# Minority Report by Senators Joyce and Xenophon

## Introduction

1.1 This inquiry was established to inquire and report on the Trade Practices Amendment (Guaranteed Lowest Prices – Blacktown Amendment) Bill, jointly introduced to the Senate on 24 June 2009 by Senators Barnaby Joyce and Nick Xenophon.

1.2 The Bill is designed to end the anti-competitive practice of geographic price discrimination, which can potentially drive independent retailers out of the market or deter them from cutting prices.

1.3 The Bill will require large retailers such as major supermarket chains and oil company operated service stations to charge the same price for the same product at all of their retail locations within 35 kilometres of another one of their sites.

## Market dominance

1.4 In terms of supermarket dominance, it's estimated that Woolworths and Coles control around 80 percent of supermarkets over 2000 square metres and 60 percent of the petrol sector.

1.5 Woolworths began selling petrol in 1999 and in 2003 joined with Caltex, which propelled it from the fifth-largest petrol retailer to equal second. Now, Mobil is proposing to sell 302 service stations in the eastern states to Caltex, giving Woolworths/Caltex an even larger market share.

1.6 The proposed Caltex acquisition itself raises serious competition concerns, enabling Caltex to gain a dominant position in the retail and wholesale petrol markets, thereby increasing the opportunities for geographic price discrimination by Caltex. The Woolworths/Caltex alliance has also enabled Woolworths to increase its dominance of the retail petrol market.

1.7 Coles also joined the petrol sector in 2003, entering into an alliance with Shell. This alliance has also enabled Coles to gain a dominant position in the petrol retail market.

1.8 The ACCC noted in its 2007 report into petrol prices that Coles and Woolworths' presence in the sector had impacted independent petrol stations:

> …the exclusive supply arrangements between the supermarkets, Coles Express and Woolworths and respective suppliers, Shell and Caltex, have diminished the supply options for many independent resellers.[1]

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1 ACCC, *Petrol prices and Australian consumers*, December 2007, p. 126.

1.9 But the role of independent retailers is crucial to ensuring a competitive marketplace. Independent retailers are critical to putting downward pressure on retail prices.

1.10 As the Service Station Association stated in its submission to the inquiry:

> It is universally accepted that diversity of competition is essential if consumers are to enjoy proper competition, and small independent retailers are an essential ingredient in that mix.[2]

1.11 Coles and Woolworths' market power in the supermarket and petrol sectors has placed extreme pressure on independent retail and petrol station operators, with many forced to close as a result of being unable to survive under the pricing practices and growing dominance of Coles and Woolworths.

1.12 The Service Station Association wrote that, due to Coles and Woolworths' large and widespread networks of outlets:

> It is common practice for them to vary the price at which they sell their petrol to suit the nature of competition at each location. It is the norm, and has been for quite some time, that the large retailers will set lower prices in more competitive areas and higher prices where competition is absent.[3]

## Geographic price discrimination

1.13 Geographic price discrimination is the practice whereby a business charges different prices for the same product in two or more different locations. Treasury argues that there are various reasons why a business might use geographic price discrimination, or "price flexibility", as Treasury chooses to refer to it.

> These might be related to supply-side aspects, such as differentials in costs or the scope of operations between locations; or demand-side factors, including the size of the local population, and the nature of local competition. Each of these reasons, including competitive differences, is a legitimate reason for prices to vary among locations.[4]

1.14 Further, the ACCC told the Senate Committee hearing that it:

> …does not believe there is something inherently wrong with price discrimination. We do not believe it is inherently anticompetitive.[5]

1.15 The Australian National Retailers Association claims that geographic price discrimination is 'extremely rare, if ever present, in the Australian commercial environment'.[6]

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2 Service Station Association, *Submission 1*, p. 1.

3 Service Station Association, *Submission 1*, p. 1.

4 Treasury, *Submission 10*, p. 2.

5 Mr Scott Gregson, ACCC, *Proof Committee Hansard*, 5 October 2009.

1.16 Similarly, Coles argued that geographic price discrimination does not exist. However, Coles did acknowledge that it gives its store managers discretion to adjust prices to compete with local competition.[7]

1.17 Geographic price discrimination is a common pricing strategy which, from time to time, raises competition concerns. For example, under United States anti-trust laws the practice is considered illegal in certain circumstances.

