The Senate

Standing Committee on Economics

Trade Practices Amendment (Predatory Pricing) Bill 2007

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Senate Standing Committee on Economics

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Ms Lauren McDougall, Executive Assistant

PO Box 6100
Parliament House
Canberra ACT 2600
Ph: 02 6277 3540
Fax: 02 6277 5719
E-mail: economics.sen@aph.gov.au

Internet: http://www.aph.gov.au/senate/committee/economics_ctte/index.htm

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Introduction

Background

1.1 The Trade Practices Amendment (Predatory Pricing) Bill 2007 was introduced into the Senate on 18 June 2007 by the Leader of the Family First Party, Senator Steve Fielding[1].

1.2 On 21 June 2007, on the recommendation of the Selection of Bills Committee, the Senate referred the bill to the Standing Committee on Economics for inquiry and report by 1 August 2007.[2] The committee dealt with this private bill concurrently with its inquiry into the provisions of the Trade Practices Legislation Amendment Bill (No. 1) 2007.

1.3 The bill proposes to amend the *Trade Practices Act 1974* to prohibit predatory pricing in the following three markets:

- the market for groceries;
- the market for the sale of fuel; and
- the market for pharmaceutical products, proprietary medicines and toiletries.[3]

Conduct of the inquiry

1.4 The committee advertised the inquiry in *The Australian* newspaper on 27 June 2007 and invited written submissions by 9 July 2007. Details of the inquiry were placed on the committee's website. The committee also wrote to a number of organisations and stakeholder groups inviting written submissions.

1.5 The committee received 27 submissions, which are listed at Appendix 1. A public hearing was held in Melbourne on 27 July 2007. Witnesses who presented evidence at this hearing are listed at Appendix 2.

1.6 The Hansard transcript of the committee's hearing and copies of the submissions are tabled with this report. These documents and the committee's report are also available on the committee's website at: http://www.aph.gov.au/Senate/committee/economics_ctte/trade_practices/index.htm.

1.7 The committee thanks those who participated in this inquiry.

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1 *Journals of the Senate,* No. 149, 18 June 2007, p. 3938.

2 Selection of Bills Committee, *Report No. 10 of 2007*, dated 21 June 2007.

3 Senator Steve Fielding, Second Reading Speech, *Senate Hansard*, 18 June 2007, pp 49–50.

Structure of the report

1.8 Chapter 2 of the report provides background information on the bill and explains the factors that a court may consider in determining a predatory pricing case. Chapter 3 covers the evidence received by the committee in submissions and at the public hearing.

Chapter 2

The bill and the determinants of 'predatory pricing'

2.1 Predatory pricing occurs where a firm deliberately sells at unsustainably low prices in an effort to cost their competitors out of the market, before raising their prices later on. Senator Fielding explained in the Second Reading Speech of the Trade Practices Amendment (Predatory Pricing) Bill 2007 that the practice of predatory pricing not only affects small businesses, but also Australian families through higher prices in the long term. He highlighted the domination of Coles and Woolworths in supermarkets and petrol retail, and their 'strong presence' in the non-prescription medicine and healthcare and toiletries market. These companies' profits increased by 'up to five per cent' last year, while food prices in Australia are rising 'at double the inflation rate'. Senator Fielding deduced that there has been 'a growing lack of competition in these markets'.[1]

2.2 Currently, the courts may prosecute a company for predatory pricing under Part IV, section 46 of the *Trade Practices Act 1974* (TPA) relating to 'misuse of market power'. Subsection 46(1) states that 'a corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of eliminating or substantially damaging a competitor'.[2] However, the section contains no explicit reference to 'predatory pricing'.

2.3 The bill seeks to insert a new section 46AA, which states that 'a corporation must not engage in predatory pricing' in the 'market for groceries', the 'market for the sale of fuel' and the 'market for pharmaceutical products'. It would establish several factors than a court may have regard to in considering whether a corporation has engaged in predatory pricing. These include: goods that are priced 'less than their cost'; the prices offered by competitors; the period of time for which the good is offered at an 'unreasonably low price'; whether the corporation is selling the good at higher prices in other markets; and the extent of competition in the market.[3]

2.4 On two counts, the bill establishes a lower threshold for the courts to make a finding of predatory pricing under section 46. First, the bill would extend the current threshold test of corporations with 'a substantial degree of power in a market' to include corporations with 'substantial financial power in a market'. Second, the bill seeks to enable the courts to find that a corporation has engaged in predatory pricing 'even where the corporation has no intention of recouping the costs of its predatory

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1 Senator Steve Fielding, Second Reading Speech, *Senate Hansard*, 18 June 2007, pp 49–50.

