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Competition in the Australian Grocery Industry

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I. INTRODUCTION

Competition in the Australian grocery retail industry has been a focus of Australian media, politics, and regulatory activity for several years. Given that the actions of Australia's largest grocery retailers have a significant impact on small business, primary producers, and consumers, Coles and Woolworths have been subject to increasingly strident criticisms about their perceived dominance of the industry, allegations they “strong-arm’ suppliers,” and the flow on effects these actions have on smaller competitors and customers’ hip pockets at the checkout.

This article describes the dynamics of the industry in Australia, details the competition concerns, and outlines how the Government and the Australian Competition and Consumer Commission (“ACCC”) have responded to these concerns running just about every play from the antitrust enforcement playbook.

In summary, antitrust issues have revolved and—to some extent—continue to revolve around:

- market concentration and the cumulative competitive impact of a series of apparently individually benign acquisitions of existing supermarkets by Coles and Woolworths—so-called “creeping acquisitions,” leading to calls for legislative amendment;
- barriers to competitive entry in the form of restrictive provisions in supermarket shopping center leases entered by the major players—the ACCC has put an end to such provisions;
- the “price wars” by the two major supermarket retailers, in particular in respect of milk, and the likely long-term competitive effect that product-specific discounting has on the supply chain;
- the increase in the sale by major supermarkets of “private label” goods—which now account for more than one-quarter of the grocery sector and the contemporaneous shrinkage of shelf space, as well as disappearance of notable brands and brand diversity;
- negotiations between each of Coles and Woolworths with their suppliers and concerns about the major supermarkets engaging in unconscionable conduct, with the result that this year the ACCC commenced proceedings against Coles for unconscionable conduct; and

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- calls for regulatory oversight from the ACCC in relation to supermarkets' negotiations with suppliers; for example, through a voluntary code of conduct to apply to the sector.

II. THE AUSTRALIAN GROCERY SECTOR

The retail grocery industry in Australia is concentrated by international standards, with the two major vertically integrated retailers accounting for approximately 70 percent of the total supermarket/grocery market. Those two players are Woolworths, owned by Woolworths Limited, a publicly listed company, which has additional interests in liquor, fuel, and hardware retailing and Coles, owned by Wesfarmers, a listed conglomerate that owns companies in a range of different sectors. In addition to the major players, there are other relatively new overseas entrants in the market such as the German-owned ALDI and the U.S. giant Costco, and a range of independent supermarkets including a large number operating under the “IGA” brand.

In the last decade, the industry has witnessed some significant developments, including the entry of ALDI and Costco as well as fierce “price wars” between Coles and Woolworths on staples such as milk. ALDI has been successful in entering the market and challenging industry norms, securing a 10 percent share since its entry in 2001 with over 300 stores on the east coast of Australia; it plans to launch over 100 stores more in South Australia and Western Australia. Besides its aggressive pricing strategies, the best example of the shake-up that ALDI has caused is an increased consumer acceptance of private label products, which has resulted in Woolworths and Coles significantly increasing their production and sales of these types of products. IGA stores and other smaller players in the market (for example, SPAR) have had more limited success in competing and pressuring the major players in the market.

III. THE ANTITRUST ISSUES: *The Grocery Inquiry, Restrictive Provisions in Supermarket Leases, and the Metcash Debacle*

In July 2008, the *Report of the ACCC Inquiry into the competitiveness of retail prices for standard groceries* was published as the result of an inquiry conducted at the request of the then Minister for Competition Policy & Consumer Affairs. That review found that while there are limitations on competition within the industry, the industry is “workably competitive.” There were, however, two key results coming from that review.

One of the competitive limitations noted in the ACCC's Report was high barriers to entry and expansion, particularly to finding new sites for development. Restrictive provisions in supermarket leases played a key part. As Coles and Woolworths had “must have” status for shopping center owners, they were in a powerful position to dictate the terms of their leases and require provisions that effectively precluded center managers from leasing space to competing supermarkets. The ACCC worked with Coles and Woolworths and, in 2009, each major supermarket “voluntarily” provided the ACCC with court enforceable undertakings not to include restrictive provisions in new supermarket leases and not to enforce restrictive provisions in existing supermarket leases five years after commencement of trading. This has arguably reduced the barriers to entry for new or expanding supermarket chains and facilitated the expansion of international supermarket chains such as Aldi.

