SUPPLEMENTARY SUBMISSION

Senate Economics References Committee

Inquiry into the impacts of supermarket price decisions on the dairy industry

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Introduction

In our original submission to this inquiry, we discussed the Hilmer Committee's recommendation to repeal the original Section 49 of the then *Trade Practices Act 1974*, dealing with anti-competitive price discrimination and referred to similar recommendations made by the Swanson Committee[1] (1976) and the Blunt Committee[2] (1979) which were referred to in the Hilmer Committee report on National Competition Policy (1995).

Note that the recommendations of both Swanson and Blunt that s49 should be repealed were rejected by the governments to which they reported. Although changes were made to the Act after the Swanson report, the section was retained because, as indicated in the second reading speech 'as being in the interest of assisting the competitive position of small business' (Blunt 10.17)

We have since had the opportunity to read the reports of the Swanson and Blunt Committees, which provide an insight into the thinking at the time.

The recommendations to repeal the prohibition on anti-competitive price control were not straightforward or based on convincing evidence that s49 had failed.

It is fair to say that neither Swanson nor Blunt came to grips with the key issues, largely, perhaps, because regulators had failed to enforce s49 and thus had not given the courts opportunities to define the law for industry and consumers.

Regulators in other developed economies seem to have no such problems and the existence of prohibitions on anti-competitive price discrimination is rarely, if ever, challenged in other jurisdictions.

In relation to s49, vested interests in Australia argue against what has been for decades standard practice in almost every other developed economy in the world.

The following comments on the Swanson and Blunt reports are pertinent:

- Both reports make comparisons between s49 of the *Trade Practices Act* and the US *Robinson-Patman Act* of 1936. Neither Committee mentioned that an anti-competitive prices discrimination prohibition was part of the *Treaty of Rome 1957* that formed the basis of what is now the European Union (which continues to enforce a prohibition on anti-competitive price discrimination), nor that it was law in Canada and elsewhere at the time.
- Both remarked that s49 was not well understood by the business community, and that the lack of understanding was the cause of some of the problems experienced after it came into effect.

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[1] Trade Practices Act Review Committee – Report to the Minister for Business and Consumer Affairs, August 1976

[2] Report of the Trade practices Consultative Committee – Small Business and the Trade Practices Act, Volume 1, December 1979.

- Both confirmed that there had been little litigation [in fact none to that time] in relation to s49, so there had not been the opportunity to see its impact on competition in practice.

The Swanson Committee

- Failed to acknowledge that a form of prohibition on price discrimination was part of the previous *Trade Practices Act 1965,* (Section 36 (1) (a) and Section 36 (2)) and that the then regulator had taken no action during the period of its operation.
- Received many submissions, some in support of its repeal and others asking for it to be strengthened. Some suggested that it should '*only be retained in specific circumstances, such as where the seller was so powerful as to be able to impose upon buyers discriminatory terms to which the buyers had no alternative, or where the buyer was so powerful that he could extract such terms'.(7.1)*
- The Swanson report said: *After February 1975, when s49 came into effect, some suppliers, either through ignorance or desire to do so, took the law to mean that they were required to charge similar prices to all customers or at least to competing customers. This led to price rigidity, which is the subject of comment by a number of submissions, and the reduction in or abolition of many discounts which in turn resulted in overall price increases....Apart from that initial round of increases of price, the Committee is unable to determine what the net effect has been since that time of the operation of this section on prices. (7.12)* (Note that the Act had been in effect for a little over a year.)
- Paragraphs 7.14 and 7.15 give hypothetical examples of suppliers who would be disadvantaged by a price discrimination prohibition – the cases of a supplier with surplus capacity and a manufacturer who wishes to expand production – who are hypothetically disadvantaged by not being able to move stock by dropping the price to some (although not all) of their customers. It is not explained why these suppliers could not benefit by temporarily cutting their price across the board: that is, the examples do not reflect a real world situation.
- The Committee concluded:
    - *....in the Australian context the conduct of a large buyer who is endeavouring to secure price cutting in his favour, whether it be discriminatory or not, may be more pro-competitive than anti-competitive. Indeed such price cuts as a large buyer is able to obtain can trigger off competition from rival suppliers or can trigger off competition in a market, where other forces are unlikely to produce active competition. (7.20)*
    - *.....The Committee believes that in the Australian context, section 49 has produced such price inflexibility that the detriment to the economy as a whole from the operation of the section outweighs assistance which small business may have derived from it. It is price flexibility*

which is at the very heart of competitive behaviour. The Committee thus recommends that section 49 be repealed. (7.21)

Note that other jurisdictions operating within price discrimination laws do not appear to have a problem with 'price inflexibility' and that Swanson concluded there had been little benefit for small business, yet the regulator had not taken a single case between 1965 and 1976.