2 *Trade Practices Act 1974*

3 Trade Practices Amendment (Predatory Pricing) Bill 2007

conduct'.[4] The following section examines some important developments in the consideration of these threshold issues of 'financial power' and recoupment.

The Boral case, the Senate Economics Committee report and 'recoupment'

2.5 In February 2003, the High Court delivered its finding on the *Boral Besser Masonry v ACCC* case.[5] The ACCC claimed that Boral was guilty of predatory pricing. It argued that one of Boral's competitors had left the market as a result. The High Court disagreed, noting that Boral did not have the market power to recoup the losses it sustained when it dropped its prices. Justices Gleeson and Callinan found that this capacity was not 'legally essential' to a finding of predatory pricing.[6] This was the first opportunity for the High Court to consider the issue of predatory pricing under section 46.

2.6 In April 2003, the Review of the *Competition Provisions of the Trade Practices Act* ('the Dawson Report') inquired into, among other matters, the misuse of market power provisions in section 46 of the Act. The ACCC highlighted the difficulty of demonstrating a company's anti-competitive purpose, and proposed that the section take into account the anti-competitive effect of company behaviour.[7] However, the Dawson Report argued against amending section 46. It noted the High Court's decision in the *Boral* case and recommended that interpretation remain a matter for the High Court. The government agreed, acknowledging the 'extensive consideration' given to the section in past reviews.[8]

2.7 In March 2004, the Senate Economics References Committee reported on the effectiveness of the *Trade Practices Act 1974*. The report recognised that one factor that may indicate predatory pricing is if the corporation plans to recoup its losses. However, there was disagreement in the evidence as to whether a corporation needs to be able to recoup its losses for a court to find it guilty of predatory pricing. The committee concluded:

> …while evidence of a corporation's intention to recoup losses may well contribute to the proof of an allegation of predatory pricing, there is nothing in s.46 which makes recoupment an element necessary to prove predatory pricing. The Committee considers that the Act could be improved by stating

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4 Trade Practices Amendment (Predatory Pricing) Bill 2007

5 [2003] HCA 5

6 *Boral* para 130 per Gleeson CJ and Callinan J.

7 Australian Competition and Consumer Commission, 'Dawson Report—Preliminary response: criminal sanctions major step forward for competition policy', Press Release, no. 74, 16 April 2003, http://www.accc.gov.au/content/index.phtml/itemId/347733 (accessed 10 July 2007).

8 The Hon. Peter Costello, 'Commonwealth Government response to the review of the competition provisions of the Trade Practices Act 1974', Commonwealth of Australia, http://www.treasurer.gov.au/tsr/content/publications/TPAResponse.asp (accessed 10 July 2007).

> that recoupment is a factor which the courts may examine when considering allegations of predatory pricing.[9]

2.8 However, the committee argued that the absence of an intention to recoup losses should not invalidate an allegation of predatory pricing. In other words, the issue of recoupment should not constitute a threshold for 'misuse of market power' in a predatory pricing case. The committee recommended an amendment to the TPA stating that:

> where the form of proscribed behaviour alleged under s.46(1) is predatory pricing, it is not necessary to demonstrate a capacity to subsequently recoup the losses experienced as a result of that predatory pricing strategy.[10]

2.9 The Trade Practices Legislation Amendment Bill (No. 1) 2007 is the government's legislative response to the March 2004 report. It does not propose that the courts may consider recoupment as an issue in a predatory pricing case, nor does it state any limitation on the courts in the absence of a recoupment strategy. The government bill therefore enables recoupment as a factor that the court can consider in determining whether below cost prices are indicative of a misuse of market power.[11] Senator Fielding's bill states that recoupment is not essential to prove predatory pricing—which reflects the current law.

The Senate Economics Committee report and the issue of 'financial power'

2.10 Another key issue raised in the March 2004 Senate Economics Committee's report relates to the section 46(1) threshold of a 'substantial degree of power in a market'. The committee received a proposal from the Law Council of Australia to lower the threshold by including reference to 'a corporation with substantial financial power'. This recognised that firms with financial power—but without market power—can engage in unilateral predatory pricing. Importantly, both the Law Council and the Business Council of Australia acknowledged in their evidence to the committee that there may be definitional difficulties with the term 'financial power'.[12]

2.11 The ACCC argued in its submission to the Senate Economics Committee that 'financial power' should not be part of the section 46(1) threshold, but one of the factors contributing to a determination of 'substantial power in the market'. The High Court, in its 2003 ruling in the *Rural Press* case, had expressly disagreed that financial

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9 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. xiii.

10 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 19, recommendation 3.

11 See Allens Arthur Robinson, 'Amendments to Trade Practices Act 1974 (Cth) to protect small business', *Focus*, June 2007, p. 2.

