

SUBMISSION

Senate Economic References Committee Inquiry into the Effectiveness of the Trade Practices Act 1974 in protecting Small Business

Submission by the

Master Grocers' Association of Victoria

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1 Introduction

- 1.1 This submission is made by the MGAV in relation to paragraph 1 of the terms of reference of the Committee, and in particular whether the *Trade Practices Act 1974* ("**the Act**") adequately protects small businesses from anti-competitive or unfair conduct, with particular reference to:
- (a) whether Section 46 of the Act deals effectively with abuses of market power by big business, and if not the implications of the inadequacy of Section 46 for small business, consumers and the competitive process (paragraph 1(a) of the terms of reference); and
 - (b) whether there are any other measures that can be implemented to assist small business in more effectively dealing with anticompetitive or unfair conduct (paragraph 1(d) of the terms of reference).
- 1.2 The MGAV is a trade association representing the interests of the independent supermarket owners of Victoria. This encompasses some 600 family owned and operated businesses across the State. The trading names of FoodWorks, I.G.A. and A.U.R. make up the MGAV membership base, with all banner names actively encouraged to have representation and involvement with the MGAV Board. All independent supermarkets throughout the suburbs of Melbourne, and rural and regional Victoria are members of the MGAV.

13 October 2003

2

2 Summary

2.1 MGAV makes the following submissions to the Committee, which are detailed in sections 3 to 7 below:

- (a) MGAV notes that recent Court decisions have prompted the ACCC to recommend in its submission to this Committee changes to Section 46 to ensure that the original legislative purposes of the 1986 amendments to the Act are preserved. The MGAV supports the ACCC's recommendation that the section be amended to clarify the requirement of "substantial degree of power in a market".
- (b) Section 46 should be clarified to ensure that it prohibits pricing below cost by the major chains in selective locations which strategically target an independent competitor, or any such behaviour by a corporation with a substantial degree of power in any market ("**location specific predatory pricing**"). MGAV submits that at a minimum, the Committee should consider the ACCC's recommendations that amendments be made to Section 46 in order to:
 - (i) clarify the requirement that the corporation shall not "take advantage" of the market power;
 - (ii) exclude any requirement for a finding in relation to recoupment of losses, in order to establish predatory pricing; and
 - (iii) clarify that conduct in one market leveraging a substantial degree of market power in another will still fall within the section.
- (c) After consultation with its members in the light of industry circumstances, MGAV opposes any amendment to Section 50 specifically to address so-called creeping acquisitions. MGAV would welcome the opportunity to appear before members of the Committee to discuss Section 50 as it bears on acquisitions in the independent grocery section. MGAV is also concerned about discrimination against some independent grocery operators in the assignment of retail leases.
- (d) MGAV supports the introduction of criminal penalties into the Act as recommended by the Dawson Committee, and also the proposal that under the civil penalty regime individuals might be excluded from management of corporations and corporations would be prohibited from indemnifying their officers or employees against the imposition of civil penalties.

13 October 2003

3

3 Section 46 – Misuse of Market Power – substantial degree of power in a market

- 3.1 MGAV believes that Section 46 in its current form may not be adequate to deal effectively with misuse of market power by big businesses.
- 3.2 MGAV notes that the ACCC in its submission to this Committee has proposed a number of amendments to Section 46, particularly in relation to the definition of “a substantial degree of power in a market”. As the Committee would be aware, in 1986 amendments were made to Section 46 re-naming the provision “misuse of market power”, rather than “monopolisation”, and reformulating the requirement that a corporation be in a position “substantially to control the market” so that the section applied to corporations having “a substantial degree of power in the market”.
- 3.3 The Explanatory Memorandum made it clear that the test for the application of the section was now such that Section 46 would apply to major participants in an oligopolistic market and in some cases to a leading firm in a less concentrated market, and not just to conduct by monopolists.
- 3.4 The 1986 amendments to Section 46 were made to address what was seen as the limited effectiveness of the existing wording of Section 46 to ensure that small businesses were given a measure of protection from the predatory actions of powerful competitors.
- 3.5 The MGAV notes that the ACCC concludes in its submission to this Committee that the majority judgments in *Boral* and the defending judgment of Justice Emmett in the subsequent full Federal Court *Safeway* appeal contained statements indicating that “an absolute freedom from constraint is required to establish a “substantial degree of monopoly power” – effectively restoring the threshold to monopolists or near monopolists contrary to parliament’s intention behind the 1986 amendment”.¹
- 3.6 MGAV submits Section 46 should be amended to clarify the application of the threshold requirement that a corporation have a “substantial degree of power in a market”, at least in each of the respects identified by the ACCC in its submission to this Committee at page 19². In particular MGAV agrees

¹ Submission of ACCC to this Committee (undated) page 18.