The Blunt Committee

- Reviews the pre-1974 history of price discrimination and reports that, under the previous 1965 Act, section 36 operated to prevent anti-competitive conduct of purchasers and suppliers. (10.2) Again, it appears that the regulator was missing in action and/or did not understand the law as it than stood:

> *'It is difficult to gauge the effectiveness or adequacy of these principles at this late stage. There were no reports of any action being taken under paragraph 36 (1) (a) during its operation. However, an extract from the Third Annual Report of the Commissioner of Trade Practices (1970) may give some indication as to how the provision was viewed:*
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> > *"My office has had no complaints from suppliers about threats or promises from a powerful buyer; presumably suppliers are glad to have the business. The smaller competitor of the powerful buyer is hardly in a position to complain either. He does not know what pressures, if any, the powerful buyer has used on the supplier. He may know that he is not able to buy as well, but probably accepts that the reason is the smaller size of his orders. The section leaves the supplier free to give discriminatory terms if he wishes."(10.3)*

The Commissioner was incorrect in that genuine economies of scale are permitted in jurisdictions which have prohibitions on anti-competitive price discrimination. Further, pro-competitive price discrimination is not caught. In any case, a lack of complaints does not necessarily entail "gladness".

The ACCC's grocery inquiry report of 2008 noted[3]:

> *The inquiry was provided with little evidence to substantiate allegations of buyer power being exercised in an anti-competitive or unconscionable manner. Having said that, however, there were some complaints of buyer power being exercised where the complainant appeared to be genuinely*

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[3] Australian Competition and Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries,* 2008, p. 357, 15.11

reluctant to provide information to the ACCC out of concern about retribution if details were provided to the ACCC and investigated.

By 2008, the major supermarket chains had developed the duopsony which now threatens to put at risk the viability of the Australian dairy industry. Reintroduction of a prohibition on anti-competitive price discrimination would go a long way towards preventing that, assuming vigorous enforcement by the regulator, a circumstance for which, admittedly, there is no precedent in Australia.

- Blunt criticises s49 through reference to criticisms of the US *Robinson Patman Act* even though it is less restrictive than the US act. Blunt repeats a criticism by Prof Breyer of the Harvard Law School, who suggested that prohibition of price discrimination was more damaging in a concentrated economy such as Australia – and that there was a *'strong move afoot'* to repeal the US equivalent – which has not happened 35 years later!
- Rather paradoxically Blunt then quotes Breyer as follows *'....Economic theory suggests that firms in such (concentrated) industries often do not compete in price, rather they tend to fix prices above competitive levels, fairly secure in the knowledge that each firm will forego the short-run advantages of a price cut for fear that all its competitors will rapidly match its lower price, preventing it from attracting new customers.' (10.8)*

Note that this is the current situation in the Australian grocery sector – market sharing, rather than competition.

- Blunt again confirms that enforcement was lacking: *'The Trade Practices Commission has indicated that section 49 is an area which it left largely to private action prior to 1977. .....The Commission has dealt with the topic of price discrimination at length in its (1979) Fifth Annual Report. "There have been no Commission proceedings in Court, and no private actions have come to hearing. The Commission has received since the Act commenced some 180 complaints about alleged price discrimination, with well over half coming from individual small businesses who typically believe that a larger outlet nearby is getting a better deal from a common supplier. Often the suspicions of the better deal in purchase is brought about by the larger outlet selling at lower prices. The complaints have come from the full range of typical small businesses. Sometimes quantity discounts do not appear to be out of line with likely economies of fewer deliveries and larger drops per delivery. Sometimes the particular market appears to be such that competition is unlikely to be substantially lessened which is a requirement before the section is breached. Most of the complaints were not taken any distance because on the facts available there appeared to be no chance of their coming within section 49. Some were really complaints about the presence of competition." (10.20)*
- Blunt goes on to explain price discrimination and concludes that it *'may be desirable or undesirable depending on its effects on competition'(10.34)*