12 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, pp 20–21.

power was a component of market power. However, the committee agreed with the ACCC and recommended that section 46 of the Act be amended to state that:

> in determining whether or not a corporation has a substantial degree of power in the market for the purpose of section 46(1), the court may have regard to whether the corporation has substantial market power.[13]

2.12 On the issue of 'financial power', therefore, the Trade Practices Amendment (Predatory Pricing) Bill 2007 goes beyond the Senate Economics Committee's March 2004 recommendation. The government did not accept the committee's recommendation on this matter and the Trade Practices Legislation Amendment Bill (No. 1) 2007 contains no reference to the term 'financial power'.

13 Senate Economics References Committee, *The effectiveness of the Trade Practices Act in protecting small business*, p. 23.

Chapter 3

Evidence in relation to the bill

3.1 A variety of views were expressed on the Trade Practices Amendment (Predatory Pricing) Bill 2007. Some submissions broadly supported the bill. A few expressed concern that the bill would be ineffective or did not go far enough in protecting small businesses from predatory pricing.[1] The majority, however, opposed the bill. They did so on various grounds:

- the addition of a 'substantial financial power in a market' test;
- the phrase 'unreasonably low prices' in the definition of predatory pricing;
- the definition of 'cost' in the bill;
- the inclusion of a clause on recoupment; and
- the bill's application to three specified markets—grocery, fuel and pharmaceuticals.

Concerns about the proposed amendments

The uncertainty of terms

3.2 The main area of concern with the bill was the uncertainty of its terms. Several submitters argued that the courts were unfamiliar with these terms, which may adversely affect the operation of section 46 of the Trade Practices Act (TPA) and its central objective of promoting competition and the welfare of consumers.

3.3 The law firm, Addisons, strongly rejected the bill given the legal uncertainty of its terms. Ms Kathryn Edghill, a partner at Addisons, told the committee that the Senator Fielding's amendments represented 'a lawyer's heaven' with more uncertainty and confusion.[2] Similarly, Mr Graham Maher, also a partner at the firm, told the committee that the uncertainty of the bill's terms would result in a 'very conservative approach to competition in the market'. Both Mr Maher and Ms Edghill argued that business would face significant costs coming to terms with the amendments, which would not be in the interests of Australian consumers.[3]

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1 On the claim that the bill is ineffective, see the comments of Associate Professor Frank Zumbo, *Submission 25*, p. 40. The submitters broadly in support of the bill were APCO Service Stations (Submission 5), Spier Consulting on behalf of the Independent Liquor Group (Submission 19), the Fair Trading Coalition (Submission 21), the Motor Trades Association of Australia (Submission 22) and the Australian Newsagents' Federation Limited (Submission 24).

2 Ms Kathryn Edghill, *Committee Hansard*, 27 July 2007, p. 25.

3 Mr Graham Maher, *Committee Hansard*, 27 July 2007, p. 27.

3.4 Several submitters had difficulty with the bill's reference to 'financial power'. Coles' submission argued that 'financial power' is 'not a relevant concept' in Australian competition law, and that its introduction would create considerable uncertainty. It could result in an increased number of court actions and ACCC investigations, which could in turn lead to greater caution, less competition, less discounting and increased costs to customers.[4] Mr Dave Poddar, a partner at Mallesons Stephens Jacques, expressed concern at how the test of 'financial power' would operate in practice. For example, there is potential confusion as to whether the test would consider corporations' parent companies or their bank facilities.[5] Mr Poddar explained that these factors are not necessarily a good guide as to whether a corporation has 'financial power' and may unnecessarily constrain corporations' activities.

3.5 There was also confusion with the bill's reference to 'unreasonably low prices'. Woolworths noted that it is a concept that is 'undefined and unknown to the law or any regulator'. Its legal effect would be to protect inefficient companies from competition.[6]

Recoupment

3.6 The bill's clause on recoupment also drew criticism from submitters and witnesses. Addisons criticised the bill for its inclusion of a clause on recoupment. Ms Edghill argued that recoupment must be a factor considered by the courts in determining a transgression of section 46. The bill's clause would send a signal that recovering losses is not a necessary indicator for the courts in determining a predatory pricing case. Mr Maher told the committee that the High Court is currently aware that the issue of recoupment is a factor that the court may consider in section 46 cases.

Sector specific amendments

3.7 Several submitters criticised the bill for its explicit reference to three markets. Coles' submission disputed that there was any evidence of market failure peculiar to these markets, or that there is any need for more stringent controls on predatory pricing in these markets. Addisons' submission argued that in the absence of 'a clear case of market failure in those sectors', the bill could distort competition and harm consumers. Addisons, Associate Professor Zumbo and the Law Council of Australia (LCA) also foresaw confusion as to whether certain products were part of the identified sectors.[7] The LCA put the issue in the following terms:

> The provisions of the *Trade Practices Act* in relation to misuse of market power should be applicable to all markets … The 'markets' identified will

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4 Coles Group Limited, *Submission 4*, p. 3.