Another competitive limitation noted in the ACCC's 2008 Report was the limited price competition faced by Coles and Woolworths from independent supermarkets, with the ACCC determining that a key was the wholesale prices of packaged groceries supplied by the wholesaler

Metcash, which supplied the independent stores operating under the IGA brands. That determination led indirectly to what might be called the Metcash debacle.

Rather than perceiving Metcash as having critical bargaining power with suppliers, allowing the independent IGA stores to compete with Coles and Woolworths, the ACCC perceived Metcash as inhibiting the ability of independent supermarkets to price competitively. When Metcash later sought to acquire Franklins, a New South Wales based wholesaler and grocery retailer, the ACCC attempted to oppose that acquisition—arguing that the relevant market about which the competitive effect of the merger needed to be considered was the wholesale supply of packaged groceries to only *independent retailers* in a defined territory, and that Franklins competitively constrained Metcash in this narrowly defined industry.

By one view, the ACCC at that stage was ignoring the elephant in the room—the constraining role of Coles and Woolworths. The Federal Court and, on appeal, the Full Federal Court spotted the elephant. In its judgment, the Full Federal Court upheld the Trial Judge's finding that the acquisition by Metcash of Franklins stores would not have the likely effect of substantially lessening competition, because Coles and Woolworths also acted as competitive constraints on Metcash. Arguably that acquisition would, in fact, prevent the Franklins stores from being cherry-picked by Coles and Woolworths.

IV. LIFE AFTER THE GROCERY INQUIRY AND THE METCASH DEBACLE

Two concerns that have lingered following the Grocery Inquiry and the Metcash debacle are concerns that the major supermarkets squeeze suppliers and that they eliminate smaller rivals. These are, of course, only competition concerns if they have an effect of substantially lessening competition in the longer term.

As outlined above, it is clear that Coles and Woolworths hold a large share in the grocery retail industry. Australia has a (relatively) small population of 23.5 million with the majority of Australians living in large capital cities. Given Australia's size, highly concentrated markets with few major players are quite common. However, the major players' attempts at growing their footprint and market share has come under heavy scrutiny, with the ACCC making it clear that one of its priorities is to closely limit mergers and acquisitions in concentrated markets, and it has specifically identified the grocery retail sector as one of those sectors.

A. Merger Review

The ACCC reviews a number of acquisitions of existing stores or new developments by Coles and Woolworths each year and analyzes whether those acquisitions or developments will have the effect of substantially lessening competition in a market. Signaling its focus on the grocery sector, the ACCC has attempted to develop merger clearance protocols specifically tailored for Coles' and Woolworths' store development and acquisitions in an attempt to streamline the approval process. In December 2012, the ACCC announced it was trialing a protocol with Coles but was unable to reach agreement with Woolworths.

In the 2012/13 financial year Woolworths increased its store numbers by 25 to almost 900 (and planned to open an additional 28 in the 2013/14 financial year). In the same period Coles increased its store count by 19 to a total of more than 750 (and has opened an additional 11 in the first half of the 2013/14 financial year). Since 2012, the ACCC has reviewed a total of 16

supermarket acquisitions or new developments by Coles and Woolworths. From the start of 2012 to June 2014, the ACCC considered 16 acquisitions by Coles or Woolworths, approving 11 (one on condition that a certain site not be acquired), opposing two, withdrawing two, and leaving one remaining subject to review.

The ACCC has expressed concern that its powers of review in the merger control process are curtailed by the fact that its analysis is limited to assessing the impact of an acquisition or development on a very small market, since, in respect of a store acquisition, the pertinent market is very local. That is, the ACCC is unable to test the combined effect of multiple acquisitions on the grocery sector at large.