1.18 There are at least four reasons why geographical price discrimination might be regarded as objectionable:

- It may be regarded as inherently inequitable or unfair for different people to pay a different price for the same good;
- It allows for the anti-competitive practice of predatory pricing;
- It allows firms to exploit a lack of competition in certain locations; and,
- It reduces economic efficiency through increasing the search costs to consumers of locating the 'best price'.

1.19 On a practical level, the impact of geographic price discrimination means that consumers could be faced with the same brand of service station or supermarket just kilometres apart, or even on the same street, charging different prices for exactly the same product, with consumers getting the product cheaper where there is local competition and paying a higher price where there is a lack of local competition.

1.20 Indeed, it is fair to argue that it would not be acceptable for a company to discriminate when selling a product based on a customer's religion, gender or race. Why, then, should it be acceptable for a company to discriminate on the basis of consumers' location?

1.21 The ACCC's July 2008 report—*Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*—found that the local presence of a competing supermarket (Coles or Woolworths) has a significant effect on prices.

1.22 Consumers shopping at Coles stores with a Woolworths supermarket within one kilometre paid prices that were on average 1.36 percent lower than the prices paid by consumers at Coles stores without a Woolworths within five kilometres.

1.23 Customers shopping at a Coles stores with an ALDI within one kilometre paid on average around 5.15 percent lower than the prices for the same items paid by consumers at Coles stores without an ALDI within five kilometres.[8]

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6 Australian National Retailers Association, *Submission 9*, p. 3.

7 Coles, Submission 5, p. 3. Mr Robert Hadler, *Proof Committee Hansard*, GROCERYchoice inquiry, Senate Economics References Committee, 28 October 2009, p. 16.

8 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008.

1.24 Coles argued in its submission to the Committee that the reason for different pricing of goods at Coles' different sites is a result of business costs, and ignores the inference that it's due to competition factors.

1.25 Some of the general costs of doing business and other factors that can contribute to different pricing at Coles' different sites [are]:

> Freight costs vary in transporting products to different sites;
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> Rental tenancy agreements can vary from site to site;
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> Products delivered directly to sites or to the Coles' distribution centres, commonly have different wholesale prices in different regions;
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> Products may be chosen for promotion in some sites but not others due to popularity within the relevant demographics of given areas;
>
> Fresh products may have subtle quality distinctions based on their sourcing origins and this is often reflected in minor price variations;
>
> Utility and other rates vary at different sites; and the
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> Staffing levels and wage differentials that exist between sites.[9]

1.26 However, no evidence to support these large cost differences was provided to the Committee, and given Aldi operates on a national pricing policy and Woolworths is moving in the same direction, it would seem that cost differences (especially within the one metropolitan area) cannot be sufficient to justify price discrepancies.

1.27 In fact, Woolworths recently commented that prices within metropolitan areas do not differ as a result of cost differences:

> Individual differences between store operating costs…are merely reflected in some stores making a better return than others, not in retail price variation…Only a handful of Woolworths stores in the remotest parts of Australia (eg Weipa and Gove) have marginally higher prices due to the extra transportation required.[10]

1.28 The Committee did express concerns about the impact this Bill, if passed, would have on products which varied in quality, such as fresh fruit and vegetables.

1.29 Firstly, it has to be noted that Coles and Woolworths don’t advertise the difference in quality of fruit and vegetables between their stores and it's fair to argue that produce between stores within a 35 kilometre region would likely be sourced from the same distribution centre.

1.30 This Bill seeks to address the issue of identical products being priced differently within the same area, and, as such, fresh produce could have the benefit of

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9 Coles, *Submission 5*, p. 4.

10 Woolworths, *Responses to questions on notice for GROCERYchoice inquiry*, Senate Economics References Committee, 11 November 2009.

an exemption under the Blacktown Amendment relating to 'imminently perishable.' This exemption would allow fresh produce to be priced to reflect the variance in produce that may arise during the shelf life of the produce.

1.31 Competition expert, Associate Professor Frank Zumbo from the University of New South Wales, argues that, ultimately, price variation tends to be driven by the presence, or lack thereof, of competition.