5 Mr Dave Poddar, *Committee Hansard*, 27 July 2007, pp 17–18 .

6 Woolworths Limited, *Submission 10*, p. 3.

7 Addisons Commercial Lawyers, *Submission 23*, p. 18. Associate Professor Frank Zumbo, *Submission 25*, p. 40.

> introduce unnecessary uncertainty, give rise to demarcation disputes (what is a 'grocery' or a 'toiletry'?) and will not be adaptable readily to developments in the economy and relevant markets. There is no clear rationale for special treatment in those cases especially.[8]

3.8 Even submitters who broadly supported the bill were critical of its narrow scope. Spier Consulting, on behalf of the Independent Liquor Group, urged that 'the liquor industry be added to list of three industries' subject to the bill.[9] The Post Office Agents Association Limited, the Fair Trading Coalition and the Motor Trades Association of Australia also suggested that the bill be considered for wider application.[10]

The wrong approach

3.9 The committee also received evidence that the bill would not guarantee greater protection for small business. Ms Edghill told the committee that expressed concern that section 46 was 'not the vehicle' to protect small business. She contrasted the intent of this section with subsection 51AC of the TPA, which clearly was introduced to protect the concerns of small business. Moreover, in her opinion, section 46 was working well and the lack of successful prosecutions on 'misuse of market power' cases was not an indicator that the section was not working as intended.[11] The bill's amendments would not lead to more prosecutions on predatory pricing because they do not resolve the fine line between aggressive competition and anti-competitive conduct. On the contrary, big and small businesses alike would face significant costs in identifying competitors' variable costs and uncertainty as to the meaning of 'financial power'.[12]

3.10 The committee enquired as to the success of the Canada's predatory pricing legislation, which is in some ways similar to Senator Fielding's bill. Ms Edghill told the committee that this legislation did not result in more prosecutions on predatory pricing. Indeed, she identified only one finding of predatory pricing under this legislation. Ms Edghill concluded that codifying 'predatory pricing' did not provide the fix that some legislators had hoped.[13]

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8 Law Council of Australia, *Submission 13*, p. 7.

9 Spier Consulting, on behalf of the Independent Liquor Group, *Submission 19*, p. 2.

10 Submissions 12, 21 and 22.

11 Ms Kathryn Edghill, *Committee Hansard*, 27 July 2007, p. 26.

12 Ms Kathryn Edghill, *Committee Hansard*, 27 July 2007, p. 26.

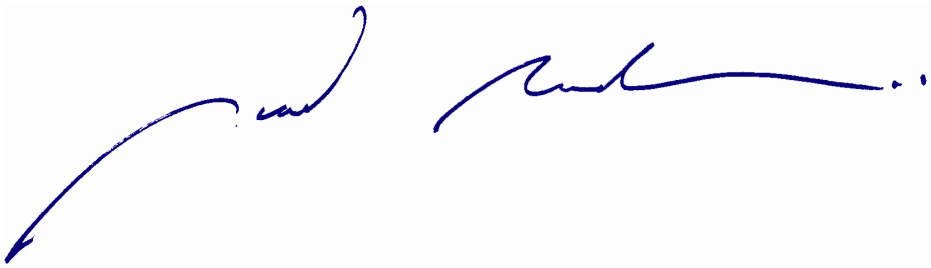
13 Ms Kathryn Edghill, *Committee Hansard*, 27 July 2007, p. 26.

Conclusion

3.11 The committee acknowledges the concerns of several submitters to this inquiry about the need to protect small business from predatory pricing and uncompetitive conduct. The overwhelming evidence, however, is that this bill is not an appropriate response to these concerns. Its terms, the clause on recoupment and its restricted scope would introduce considerable complexity and uncertainty to the Act. It is highly unlikely to protect small business, Australian consumers or Australian families from anti-competitive practices. Indeed, the committee believes that the bill would harm these groups.

Recommendation 1

3.12 **The committee recommends that the bill not be passed.**



Senator the Hon Michael Ronaldson
Chair

FAMILY FIRST
Dissenting Report

Provisions of the Trade Practices Amendment (Predatory Pricing) Bill 2007

FAMILY FIRST introduced its *Trade Practices Amendment (Predatory Pricing) Bill 2007* because of a concern that anti-competitive conduct like predatory pricing can drive small businesses out of the market, driving up prices for consumers, and that small businesses are particularly vulnerable because of their limited resources.

When FAMILY FIRST introduced its bill, small business had been waiting for a Government bill for more than three years since the Senate Economics References Committee recommended action.

Predatory pricing is where powerful retailers use their substantial market power or substantial financial power to drop their prices in one area to drive out competitors.