² The ACCC proposed that:

13 October 2003

4

that it is essential to clarify that the requirement of substantial market power does *not require the absence of constraint* and that the section may apply where the corporation is not constrained to a significant extent by competitors or suppliers.

- 3.7 MGAV also notes that the ACCC recommended clarification of the requirement of Section 46 that the corporation “take advantage” of its substantial degree of power in the market. One of the purposes of the 1986 amendments was to ensure that the Courts could infer the requisite predatory purpose (or taking advantage) from the conduct of the corporation or from the surrounding circumstances. The MGAV believes clarification of this aspect of Section 46 is particularly important in relation to predatory pricing practices, and supports the ACCC’s recommendations in relation to this requirement (further discussed below).

4 Section 46 – Aspects relevant to predatory pricing

- 4.1 MGAV is concerned that its members have experienced what they perceive as location specific predatory pricing. The major participants in the grocery market, Coles Myer Ltd and Woolworths Limited, have the ability to cross-subsidise this activity by differential pricing in regions or local markets. MGAV wishes to see Section 46 clarified, and where necessary strengthened, to clearly apply to misuse of market power by below cost pricing targeted against local competitors.
- 4.2 MGAV acknowledges that there are difficulties in drafting complex provisions to regulate or prohibit below-cost pricing by competitors. It acknowledges that it is not predatory pricing to sell at prices which reflect the lower variable costs that some competitors may have arising from technological and volume based efficiencies³. It agrees that it is not predatory pricing for a

“The policy intention behind Section 46 should be given effect by amending Section 46 to clarify the following principles:

1. the threshold of “a substantial degree of power in a market” is lower than the former threshold of substantial control;
2. the substantial market power threshold 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;
3. more than one corporation can have a substantial degree of power in the market; and
4. evidence of a corporation’s behaviour in the market is relevant to a determination of substantial market power.”

See Submission of ACCC to this Committee (undated) pages 20 to 21.

³See A.49 of the Submission to this Committee of Woolworths Limited dated September 2003, at page 35.

13 October 2003

5

competitor to reduce its prices to match those of another competitor in order to defend its business⁴.

4.3 However it seems clear that there are several aspects of Section 46 which should be clarified, given the current state of decided cases. MGAV seeks to adopt the recommendations of the ACCC in relation to 3 relevant aspects of Section 46:

- (a) clarification of the expression "take advantage" where used in relation to the threshold requirement of a substantial degree of market power;
- (b) confirmation that that no expectation of recoupment is required to establish predatory pricing has occurred in contravention of Section 46; and
- (c) stating that there be no requirement that the conduct within Section 46 must take place in the same market where the substantial degree of market power is present.

4.4 In relation to the "taking advantage" requirement, the ACCC recommended that relevant amendments should clarify the following principles:

- (a) the "take advantage" element should be applied by the courts consistently with the underlying policy and existing High Court authority – the relevant inquiries are:
 - (i) whether the corporation would be likely to engage in the conduct in a competitive market;
 - (ii) whether the conduct of the corporation was materially facilitated by its substantial degree of power in the market; or
 - (iii) whether the conduct was otherwise in reliance upon or related to its substantial degree of power in the market.
- (b) an inquiry as to the business rationale for the relevant conduct may be a relevant circumstance, but is not critical, to determining whether a corporation has taken advantage of its substantial market power in any particular matter.⁵

4.5 MGAV submits that any amendment to Section 46, while not prohibiting defensive pricing practices that may be undertaken by a competitor as a

⁴ See A.50 of the Submission to this Committee of Woolworths Limited dated September 2003, at page 35.

⁵ Submission to this Committee of ACCC (undated), pages 20 to 21.

13 October 2003

6

competitive response, should operate to prohibit predatory pricing, particularly where this targeted against a particular trader in a local market, and is facilitated by the power of that competitor across a number of other markets.