- Blunt goes on to explain that, unlike the US *Robinson Patman Act,* the section is not normally concerned with damage to an individual competitor: *'For this reason, it is possible and consistent with the thrust of the section for a competitor occupying a small share of a large market, to be completely eliminated by means of discriminatory conduct, because that discrimination may not be of such magnitude or of recurring or systematic character which would be sufficient to have the likely effect of substantially lessening competition in the whole market' (10.39)... 'This requirement of damage to competition and not to individual competitors highlights a major difference between section 49 and section 2 of the US Robinson Patman Act' (10.40)*

Which helps explain why (apart from regulators' lassitude) the then section 49 did not do much to help small business in Australia during its currency and suggests that objections against that section on competition grounds were unfounded.

- The Blunt Committee canvassed a proposal for some form of administrative process which would allow the then Trade Practices Commission to rule on pricing and remove uncertainty (and hence price rigidity) but concluded that this would be too onerous for the Commission. (10.55 et al)
- Paragraph 10.59 suggests that price discrimination will only have anti-competitive effects *'if it makes entry or continuance in a particular market unprofitable for participants disadvantaged by the discrimination'* but suggests that an investigation to determine this would be *'would impose a substantial burden on the resources of the Trade Practices Commission'....and 'doubt that such a use of resources would be warranted' (10.59)*

We wonder whether small business would have come to such a conclusion.

- This is answered in paragraph 10.64: *'Arguments put forward by small business interests indicate that they view section 49's retention as vital for their survival and that the section should be 'strengthened' so as to allow, at least initially, some equality between competitors regardless of their respective market share and power.'*

How else would they compete?

- Blunt highlights the difference between the early form of the *Robinson Patman Act* and the *Clayton Act* which preceded it. The latter, which was found ineffectual, focussed on damage to *competition* as did section 49. The former added potential for injury to competitors – which is necessary in order to have a competitive market.
- The Committee then concludes in 10.111 that *'....section 49 is not capable, in practice, of having the effects sought, because of doubts by business as to its interpretation, as well as inconsistencies with other provisions in part IV of the Act. Its anti-competitive inflationary effects are undesirable. These difficulties cannot be overcome by redrafting.'*

It appears that the Committee confused the impact of s49 (unenforced) with the impact of a lack of understanding of s49. Nowhere is evidence presented to support any anti-competitive effects of s49. All other OECD countries which have such provisions seem to have been able to educate their business sectors as to the meaning of anti-competitive price discrimination. The taking of cases by a vigorous regulator would, perhaps, be highly educational - both for industry and the regulator.

The committee's recommendation for the repeal of s49, absent any recommendation as to what other changes could be made to the Act to assist the competitive position of small business, is hard to explain given that its brief was to review the Act in the context of small business. Why would one of the Committee's recommendations be the removal of the Act's most important provision protecting the competitive position of small business?

Conclusion

The history of the regulation of anti-competitive price discrimination in Australia reveals regulatory indolence over almost fifty years.

Over this period every OECD country has included in its trade practices regime specific mechanisms which 'level the playing field' for business and in so doing providing a platform for the type of competition that advantages the final consumer. It is clear from the overseas experience that two key elements of such a platform are a prohibition against anticompetitive price discrimination (expressed as *'applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage'*[4]) and a prohibition against predatory pricing activity *('directly or indirectly imposing unfair purchasing or selling prices or other unfair trading conditions'*[5]) and other abuses of a dominant position in a market. We should note here that a prohibition against predatory pricing is rendered ineffective in the absence of a prohibition against price discrimination because a buyer with substantial market power can purchase a product at a price so low that it can be on-sold at such a low price as to be anti-competitve without being 'below relevant cost'.

The recommendations of the Swanson and Blunt Committees to repeal s49 were based on both lack of understanding of business competition and the confusion of some parts of the business sector - including some small businesses - about the actual meaning and significance of the prohibition on anti-competitive price discrimination. And there appeared to have been a reluctance to either educate business or oblige regulators to implement the legislation it was their duty to administer.

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[4] Competition Act 1998 UK, 2 (2) (d)
[5] Competition Act 1998 UK 18 (2) (a)

As a consequence, Australia now has the most concentrated grocery industry in the world and a dairy industry that is at great risk of permanent damage because of the actions of one major supermarket chain.