Not only are small businesses affected, with some forced to shut up shop because they can no longer compete, but Australian families suffer as well from higher prices in the long term.

The *Trade Practices Act* states "the object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection."[1]

The "welfare of Australians" is central, but to achieve that we need a mechanism to protect consumer welfare, which is fair trading and competition. There is a danger that without appropriate regulation, unfair trading and distorted competition can lead to higher prices and less choice for consumers as well as the loss of the benefit of small businesses to local communities.

FAMILY FIRST shares the Business Council of Australia's concern that "heavy handed responses risk stifling competition",[2] but believes there needs to be a good balance struck and that a lack of effective regulation to stop anti-competitive behaviour also stifles competition.

FAMILY FIRST agrees with the assessment of Professor Frank Zumbo, who states:

> … competition is a ruthless process, but that proposition is not in any way inconsistent with the proposition that there must be effective laws against anti-competitive conduct. Just like excessive regulation may stifle

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1 Section 2, *Trade Practices Act 1974*.

2 Submission 11 (Business Council of Australia), page 2.

> competition, so too may competition be stifled by ineffective prohibitions against anti-competitive conduct. Accordingly, the central question to be addressed in relation to s 46 (and indeed any section of the competition provisions of the *Trade Practices Act*) is whether the section is operating effectively to prohibit anti-competitive conduct; in this case, abuses of market power by large and powerful corporations.[3]

Australian Competition and Consumer Commission Chair Graeme Samuel said in July this year "small business has a fine tradition in this country, thanks in no small part to our open, competitive market that provides an opportunity for anyone to become their own boss and succeed. But in order for those businesses to be able to realise their potential, they require the same opportunities as every other competitor. In short, they deserve a fair go."[4]

Small business concern about the Trade Practices Act

Small business groups such as the Fair Trading Coalition have pointed to problems in the operation of the *Trade Practices Act* to stop anti-competitive practices, arguing that:

> … as markets become more concentrated (as is the case in many sectors of the Australian economy) Australia needs to have strong and properly administered laws which guard against the misuse of market power and in particular, predatory behaviour by large businesses. Without significant laws against such behaviour, the FTC believes that large businesses will continue to take advantage of their market power, resulting in further concentration of markets. That concentration will eventually lead to a loss of competitors and thus competition in markets, a loss of choice for consumers and ultimately less price competition, which further disadvantages consumers.[5]

There is a widespread concern that "… s 46 [of the *Trade Practices Act*] is not operating effectively to prevent large and powerful corporations from engaging in predatory conduct or other abuses of market power."[6]

One submission made the flimsy and circular argument that the fact there are few successful prosecutions under section 46 "should … be regarded as proof of the law working as it should to ensure the protection of competition and not as a failure of those laws".[7]

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3 Submission 25 (Professor Zumbo), page 2.

4 Submission 17 (Dr Evan Jones), page 1.

5 Submission 21 (Fair Trading Coalition), page 5.

6 Submission 25 (Professor Zumbo), page 2.

7 Submission 23 (Addisons Lawyers), page 7.

Evidence of market failure

Coles argued "… there is no evidence of market failure that would justify increased government regulation in retail"[8], but that is not the case.

Concentrated supermarket industry

The supermarket industry is one that is frequently cited as an area of concern. A report commissioned by the National Association of Retail Grocers of Australia (NARGA) found that:

> since the early 1990s, the supermarket industry has undergone significant restructuring. Australia's grocery market has become one of the most concentrated in the world. Current ACNielsen estimates indicate that the two major supermarket chains, Woolworths and Coles, have approximately 78-79% of the market. The Australian market share growth of these two key MGRs [major grocery retailers] over the past three decades has been significant – growing from approximately 35% to around 79% …[9]

NARGA is concerned this market concentration is not helping consumers and the situation may get worse:

> This dominance, whilst it is expected to offer consumers lower prices due to the economies of scale and lower unit costs, is generating growing concerns over the current high level of food price inflation and over the long-term implications for competition. The adverse impact of any reductions in the level of market share of SMEs would be likely to both further reduce the bargaining power of small primary producers and endanger consumer welfare in the form of reduced choice and less price competition.[10]

Dr Evan Jones argues that the major supermarkets raise their prices where there is no nearby competition:

> A mid 2003 price survey by Choice magazine exposed that prices at Woolworths Leichhardt Market Town (suburban Sydney) after Franklins had been taken out as a competitor had increased by 23%, compared to the CPI increase for food of 13% over the same period. Another study of grocery retail prices has confirmed the inverse relationship between prices and local access to competing stores (especially those other than Coles or Woolworths).[11]

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8 Submission 4 (Coles Group), page 1.