- 4.6 MGAV notes that the ACCC in its submission to the Committee⁶ expressed concern that the decision of the Full Federal Court in *Safeway* may provide a basis to argue that where a corporation has a “business rationale” for engaging in conduct, this may in some circumstances preclude a finding that the corporation has taken advantage of market power. MGAV submits that for Section 46 to have continuing utility, it must be clear that “taking advantage” where used in the section simply means “use”, and that it is sufficient that the conduct was “materially facilitated” by market power.
- 4.7 In relation to recoupment, MGAV agrees that it is critical that there be clarification of Section 46 to remove any requirement that may be developing in the decided cases that a finding of expectation or likely ability to recoup losses is required to establish a contravention of Section 46. It is inherent in location specific predatory pricing, as identified by MGAV, that a corporation does not need to recoup losses in the regional market or sub-market, and the conduct is facilitated by the substantial degree of market power of the corporation, which means it may recoup in other markets, or may not need to recoup at all.
- 4.8 In relation to leveraging a substantial degree of market power in one market, in order to engage in conduct in a second market, MGAV supports the ACCC recommendation that Section 46 be clarified so the provision applies to any use of substantial market power with a proscribed purpose, *irrespective of whether the relevant conduct takes place in the same market where the power is*. It is an amendment particularly appropriate to location specific predatory pricing.
- 4.9 These amendments pre-suppose that the Courts will continue to determine what, in each case, amounts to “predatory pricing”, and do not require a particular statutory formulation of what “below cost pricing” may mean. It would still be necessary to establish the other requirements of Section 46.
- 4.10 MGAV rejects the suggestion by Coles Myer Ltd in its submission to this Committee that amendments of this kind made to Section 46 have the propensity to limit the opening of new stores in new markets and especially

⁶ Submission to this Committee of ACCC (undated), page 20.

13 October 2003

7

in regional areas⁷. MGAV notes that Woolworths Limited in its submission to this Committee⁸ suggested that price reductions to meet localised competition “should not be prohibited or discouraged under the Act”. MGAV does not object to vigorous local competition. It is concerned that the ability of the major chains to cross-subsidise the losses of one regional operation in relation to particular product lines or across the whole of its business, on a sustained basis, should be addressed in Section 46.

5 Other measures – Section 50 and creeping acquisitions

5.1 MGAV notes that some submissions to this Committee have suggested that changes be made to Section 50 of the Act to regulate acquisitions once a nominated degree of market concentration has occurred (“**creeping acquisitions**”).

5.2 The issue arises because Section 50 is addressed to individual acquisitions, and is not suited to the regulation of a series of acquisitions undertaken by and acquirer which has a substantial market share, where each acquisition of itself does not have the effect or be likely to have the effect of substantially lessening competition in a market. Although Section 50 was amended in 2001 to provide that “market” for the purposes of the section means “a substantial market for goods or services in;

- (a) Australia;
- (b) a State;
- (c) a territory; or
- (d) a region of Australia”,

Section 50 does not address the effects on competition, over time, of a series of acquisitions, each of which is outside Section 50.

5.3 In its own submission to the Dawson Committee⁹ MGAV advocated that Committee consider specific changes to Section 50 to address this issue.

5.4 However, since 2002, MGAV has consulted widely with its members in the light of changing industry circumstances, and now takes a different view of Section 50.

⁷ See Submission to this Committee of Coles Myer Ltd dated 5 September, 2002, at page 7.

⁸ See A.51 of the Submission to this Committee of Woolworths Limited dated September 2003, at page 36.

⁹ See Submission of Master Grocers' Association of Victoria to Trade Practices Act Review Committee (“Dawson Committee”) undated pages 5 to 7.

13 October 2003

8

- 5.5 MGAV considers that amendments of this kind to Section 50 will not necessarily assist small business in more effectively dealing with unfair conduct. In addition, these provisions may work to the detriment of individual small businesses in particular markets, and to the independent grocery sector as a whole.
- 5.6 MGAV believes that attempting to stop creeping acquisitions by amending Section 50 in each of the ways suggested in other submissions, including by use of Concentrated Market Notices or Anti-Competitive Acquisition Notices, could in be detrimental to the interests of its individual members and to the independent grocery sector as a whole.
- 5.7 These amendments could confine the ability of independent grocers to sell their businesses to particular purchasers, with the following results for affected businesses and the independent sector:
- (a) Limitation of current value of a business;
 - (b) Limitation of capital growth in the business;
 - (c) Restriction on funds available from lenders (where recoupment is considered an issue and/or capital growth likely to be limited);
 - (d) Restriction on investment/re-investment by the business;
 - (e) Loss of resources available to the independent sector; and
 - (f) Loss of growth and vitality in the independent sector.
 - (g) These issues have the potential to bring about an element of stagnation in independent business.
- 5.8 MGAV recognises that there is a balance to be sought between these matters and other factors affecting the viability of the independent grocery sector, such as the need for a sufficient number of members to preserve the economies of scale that operate in that sector to the benefit of all participants, and to the consumers and community. (The interplay of these issues was reflected in comments in a recent speech to the Food and Grocery Council of Australia on 16 September 2003, by the Chairman of the ACCC.¹⁰)

