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Department of the Senate
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By email to: economics.sen@aph.gov.au

Dear Dr Grant,

Senate Economics References Committee: Inquiry into the impacts of supermarket price decisions on the dairy Industry – Questions on Notice – Question 1, 6 October 2011

Senator Xenophon asked for information relating to our statement that a Section 49 type of prohibition on anti-competitive price discrimination was regarded by competition regulators as 'core to running a level playing field in business across the board' – for big companies as well as small companies rather than, as Prof Hilmer suggested in his report in 1993, specifically aimed at protecting small business.

Whilst such a prohibition, by levelling the playing field, does help small business it also helps competition in general by allowing a wider range of entities to compete on a fair basis thereby generating a better competitive environment.

We outlined the benefits of such a provision in competition law as viewed by regulators in the USA in our March 17 submission as follow:

> 'Much of the approach taken by legislators worldwide in relation to a prohibition of anti-competitive price discrimination in competition law has its origins in the US Robinson-Patman Act of 1936. We have been fortunate in being able to acquire a copy of the first book[1] written in 1938 by Mr Wright Patman, a co-sponsor of the Act, to explain the Act, its purpose and its provisions.....'

[1] Patman W. *The Robinson-Patman Act, What you can and cannot do under this law,* The Ronald Press Company, New York, 1938

'The following comments are pertinent:

- Mr Patman makes it clear that the purpose of the Act was not to interfere with sound business practices but to deal with the small minority 'bandit fringe'.

  'Essentially the present Act provides that when a man sells a product to two or more customers, he must not discriminate between them in such a way that one is given an unfair advantage over the other.' (Preface p. iv)

  It is clear that when such an advantage is given early in the supply chain, the disadvantaged party can never make up the difference brought about at that point and will be at a competitive disadvantage when on-selling his product to the final consumer. The end result is that the disadvantaged entity has difficulty in surviving as a competitor and drops out of the market, reducing competition in that market.

- Patman goes on to explain:

  'The soundness of the Act is now generally acclaimed by business. It adds the force of law to many of the principles in codes of ethics adopted voluntarily by industry groups over the last twenty years, and makes possible for the first time their enforcement against the recalcitrant minority with whom every industry is afflicted. It is not a 'reform bill' but rather a long step toward the arming of business with effective weapons against the relatively few outlaws who will not play fair.'(Ibid)

The corollary to that statement is, of course, that companies who want to 'play fair' have nothing to fear from the re-introduction of a Section 49 style prohibition.

- Patman goes on to quote W H S Stevens from the Harvard School of Business:

  'The danger to fair competition comes not primarily from the customary and relatively small open and published price differentials given by nearly all sellers, and taken advantage of by hundreds and thousands of distributors, but rather from the large differentials, open or secret, available only to a limited number of large mass buyers.' (Preface p. v)

- In Chapter 1, *The purpose of the Act,* Patman details the long term effect of such pricing differentials:

'In time the industry as a whole found itself in troubles from which it could not extricate itself. The resulting difficulties spread to the raw material suppliers and reacted upon the earnings and purchasing power of the workers. For wages were cut, profits disappeared, weak producers soon gave way to the stronger, and monopolistic control became centralized in the hands of a few men. That is a true story, and the industry is one of our rather large industries, still in a few hands.' (Chapter 1, pp 4-5)

We have seen this type of market concentration develop in our retail grocery sector – fed by the unrestrained pricing pressure that can be brought to bear by the large chains on their suppliers....."

We also have a copy of Senator Patman's second book[2], an update of the book quoted above. We include a series of quotes from this book that shows the philosophy and economic thought behind the US prohibition against anti-competitive price discrimination:

- *'In the concluding chapters of this volume reference is made to the strong support given to the Robinson-Patman Act by representatives of business at all levels. It has been made clear by representatives of business that the discriminatory practices against which the Robinson-Patman Act is directed are unsound practices. They are harmful to business enterprises endeavouring to maintain high ethical standards and are destructive of competition generally....'*[3]

- *In the course of its consideration of proposed legislation against price discrimination, Congress became quite well informed on the economic significance of price discrimination. It was found that price discrimination had become a weapon of sellers who held some degree of monopoly power. This power had been effectively employed by powerful sellers, with the effect of destroying competition and the tendency to create stronger monopolies.'*[4] (Same argument could be applied to powerful buyers.)