> Coles and Woolworths will only lower their prices in a local market where they have to by the presence of a strong price competitive independent in that local market.[11]

1.32 Coles also stated in its submission that:

> Compliance with the Bill would necessitate retailers adopting homogenised prices for identical items across most or even all of their respective sites. The likely effect of this would be that retailers would adopt price points at the upper end of their existing price bands.[12]

1.33 This argument was supported by the Law Council of Australia, who claimed:

> If enacted, the Blacktown Bill would raise the costs to a firm of cutting its prices in a particular location, since the law would require that these lower prices are extended to all other locations (within a 35km radius), even though the firm would otherwise not have lowered its prices in those other locations. Thus, rather than extending lower prices to locations that otherwise may not have benefited from them, the Bill is more likely to discourage firms from price discounting at any of their outlets.[13]

1.34 However, this implies a lack of a desire by large corporations to provide all consumers with lowest possible prices everyday.

1.35 Hypothetically speaking, if competitive markets have lower prices and monopoly markets have higher prices, then the impact of the Blacktown Amendment would be to lower prices in monopoly markets to the level of prices in competitive markets.

1.36 In this way, the Blacktown Amendment replicates the competitive process obviously lacking in monopoly markets.

1.37 Contrary to criticisms of this Bill, a company choosing to raise prices in competitive markets following the enactment of the Blacktown Amendment would simply lose business in those competitive markets. With competition keeping prices low in competitive markets, the Blacktown Amendment would require those low prices to also be offered in monopoly markets. As such, where there are more

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11 Associate Professor Frank Zumbo, *Submission 11*, p. 3.

12 Coles, *Submission 5*, p. 2.

13 Law Council of Australia, *Submission 2*, p. 4.

monopoly markets than competitive markets, the benefits of the Blacktown Amendment would be magnified accordingly through lower prices across those monopoly markets.

1.38 On the other hand, if there are many competitive markets and modest numbers of monopoly markets, the impact of the Blacktown Amendment will still, as its drafters intended, be beneficial in bringing the benefits of lower prices from the competitive markets to the monopoly markets. Again, the Blacktown Amendment would provide consumers with lowest possible prices everyday.

1.39 As Associate Professor Frank Zumbo stated in his submission to the Committee:

> A single lowest price strategy everyday and everywhere in the same geographic area is the most economic and competitive pricing strategy that a company can adopt. A single lowest price strategy in these circumstances means that the company will be maximising its customer base and turnover as it will be attracting customers with the most competitive price that the company can offer consumers everyday and everywhere in the same geographic area.[14]

1.40 Currently, it's understood that prices, including promotional prices, are set by the Head Offices of Coles and Woolworths and then can be modified as and when determined by the local store manager.

> The local store manager can reduce prices below the standard shelf price in a range of circumstances including clearances of discontinued stock and stock approaching its use-by date and as a response to local competition.[15]

1.41 In contrast, supermarket chain, ALDI, has a national pricing policy whereby all items are priced uniformly across all stores across the country.

1.42 ALDI's website states:

> We believe you shouldn't have to pay more for your groceries simply because of where you live, which is why from Rosehill to Rutherford, Bundaberg to Ballarat, you'll pay the same low prices on groceries in every ALDI store. It's our way of keeping things fairer for all Australians.[16]

1.43 Geographic price discrimination enables 'predatory pricing' to occur, which is when a firm with 'deep pockets' cuts prices at an outlet to below-cost for a sustained period of time to drive a direct competitor out of business. Subsequently, once the competition is gone, prices tend to rise above competitive levels.

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14 Associate Professor Frank Zumbo, *Submission 11*, p. 5.

15 ACCC, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008, p. 467.

16 http://www.aldi.com.au/au/html/ALDI_national_pricing.htm

1.44 It is important to note that competition is not only reduced by actual predatory pricing but by the threat of it. An independent may be deterred from entering, or an existing operator from cutting prices, for fear of inducing a predatory response from a major chain.

1.45 Over a number of decades, domestic competitors having a comparable scale of operations to Coles or Woolworths have been very rare and have either been bought out by one of the major supermarket chains or have exited the local market.

1.46 Only one foreign competitor (Aldi) has entered the retail market to a point that it offers some competitive tension at the retail level, and even then it only retains a market share of a few percent. Another foreign entrant—Costco—has only recently opened a single outlet.

1.47 The advantage of this Bill is that it reduces the credibility of an implicit or explicit threat to engage in predatory pricing, as a below-cost price could not be charged next door to an independent retailer, but would have to be offered across all stores within a 35 kilometre region.

## Impact on Independents

1.48 The consequence of geographic price discrimination on smaller retailers and independents is such that they are being priced out of the market.