9 *The Economic Contribution of Small to Medium-Sized Grocery Retailers to the Australian Economy, with a Particular Focus on Western Australia*. A report prepared by PriceWaterhouse Coopers for the National Association of Retail Grocers of Australia, June 2007. Page 14. (NARGA Report)

10 NARGA Report, page 44.

11 Submission 17 (Dr Evan Jones), page 11.

Another survey in suburban Sydney found that:

> the residents of Moorebank, who purchased an everyday basket of fruit and vegetables from Woolworths consisting of; a Capsicum, Tomatoes, Potatoes, Avocado, Bananas, Apples, Grapes, Rockmelon, Pears, Beans, Cucumbers, Broccoli and a Cauliflower - on the understanding that these were .Low Prices you can count on everyday - were in fact being slugged with prices 81% higher than what they would have paid for exactly the same items less than 5kms from another Woolworths outlet at Liverpool The possible reason - at Liverpool a new independent competitor had recently entered the market - at Moorebank there was limited competition. [12]

The Southern Sydney Retailers Association argues that:

> … the only thing that keeps firms from exploiting consumers is competition from other firms - and a clear indication of lack of competition in a market, (especially a mature market such as grocery retailing) is if the majority of the firms in the market are making excessive profits well above international averages of similar markets - and all continue to raise their profit margins at the same time over a substantial period of time. [13]

The Australian National Retailers Association (ANRA), which represents some of Australia's largest retailers, conceded that the major supermarkets have a profit margin before interest and tax (EBIT) of up to 5 per cent. While they claimed comparable margins in the United States were up to 7 per cent,[14] other evidence given to the Committee disputes this.

The Southern Sydney Retailers Association points out that the US Food Marketing Institute states "the intense competition among food retailers for the consumer dollar is best demonstrated by profit margins that continue to be less then 1.5 cents on each dollar of sales [1.5% EBIT%] … This measure has remained in the 1 percent range throughout the industry's history …".

This means that major Australian supermarkets are making big profit margins by international standards.

Continuing growing food prices is evidence that competition is not working effectively in the supermarket industry.

ANRA states that "in relative terms [food prices compared to income, calculated as minutes worked for a basket of groceries], food is cheaper now than it was 26 years ago."[15] But this is an attempt to mask the increase in real prices over time.

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12 Submission 15B (Southern Sydney Retailers Association), page 16.

13 Submission 15B (Southern Sydney Retailers Association), page 17-18.

14 Submission 16 (Australian National Retailers Association), page 10.

15 Submission 16 (Australian National Retailers Association), pages 9-10.

Even ANRA admitted "Australia's food price growth is higher than in many other countries".[16]

In fact, "… food prices have consistently grown at a higher rate than the CPI [1982-2006] and in the most recent years food price inflation has risen significantly."[17]

The Southern Sydney Retailers Association points out:

> Australia has the developed world's highest food inflation since 1990 [to 2006] … However the truly alarming situation of food price inflation in Australia is even more apparent when we compare food inflation v CPI since 1990 [to 2006] - everywhere in the developed world consumers seem to be benefiting from competitive retail markets, where food inflation, especially supermarket prices, are lower than the CPI – well everywhere in the developed world – except one remarkable stand-out exception [Australia].[18]

NARGA argues that "… the lower [food] prices in Perth [compared to Sydney and Melbourne] [are] substantially a result of the higher market share of the independent grocery sector [in Western Australia]."[19]

FAMILY FIRST also acknowledges the importance of small locally owned businesses to keeping wealth in local communities and the impact the decisions of large retailers have on the viability of Australian primary producers and food manufacturers.[20]

FAMILY FIRST believes that on of the major reasons for high food and grocery prices in Australia is that the market is not working. There is not enough competition to keep prices as low as they should be and families are suffering because of it. Families and small businesses are the victims of the market power being wielded by some of Australia's retail giants who dominate key sectors.

Unilateral changes in terms

There is other evidence that big businesses are taking advantage of their market power.

The unilateral change in terms of payment to suppliers is one way big businesses exert their market power over small businesses. One small business owner contacted FAMILY FIRST with an example:

> [Company Alpha] purchases $5Billion from 20,000 suppliers. If they delay payment by 30 days (as they dictate in the attached letter) they are

16 Submission 16 (Australian National Retailers Association), page 12.

17 NARGA Report, Page 6.

18 Submission 15A (Southern Sydney Retailers Association), page 18-19.

19 NARGA Report, page 39.

20 NARGA Report, pages vii and 7.

> generating a benefit to themselves of $33M of interest savings per annum. But more importantly, they are generating an increase in the working capital demands of their supplier businesses of over $400 Million. To the extent to which that impacts on small businesses, chances are that small businesses are having to go to second mortgage funding or cash flow finance in order to be able to fund the extension in days receivable. That would be charged at effective interest rates around 11.5% to 13% - a cost of around $50 Million, if all of the $400M was small business. If small businesses can't manage the account, the inevitable result is that the business transfers to large consolidators (like internationally-owned wholesale chains) who have adequate capital resources and can maintain heavy cross-subsidization from one customer category to another.