- *The conclusions of Congress regarding the economic significance of the practice of price discrimination were vividly recorded in the committee reports on the Bill that became the Clayton Act. In those reports, references were made to the price discrimination practices of the Standard Oil Co of New Jersey and the American Tobacco Co., and to the great market power that these multi-market operators had acquired and abused through the use of price discrimination, with the reult of destroying competition and creating monopolies.'*[5]

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[2] Patman W.,Complete guide to the Robinson-Patman Act, Prentice Hall Inc, 1963
[3] Ibid Page vi
[4] Ibid Page 1
[5] Ibid Page 6

- *'The House Committee on the Judiciary, in reporting H.R.8442 (the Patman Bill) stated "....Discrimination in excess of sound economic differences between the customers concerned, in the treatment accorded them, involve generally an element of loss, whether only of the necessary minimum of profits or of actual costs,* ***that must be recouped from the business of customers not granted them."***[6] (Our emphasis – placing those other customers at a competitive disadvantage)

- *From the same House Report, "...The existing law* (without the prohibition) *has in practice been too restrictive in requiring a showing of general injury to competitive conditions in the line of commerce concerned, whereas the more immediately important concern is in injury to the competitor victimised by the discrimination.* ***Only through such injury can the larger, general injury result.*** *Through this broadening of the jurisdiction of the Act, a more effective suppression of such injuries is possible and the more effective protection of the public interest at the same time is achieved."*[7] (Our emphasis)

- *'In short, the effects on competition to be questioned are the long-range effects. Although it is obvious that consumers may temporarily enjoy lower prices in the areas where discrimination takes place, and the competition may appear active and vigorous, the question to be answered is whether the long-range effects will be a substantial disappearance of competitors and, presumably, a substantial lessening of competition.'*[8]

- *The Grocery Industry Group I Rules published by the Federal Trade Commission January 16, 1929 contained the following elaboration on the typical trade-practice conference prohibition of secret rebates and allowances:*

  "Rule I. Whereas it is essential in the interest of the trade and the consuming public that the production and distribution of grocery products be conducted in accordance with sound principles of economics and justice, in order to afford an equal opportunity to all manufacturers and merchants and to secure effective competition in serving the public: Be it Resolved, That (1) terms of sale shall be open and strictly adhered to; (2) secret rebates or secret concessions, or secret allowances of any kind are unfair methods of business; (3) price discrimination that is uneconomic or unjustly discriminatory is an unfair method of business."

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[6] Ibid Page 9
[7] Ibid Page 9-10
[8] Ibid Page 59

'Of course prior to 1936,all responsible functioners in the food industry tried to practice these fair rules of the game, but their high hopes and good intentions were frustrated by the incessant coercive influence of mass buyers in all the market places.'[9]

- *Among unfair business practices, price discrimination most directly denies to small business an equal opportunity to live and grow on the basis of efficiency. Such opportunity is the very essence of the competitive economic system which our antitrust laws seek to preserve, maintain and restore.*

  That small business has survived or even grown despite price discrimination is of no relevancy when offered as evidence that price discrimination is not destructive of small business. What is relevant, but what must remain unknown until price discrimination is eliminated, is how successful small business can be when their larger rivals cannot exercise their monopolistic power to grant and receive price discriminations. Small business is entitled to the opportunity of showing what it can do in absence of the crippling handicap of discriminatory prices. Continued enforcement of the Robinson-Patman Act will ensure that small business is granted that opportunity.'(from a report submitted by the federal Trade Commission to the chairman of the Select Committee on Small Business, United States Senate, February 21,1952)[10]

- *'Price discrimination favouring preferred buyers presents a danger to the competitive enterprise system which is inconsistent with the policy of the price discrimination statute. Firms can abuse their superior market position and engage in discriminatory practices that eliminate small suppliers and small retailers from the competitive scene.' (conclusion of the House Committee on the Judiciary in 1956)*[11]

- *'In conclusion, it is clear that Members of Congress and other public officials are faced with the problems of weighing those arguments for and against the practice of price discrimination. Congress has done that in the past on the basis of an abundance of factual information and has found that the effects of price discrimination are substantially to lessen competition and to create monopolies. In other words, Congress has found the practice of price discrimination to be anti-competitive – and it has done so on each occasion when it studied the details of the factual information about the practice of price discrimination. These legislative findings have been made despite arguments by the advocates of price discrimination that it is a form of*

[9] Ibid Pages 107-8
[10] Ibid Page 200
[11] Ibid Page 206

competition and that the Robinson Patman Act and other similar legislation are antidiscriminatory....'[12]

The above quotes appear to have some resonance with our current competitive situation.

