to essentially eliminate that element as a necessary element of the cause of action. The relevant enquiries that it proposes are:
 - (a) whether the corporation would be likely to engage in the conduct in a competitive market;
 - (b) whether the conduct of the corporation was materially facilitated by its substantial degree of power in the market; or
 - (c) whether the conduct was otherwise in reliance upon or related to its substantial degree of power in the market.
7. The ACCC proposal would tend to eliminate from s.46 the issue of whether the power which a firm enjoyed has actually been engaged. It would tend to simplify the section to issues of power and purpose only. The High Court appears to have endorsed the "materially facilitated" test of whether a corporation has taken advantage of market power. Any such amendment would have unintended consequences.
8. Further, the ACCC has recommended that the section be amended to clarify that an enquiry as to the business rationale for the relevant conduct is not critical to determining whether a corporation has taken advantage of its substantial market power in any particular matter. This is contrary to the *Safeway* court which said that rationale is "critical".
9. This proposal arguably ignores the commercial realities facing Australian businesses, and that business rationale is important. Assessing the business rationale for particular conduct should be integral to determining whether the corporation has used its market power. To expressly remove this line of enquiry by amending section 46 could cause uncertainty for larger businesses - they could be faced with a situation in which their conduct comprises a "taking advantage" of their market power even though it made perfect commercial sense and would have been undertaken by any corporation in the market. The majority in *Melway* stated:

"But it does not follow that because a firm in fact enjoys freedom from competitive constraint, and in fact refuses to supply a particular person, there is a relevant connection between the freedom and the refusal. Presence of competitive constraint might be compatible with a similar refusal, especially if it is done to secure business advantages which would exist in a competitive environment."

WOOLWORTHS LIMITED

Predatory pricing - recoupment?

10. The ACCC has recommended that section 46 be amended to state that in allegations of predatory pricing, a finding of expectation or likely ability to recoup losses is not required to establish a contravention of section 46.
11. The High Court did not decide in *Boral* that recoupment is necessary. US law based on accepted economic analysis holds that it is necessary. The ACCC provides no answer to that economic rationale.
12. It is axiomatic that such an amendment would require the insertion of a definition of "predatory pricing". Presumably this would have to be, in some way, defined by reference to a corporation's costs. For the reasons set out in Woolworths' submission, this is not desirable.

Leveraging Power into different markets

13. The ACCC has also sought an amendment to section 46 to clarify that the provision applies to any use of substantial market power with a prescribed purpose, irrespective of whether the relevant conduct takes place in the same market where the power exists.
14. This amendment is designed to deal with comments made by the Full Federal Court in the *Rural Press* decision that, for there to be a taking advantage of power in a market, the relevant conduct must take place in the market where the power exists. Woolworths submits that it is best to wait for the High Court decision in *Rural Press* to decide this case to see if such an amendment is necessary. It is logical to confine s. 46 to conduct which represents use of market power and not any conduct by a company with power.
15. This amendment is designed to prevent large corporations from leveraging their positions in other markets in which they do not have substantial market power. This would have relevance to Woolworths which operates in a number of markets (such as petrol) in which it may not have a substantial degree of market power.
16. The risk in such an amendment is that, unless very precisely worded, it may mean that the conduct of a corporation in a market in which it has no substantial market power could be caught by section 46 if it has substantial market power in any other market (even if there is no causal link). For example, if Woolworths opened a small number of hardware stores, it would presumably not have market power in the hardware market. It would be of concern if the ACCC's amendment meant that Woolworths' business conduct in its hardware stores were limited because of unrelated market power that it may be found to possess in supermarkets. This would limit Woolworths' ability to enter, and compete strongly in, new businesses. This would ultimately be to the detriment of new entry, innovation and competition generally.

WOOLWORTHS LIMITED

Co-ordinated market power?