> In petrol retailing, small independent operators are in decline, brought about by the huge distortion in market power between them and the supermarkets and the multi-national oil companies. The reduction in the number of service stations has accelerated since the supermarkets entered the industry to the extent that many small communities no longer have a petrol outlet to service their needs.[17]

1.49 The experiment conducted by the Southern Sydney Retailers Association in 2008–09 clearly demonstrated the impact of geographic price discrimination on independent retailers and on consumers.[18]

1.50 Situated less than 5kms apart, the shopping centre in Greystanes, Sydney, featured a Woolworths supermarket with no competition, while the Woolworths in Fairfield had an independent grocer selling produce in the same shopping centre.

1.51 On the same day, less than one hour apart, the same basket of goods was purchased from the two Woolworths supermarkets.

1.52 There was a staggering 131 percent difference between the costs of the baskets—higher at the Greystanes Woolworths, which did not have any competition.

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17 Service Station Association, *Submission 1*, p. 1.

18 Southern Sydney Retailers Association, *Submission 12*.

1.53 One year later, the same experiment was conducted; however, the independent grocer at Fairfield had since closed down.

1.54 Perhaps unsurprisingly, the cost of the same basket of goods at the Fairfield Woolworths had increased 80 percent on the previous year.

> It was obvious that once the independent competitor disappeared, so did the low prices.[19]

1.55 This case study, and how the Blacktown Amendment would have potentially altered the situation, was discussed during the Committee hearing.

> CHAIR—Do you think Woolworths should go down to the lower price that they charge at Fairfield, or should it be somewhere between the Fairfield price and the Greystanes price? If Woolworths had to charge exactly the same price for that basket of fruit and veg, do you think they would go down to the absolutely lowest price?
>
> Mr Kelly—They would have an option. Woolworths could have raised their prices in 2008, when the independent was there. The only thing stopping them was that independent business being there. If Woolworths decided to raise their prices at Fairfield, they would simply lose business to the independent competitors. They would have a choice. If they raised their prices at Fairfield because of this law, they would lose business—and that would stop them from doing it. The competition at Fairfield would act as de facto competition for the non-existent competition at Greystanes to bring those prices at Greystanes down.[20]

1.56 Further, in terms of entry to the market:

> CHAIR—If the prices are so high at Greystanes, why do you think a competitor has not moved into the area?
>
> Mr Kelly—It is because of the practice of geographic price discrimination. A competitor can see the super competitive prices that Woolworths are charging at Greystanes. If I were a small greengrocer or independent businessman I would normally think it was a great opportunity for me to go into Greystanes shopping centre and open up a small business and bring that competitive pressure. But that businessman knows that the minute he does that, no matter what price he puts up, Woolworths will automatically slash their prices to supposedly match him without regard to any price they have in the other shopping centre.[21]

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19 Southern Sydney Retailers Association, *Submission 12*, p. 8.

20 Mr Craig Kelly, Southern Sydney Retailers Association, *Proof Committee Hansard*, 25 September 2009, p. 4.

21 Mr Craig Kelly, Southern Sydney Retailers Association, *Proof Committee Hansard*, 25 September 2009, p. 3.

## Conclusion

1.57 This Bill seeks to ensure that consumers are provided with lowest possible prices everyday and everywhere within a 35 kilometre region.

1.58 The dominance of Coles and Woolworths in both the supermarket and petrol sectors means that small independent retailers can be priced out of the market and retail prices inflated in areas where there is no competition.

1.59 Geographic price discrimination is a real and existing threat to competition and is unfair for consumers who, within one suburb, may face price differences of 100 percent for the same product, or 10 cents a litre, for example.

1.60 While overhead costs may vary from site to site, it has to be fair to say that those costs cannot be so substantially different within 35 kilometres as to require highly inflated retail prices or price variations for an identical product.

1.61 Geographic price discrimination not only affects consumers but also small businesses who can be driven out of business as a result of the ever expanding market power held by the two major supermarket chains in both the supermarket and petrol sectors.

1.62 This Bill seeks to address this issue and promote a level and competitive playing field by ensuring that the anti-competitive practices of geographic price discrimination and predatory pricing are effectively dealt with.

### Recommendation 1

**1.63 That the Bill be passed.**

### Alternate Recommendation

**Defer consideration of the Bill and establish a Working Group to examine the extent and nature of geographic price discrimination within the major metropolitan and regional centres in Australia. The Working Group could include officials from Treasury and the ACCC, representatives from the major supermarket and petrol retailers, small business groups and consumer groups and academic experts.**

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