We note that the US is still enforcing the Robinson-Patman Act as shown by the following extract from the FTC Guide on anti-trust law. Note that the advice makes it clear that there are many form of legal price discrimination, it is only discrimination of the anti-competitive type that is illegal.

AN FTC GUIDE TO

PRICE DISCRIMINATION AMONG BUYERS

ROBINSON-PATMAN VIOLATIONS

A SELLER CHARGING COMPETING BUYERS DIFFERENT PRICES for the same "commodity" or discriminating in the provision of "allowances"—compensation for advertising and other services—may be violating the Robinson-Patman Act. This kind of price discrimination may give favored customers an edge in the market that has nothing to do with their superior efficiency. Price discriminations are generally lawful, particularly if they reflect the different costs of dealing with different buyers or are the result of a seller's attempts to meet a competitor's offering.

The prohibition of anti-competitive discrimination was taken up by the Treaty of Rome in 1957 (and subsequent versions) which set up the Common Market and later the European Union – See Article 85 1.(d) below:

ARTICLE 85

1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decision by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

[12] Ibid Page 208

It has its parallel in UK competition law (Competition Act 1998):

The prohibition

2 Agreements etc. preventing, restricting or distorting competition.

(1) Subject to section 3, agreements between undertakings, decisions by associations of undertakings or concerted practices which—

(a) may affect trade within the United Kingdom, and

(b) have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom,

are prohibited unless they are exempt in accordance with the provisions of this Part.

(2) Subsection (1) applies, in particular, to agreements, decisions or practices which—

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The prohibition

18 Abuse of dominant position.

(1) Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.

(2) Conduct may, in particular, constitute such an abuse if it consists in—

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.

The above clauses dealing with anti-competitive agreements and with abuse of market power both make specific mention of anti-competitive price discrimination. We do not see that parallel in the Australian *Competition and*

Consumer Act 2010, since s 49, the section dealing with this form of anti-competitive conduct in the *Trade Practices Act 1974* was repealed in 1995 with the result that this type of anti-competitive conduct has flourished, while the regulator has never taken a single case against alleged anti-competitive price discrimination under either s45 or s46. Hilmer had argued in his 1993 *National Competition Policy* report that s49 was not needed because s45 and/or s46 would do the job. History has shown that under an indolent regulator, neither will do so. The parliament repealed s49 on Hilmer's flawed recommendation but has never conceded that anti-competitive price discrimination was acceptable conduct.

Canada's *Competition Act* makes its purpose quite clear and does not shy away from support of SMEs as a means of maintaining a competitive market:

> **1.1** The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

The Canadian act refers to anti-competitive price discrimination as follows:

Delivered pricing

81 (1) Where, on application by the Commissioner, the Tribunal finds that delivered pricing is engaged in by a major supplier of an article in a market or is widespread in a market with the result that a customer, or a person seeking to become a customer, is denied an advantage that would otherwise be available to him in the market, the Tribunal may make an order prohibiting all or any of such suppliers from engaging in delivered pricing.

Definition of *delivered pricing*

80 (1) For the purposes of section 81, ***delivered pricing*** means the practice of refusing a customer, or a person seeking to become a customer, delivery of an article at any place in which the supplier engages in a practice of making delivery of the article to any other of the supplier's customers on the same trade terms that would be available to the first-mentioned customer if his place of business were located in that place.

We conclude from the above that anti-competitive price discrimination is a practice that is viewed as deleterious to competition by competition regulators generally as it is injurious to competition, not just competitors.

The fact that price discrimination hurts large businesses was made clear during evidence given to the Committee by dairy industry suppliers who were obviously being disadvantaged by the low prices that they themselves had agreed to.

We do not understand the opposition by some to the re-introduction of such a prohibition as, by definition, the ***only type of price discrimination that is prohibited by such a clause is one that is anti-competitive.*** In other words, companies that are behaving ethically and fairly have nothing to fear.