17. The ACCC has recommended that consideration should be given to amending section 46 to encompass the concept of co-ordinated market power in the absence of an explicit agreement between competitors. The example of such coordinated interaction given by the ACCC is if a price war eliminates several competitors and the remaining firms are subsequently content to raise prices to supra competitive levels without further vigorous competition.
18. It is unclear what the effect of the ACCC's amendment would be. It is clear from case law (*Dowling v Dalgety (1992) 106 ALR 75*) that the courts will already look to arrangements and understandings with other corporations in determining whether a particular corporation has substantial market power. Gleeson CJ and Callinan J in *Boral* hinted at the possibility that s.46 could encompass the concept of co-ordinated market power, even where there are no understandings between competitors but due to their coordinated behaviour they each share in a degree of power. No such case has yet had to grapple with these issues and one suspects it will only arise in a very rare case. As such the ACCC suggestion is really "tinkering" to deal with exceptional circumstances.
19. The ACCC proposal would seem to need substantial "fleshing out" before it should be seriously considered by the Committee. The proposal raises a number of questions. For example, would the amendment mean that a firm could be found to have substantial market power by reason only of it engaging in tacit collusion with other firms in the market? If so, it could be that a number of smaller firms who operate in tacitly collusive markets may be found to have substantial "co-ordinated" market power?
20. Further, in an oligopoly, parallel conduct (without any understanding or agreement) may be a legitimate business strategy. It would be of concern if the ACCC's amendment meant that firms operating in a concentrated market, who - often as a matter of commercial necessity - follow the actions of price leaders were deemed to be exercising co-ordinated market power.

Section 155 powers during litigation?

21. Currently, the ACCC cannot issue section 155 notices after it has commenced legal proceedings.
22. The ACCC has recommended that it retain its power to issue section 155 notices in cases where it seeks an interim injunction. The ACCC has argued that it would be appropriate to amend the Act to extend the application of section 155 powers until substantive enforcement proceedings have commenced. The reasons for this are not clear.
23. Woolworths opposes this amendment as it would give the ACCC an unfair procedural advantage. The issue of a section 155 notice may unfairly prejudice and burden corporations who are faced with an ACCC injunction application.
24. The ACCC can issue a subpoena or notice to produce under Court supervision. There is no good reason why the ACCC's power should be granted outside the court processes.

WOOLWORTHS LIMITED

Attempts to Achieve Substantial Market Power

25. The ACCC has also suggested that a new provision could be added to the Act to address illegitimate conduct designed to achieve substantial market power by a firm which does not possess such power.
26. The ACCC appears to be proposing that if a firm engages in illegitimate unilateral conduct designed to achieve market power, it should be illegal. The precise scope of the ACCC's suggested amendment is not clear. It could catch quite a few SME's rather than big business.
27. The example given by the ACCC is that a corporation with "deep pockets" is able to engage in predatory pricing conduct with impunity, including targeting of particular businesses, without contravening the Act.
28. In our view, this amendment would represent a novel departure from the current operation of the Act. It might make it more difficult for corporations to expand, enter new markets and compete on their merits to gain market share. Such a provision could deter small businesses from growing. It would also make entry by larger corporations into other markets extremely difficult.
29. Without a more precise proposal from the ACCC, such a radical proposal, with its far-reaching and possibly unintended consequences, should not be contemplated by the Committee.

Unconscionable conduct

30. Section 51AC prohibits unconscionable conduct in business transactions. The ACCC has recommended that the \$3m maximum transaction limit for section 51AC should be abolished. This would greatly expand the scope of the section and would enable larger corporations to make use of the provision.
31. Although actions under section 51AC cannot be brought by listed public companies, the prospect of legal action under section 51AC arising from dealings between large corporations would be a significant impediment to commercial negotiations and to competitive commercial behaviour.
32. The ACCC has also recommended that the imposition or exploitation of an unfettered unilateral variation clause, by a business in a superior bargaining position, should be added to the list of factors that a court may have regard to when determining whether conduct is unconscionable within the meaning of section 51AC.
33. Woolworths would be concerned if the insertion of this factor to the checklist under section 51AC operated as a de facto prohibition on all unilateral variation clauses.
34. Often, large corporations include such conditions because of administrative reasons and their large number of customers (or vendors). They need to be able to respond quickly to changing circumstances and legal requirements, without becoming involved in protracted negotiations with each individual customer. Unilateral variation clauses are often commercially necessary.

WOOLWORTHS LIMITED

35. Woolworths opposes the ACCC's amendment on the basis that it would make a common business practice uncertain and subject to legal challenge.

16 September 2003