The small business was reluctant to put this information in a submission to the Committee as the businessman explained: "if I was to put in an official submission I risk damaging very important business relationships. So how can I protest without damaging my own interests or waiting until I get out of the business?"[21]

Other large companies also make unilateral changes to terms. FAMILY FIRST has a copy of a letter from a large retailer informing suppliers, not negotiating with them, that "… your settlement terms will change from 3.00%, 30 days to 3.00%, 60 days". This obliges suppliers to find finance to cover their bills for another 30 days before payment.

Rebates and discounts

The Pharmacy Guild of Australia argued that supplier discounts should be transparent so that small businesses can band together to make large purchases for the same prices available to big businesses for the same volume:

> I think it is reasonable that we should at least have the information in the marketplace so that when somebody wishes to buy something they can say, 'If you buy 500,000 of these, you get this price and, if you buy two, you get this price and there are steps in the middle.' Then you at least know that, if you want to compete, you have to buy 500,000. But the market sometimes does not allow people to have that information.[22]

Mr Scott commented on products he had bought in cooperation with a group of others for a maximum volume discount, but found others retailing the same product for less than he was able to buy it wholesale:

> Either the company is not being honest about what the cost price is or, alternatively, the other group is selling it for less than it purchased it for. Either way, those things are commonly used to cause the opposition to go

21 Email from Businessman A, 29 July 2007.

22 Mr Scott, Pharmacy Guild of Australia, Committee Hansard, 27 July 2007, page 23-24.

> out of business or to cause the opposition considerable trouble. I do not believe they are reasonable ways for trade to take place.[23]

Shelf space

One submission refers to a statement on Dick Smith Foods website, since modified, which refers to the difficulty the company was having finding shelf space to sell products through Coles and Woolworths:

> In recent weeks the problem has been compounded by Coles [a major supermarket] suggesting to many of our manufacturers that unless they receive large sums of money by way of an up-front payment, which in some cases is up to $100,000, then they will no longer be prepared to carry our products**.** Interestingly, none of the requests for money are being sought in writing. As our own company and most of our manufacturers are small businesses, there is simply no way we can afford to pay these amounts and remain financially viable. If this policy continues, it will force the remaining small Australian manufacturers out of business and open the door to even more products from overseas.[24]

The Southern Sydney Retailers Associations comments that:

> Although Dick Smith Foods may be technically free not to sell to the large supermarket chain that made these coercive demands - the reality is, that when just two buyers are the gatekeepers of 80% of the supermarket shelves of the nation (up from 35% in 1975) - just how conceivable is it for Dick Smith Foods or any other Australian food producer to walk away and say no? These food producers have long term leases on plant & equipment, they have investments in machinery, bank loans that require servicing, on-going commitments to their skilled employees - to say no to any demand from one of the major supermarket chains and to walk away, would simply be suicidal. The producer simply has no way to replace the lost sales, or any practical alternate mechanisms to get his products to the consumer, in such a highly concentrated market as has evolved in Australia, under the *Trade Practices Act*. [25]

These practices demonstrate the market power exerted by big businesses that mean fair competition is not always available to small businesses. They also demonstrate that changes in the law are necessary to ensure competition and fair trading.

Proposed changes to the Trade Practices Act

The Fair Trading Coalition has declared its support for FAMILY FIRST's *Trade Practices Amendment (Predatory Pricing) Bill 2007*, noting that it would support "the

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23 Mr Scott, Pharmacy Guild of Australia, Committee Hansard, 27 July 2007, page 20.

24 Submission 15B (Southern Sydney Retailers Association), page 3.

25 Submission 15B (Southern Sydney Retailers Association), page 4.

wider application" of the bill.[26] Other small business groups like the Independent Liquor Group[27] have also asked to have their markets included in the bill.