¹⁰ Graeme Samuel, Chairman ACCC, Speech to the Food and Grocery Council of Australia, Canberra, 16 September 2003: "Competition and the nation's supermarket trolley: A perspective of the Australian Competition and Consumer Submission": at page 7 "The Commission recognises that detriment to independent operators could result from creeping acquisitions. There is the potential for loss of sales volume at the wholesale level giving rise to a loss of economies of scale. This, in turn, could generate cost pressures on the entire independent grocer sector. The Commission acknowledges this potential. But the difficulty remains that each individual acquisition must be considered against the test specified in section 50. That is, will the acquisition of a single

13 October 2003

9

5.9 In view of some of the other submissions made to the Committee, and the various interests of its members, MGAV would welcome the opportunity to appear before the members of the Committee on Section 50, as it bears on acquisitions in the independent grocery sector. MGAV believes that its views may also be relevant to any other sector with a high concentration of market power in at least two major competitors.

6 Other measures – assignment of retail leases

6.1 MGAV members are concerned about the conduct of landlords who discriminate against independent grocery business operators in refusing to assign leasing contracts to the proposed assignee of that business. MGAV notes that the Committee has received submissions dealing with Section 51AA, 51AB and 51AC of the Act, especially in view of the outcome in the *Berbatis* case in the High Court.

6.2 MGAV sees this issue as having particular significance for its members. It is relevant to an understanding of the market power of the supermarket chains, and to the context in which acquisitions of independent grocery business occur. This question bears on the Committee's consideration of section 46 and section 50. Should the Committee invite MGAV to appear before members of the Committee, MGAV would be pleased to deal with this further in oral submissions.

7 Other Measures - Penalties

7.1 MGAV considers that existing penalties under the Act may not act as an effective deterrent to anti-competitive behaviour. MGAV considers it is in the interests of small business that penalty provisions be strengthened, especially in relation to individuals. MGAV is concerned that where individuals deliberately engage in unlawful anti-competitive conduct there is no prohibition upon their employer meeting the cost of any penalty imposed.

7.2 MGAV notes that the Dawson Committee recommended the introduction of criminal penalties for cartel behaviour, including imprisonment for individuals, and welcomes the appointment by the Treasurer of the Commonwealth of Australia on 3 October 2003 of a Working Party to examine matters identified

supermarket result in a substantial lessening of competition? But I also note that the focus on "creeping acquisitions" has the potential to generate unintended and perhaps harmful consequences. This potentially could arise when incumbents seek to sell properties in a market made thinner by a prohibition on creeping acquisitions. Creeping acquisitions provide an exit path for those wishing to sell their business. Organic growth by Coles and Woolworths does not provide that exit. Stopping creeping acquisitions may remove an exit path, but will not address increases in market shares through organic growth."

13 October 2003

10

by the Dawson Committee that should be resolved before criminal sanctions can be introduced. MGAV supports the introduction of such criminal penalties.

7.3 MGAV also supports the Recommendation 10.2 of the Dawson Committee in relation to the increase of the maximum civil penalties under the Act and particularly the proposal that:

- (a) the Court be given the option to exclude an individual implicated in a contravention from being a director of a corporation or being involved in its management; and
- (b) corporations be prohibited from indemnifying, directly or indirectly, officers, employees or agents against the imposition of a pecuniary penalty upon an officer, employee or agent.

MGAV considers these proposals will provide an effective incentive for individual compliance with the requirements of the Act.

7.4 MGAV notes that the Commonwealth Government in its response to the Dawson Committee Report indicated its intention to implement this recommendation and welcomes this decision.

Geoff Gledhill

President

on behalf of Master Grocers' Association of Victoria
13 October 2003