The current debate over milk pricing

Australia's Competition and Consumer Act 2010 has Sections 45 and 46 that deal with anti-competitive agreements and abuse of market power respectively. The question is whether anti-competitive price discrimination is seen as illegal under either Section 45 (because it is based on an agreement that is anti-competitive) or under Section 46 (because it is based on the abuse of market power – maybe even unconscious abuse[13] – i.e. abuse that results from the unconscious power due to sheer size.).

The problem here is that even if the answer to either question were 'yes' both Section 45 and 46 are relatively difficult to enforce, requiring evidence of a substantial effect on competition (which itself is undefined in the Act). Of course once the effect on competition emerges, the damage has already been done.

We do not know whether the behaviour of the major chains and their suppliers in the case of milk prices are in breach of either Section 45 or 46 as no assessment of the relevant facts has been made public by the ACCC.

Investigations of the Coles changes to milk pricing were initiated under the previous Chairman of the ACCC and concentrated on the 'straw man' of predatory pricing and the validity of the Coles 'Down, Down' campaign with the only conclusion in the public domain being the obvious one, that there had been no breach of the law in relation to predatory pricing or misrepresentation.

We also know that all Coles did (followed by Woolworths) was to reduce the price of their private label milk from $1.09 per litre to $1.00 per litre. The evidence appears to be that at the time Coles' purchase price of milk had not changed.

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[13] The two major grocery chains represent such a large proportion of the market that a supplier cannot afford to lose the volume of business associated with either. The tendency is therefore to accommodate them in any way possible, even to the extent that doing business with them could incur a loss. The alternative would involve a greater impact on the business due to losses in economies of scale. Losses on the business dealings with the majors are compensated for by higher prices elsewhere, either for the same goods or for other goods the supplier provides to the sector generally.

The retail price drop was not great, but the subsequent promotion of that drop – including an initial claim that the decrease had been more substantial – has seen a substantial shift from branded milk to private label milk and from smaller retailers (e.g. convenience stores and route trade) to the major chains, to the extent that the overall supplier profitability of milk sales has been affected. So obviously there has been an impact on the market and on competition.

The basic questions that have not been answered include:

- Is the low price the major chains pay for private label milk a result of their market power or its abuse?
- Is the agreement between the suppliers of private label milk and the major chains anti-competitive?
- Did the ACCC in its assessment of compliance with Section 46 of the Act take note of 46 (7)

(7) Without in any way limiting the manner in which the purpose of a person may be established for the purposes of any other provision of this Act, a corporation may be taken to have taken advantage of its power for a purpose referred to in subsection (1) notwithstanding that, after all the evidence has been considered, the existence of that purpose is ascertainable only by inference from the conduct of the corporation or of any other person or from other relevant circumstances.

The benefits of a specific prohibition on anti-competitive price discrimination are many. Such a prohibition:

- Makes it clear to business that this type of behaviour is clearly illegal – without the need to parse the intricacies of Sections 45 and 46. (It is for that reason that other jurisdictions include this specific prohibition.)
- The evidence for a prosecution (or injunction) is relatively easy to obtain – the parties need to be able to justify any pricing differential and an outside affected party can lodge a complaint.
- Both parties, the supplier and the purchaser, are liable under law, enhancing likelihood of compliance.
- Suppliers will have a mechanism that can be used to negate unrealistic pricing demands from larger customers – demands which, if acceded to will either damage their viability or require them to increase prices to other customers.

The final question then is whether the reintroduction of a prohibition on anti-competitive price discrimination will help the dairy industry (and other sectors in a similar position).

Another way of addressing this question is to ask how, under current law, a supplier can resist the pressure from the major chains for lower prices without risking the relationship and potentially losing the sales involved? Note here that we have seen in the case of the dairy sector that private label milk prices are so low as to be unprofitable and to have an impact on prices charged to others.

It is our contention that, armed with a prohibition on anti-competitive price discrimination, the dairy sector is better able to resist unrealistic pricing pressures. This may mean higher priced private label milk (unless the major chains are prepared to reduce their own margins), but could mean lower prices for dairy products generally and a more competitive grocery market in the longer term.

Please contact me should you need any further information.

Yours sincerely,

Ken Henrick
Chief Executive Officer