FAMILY FIRST's predatory pricing bill received support from a significant number of small businesses and other submissions.[28]

FAMILY FIRST's bill introduces the concept of "substantial financial power" as one of the requirements to prove predatory pricing. This received support:

> Substantial financial power is a useful concept because financial strength is ultimately what allows the anticompetitive conduct to be sustained for a period way beyond what it would have been in a context where the firm had no market power or substantial power. So the 'deep pockets' aspect is very important to fund the anticompetitive conduct—or the allegedly anticompetitive conduct. The High Court has said that financial power is not a factor that should be taken into account. I respectfully disagree because, if we are trying to assess whether conduct is procompetitive or anticompetitive and if what the firm actually does when it has substantial market power has an adverse effect on competition, we should be looking very carefully as to how that financial power has been used.[29]

FAMILY FIRST's bill also states that a company may be held to have engaged in predatory pricing even where it has no intention to recoup the funds it spends engaging in predatory pricing. This also received support:

> … we do not need proof of recoupment, because recoupment is not mentioned in section 46. You have substantial market power and you take the advantage of that market power for an anticompetitive purpose. That is conduct at a point in time. If at a point in time you have substantial market power and substantial financial power and you use that power in an anticompetitive way—that is, you behave at that point in time to destroy competition, to deter competition or to prevent competitive conduct—then that should be the only issue that is relevant under section 46, because that is how section 46 is worded. To introduce new concepts is to add new hurdles by judicial law making …
>
> If you have a recoupment element, it becomes almost impossible because you are asking for proof about the future. And if you are asking for a dead body—that is, that the small business or the smaller player has been driven out of business—as an element of proving a breach of section 46 then section 46 is not working effectively to protect competition because the competition is gone …[30]

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26 Submission 21 (Fair Trading Coalition), page ii, iii.

27 Submission 19.

28 Submissions 5, 15, 19, 20, 22, 24.

29 Professor Zumbo, Committee Hansard, 27 July 2007, page 11.

30 Professor Zumbo, Committee Hansard, 27 July 2007, page 11.

FAMILY FIRST is certainly not against price cutting, but when you undercut for extended periods of time with the purpose or effect of squeezing out a competitor that's not on. FAMILY FIRST rejects the argument that it wants to protect small business by any other method than by ensuring fair competition.

The Bill also adds an "effects test", which means those corporations that do have "financial" or "market" power need to be careful in how they use that power so they do not substantially lessen competition or eliminate competitors.

A number of submissions were critical of FAMILY FIRST's bill.[31] FAMILY FIRST will consider whether it is necessary to amend the predatory pricing bill to meet its objectives, mindful that most submissions criticising the bill were from big businesses or organisations that represented big businesses, which are doing well under the current laws.

Conclusion

FAMILY FIRST introduced the *Trade Practices Amendment (Predatory Pricing) Bill 2007* to give small businesses much needed protection from predatory pricing, by ensuring competition and fair trading. Fair competition will help to ensure the lowest prices for families.

FAMILY FIRST is convinced that food and grocery prices are soaring because the market is not working, especially in concentrated markets like the grocery market where Coles and Woolworths control 80 per cent of turnover. This is one of the most concentrated grocery markets in the world. Coles and Woolworths also dominate the petrol market.

There needs to be a good balance in the *Trade Practices Act* between too much regulation and not enough. FAMILY FIRST believes a lack of effective regulation to stop anti-competitive behaviour is stifling competition.

Senator Steve Fielding
FAMILY FIRST Leader
FAMILY FIRST Senator for Victoria

31 For example, submissions 13, 16 and 23.

APPENDIX 1
Submissions Received

Submission Number	Submitter
1	Alan Edward Barnard
2	Shopping Centre Council of Australia (SCCA)
3	Coles Group Limited
4	APCO Service Stations Pty Ltd
5	David Lieberman and Associates (Lawyers and Mediators)
6	TC Boxall
7	National Farmers' Federation
8	Queensland Lease Consultants
9	Woolworths Limited
10	Business Council of Australia
11	Post Office Agents Association Limited (POAAL)
12	Law Council of Australia
13	Southern Sydney Retailers Association
14	Australian National Retailers Association (ANRA)
15	Spier Consulting
16	The Pharmacy Guild of Australia
17	Fair Trading Coalition (FTC)
18	Motor Trades Association of Australia (MTAA)
19	Addisons Commercial Lawyers
20	Australian Newsagents' Federation Ltd
21	Associate Professor Frank Zumbo
22	Boral Limited
23	Queensland Newsagents Federation

APPENDIX 2

Public Hearing and Witnesses

Friday, 27 July 2007 – Melbourne

CILENTO, Ms Melinda, Deputy Chief Executive
Business Council of Australia

EDGEHILL, Ms Kathryn, Partner
Addisons

HOLDAWAY, Ms H K, Policy Manager, Competition Framework Unit
Department of the Treasury

MAHER, Mr Graham, Partner
Addisons

OSMOND, Ms Margy, Chief Executive Officer
Australian National Retailers Association

PODDAR, Mr Dave, Partner
Mallesons Stephen Jacques

ROGERS, Mr Scott, Senior Advisor, Competition Framework Unit
Department of the Treasury

SCOTT, Mr Bill, Branch Committee Member
Pharmacy Guild of Australia

SHEEHAN, Mr Maurice, Branch Director, Victoria
Pharmacy Guild of Australia

ZUMBO, Associate Professor Frank