The concerns expressed by the ACCC have resulted in calls for legislative change to allow the ACCC to specifically consider “creeping acquisitions.” Critics, including independent retailers, have argued that the competitive harm of creeping acquisitions is that while an individual transaction may not cause harm, the cumulative effect of many transactions is anticompetitive, or will undermine competition in the future and this harm will be difficult to reverse. The ACCC has re-positioned the competitive harm argument of creeping acquisitions to be a concern based on market power (dominance); that is, that acquisitions by a firm that already holds market power will further strengthen this market power which will provide opportunities for that power to be misused.

In its 2008 report on the competitiveness of retail prices for standard groceries, the ACCC rejected concerns that creeping acquisitions had caused competition concerns in the industry, but did support the introduction of a “creeping acquisitions prohibition” to avoid any future issues. In response, the Government released successive consultations papers in 2008 and 2009 calling for public comment on laws to prevent creeping acquisitions. While such a bill was introduced into Parliament proposing amendments to bring about anti-creeping acquisition legislation before the ACCC's Report was published, that bill was never passed.

Some independent members of parliament have sought amendments to competition laws to directly target the substantial market shares of the major supermarkets. One such attempt included a drastic proposal to set maximum market share caps, establish a Commissioner for Food Retailing, and significantly amend the misuse of power (abuse of dominance) provisions of the CCA. However, no substantive legislative amendments have resulted.

B. Concern About Leveraging Power Into Other Sectors

The ACCC has also made clear its concern with Coles' and Woolworths' involvement in other markets, such as liquor and fuel. An example of this is in relation to fuel discounts linked to shopping purchases—so-called “shopper docket discounts.” Coles and Woolworths both offer significant fuel discounts at their branded service stations when customers spend a certain amount at their supermarkets.

The ACCC has expressed concern about fuel discounts offered by the major supermarkets contingent on the past acquisitions of goods from their supermarkets. While fuel discount offers may be in a consumers' short-term interests, the ACCC is concerned that such discounting may ultimately damage other fuel retailers who do not have the scope to balance revenue from different offerings. This could have the long-term effect of tying consumers'

grocery spend to their choice of retail fuel outlet, with the likely effect of lessening competition in the retail fuel market.

After an investigation by the ACCC, in December 2013 each of Coles and Woolworths entered into court enforceable undertakings, which, from the ACCC's viewpoint, were designed to cap discounting at 4 cents per liter. The undertakings preclude the two major supermarket chains from providing a discount on any single transaction of fuel of more than 4 cents per liter contingent on the past acquisition of goods or services from the supermarket.

The saga didn't end with those undertakings. The major supermarkets went ahead and offered fuel discounts of more than 4 cents per liter, but only tied 4 cents of the discount offer to purchases made at their supermarkets (the additional discount being linked to purchases at the retail fuel outlets themselves). Earlier this year the ACCC brought proceedings against both Coles and Woolworths for breach of their undertakings. In all but one instance, the Court found in favor of the supermarkets. In the Judge's view, when the terms and conditions of the Coles and later Woolworths deals were considered, the total discounts could be said to be contingent "only as to 4 cents per litre" on supermarket purchases, with the remainder of the total discounts being contingent on service-station purchases, meaning these offers did not breach the undertakings.

While the ACCC was largely unsuccessful, and perhaps learned a lesson in terms of drafting enforceable undertakings that the courts are prepared to accept, it has still served as a powerful signal that the ACCC will not shy away from prosecuting the major supermarket chains.

C. Relationships With Suppliers

Stemming from their large market shares, Coles and Woolworths have been criticized for the way in which they deal with their suppliers, including both product manufacturers and farmers. These major players have been accused of unconscionable conduct by demanding additional payments from suppliers beyond those negotiated, and by imposing penalties and threatening to remove products from shelves if the suppliers fail to surrender to the retailers' demands. In addition, suppliers have argued that the major supermarkets have favored their own private label products through pricing and other strategies.

These issues and criticisms have developed as a result of a shift in market dynamics caused by competition in the sector. For example, the successful entry of ALDI into the sector, and especially its ability to create consumer acceptance of non-branded products, have prompted Woolworths and Coles to significantly increase their investments in, and offerings of, private label products.

Private label products account for approximately one-quarter of total retail grocery sales. The major supermarkets have publicly announced plans to continue to grow this share. The development, promotion, and heavy discounting of private label products have allegedly come at the expense of suppliers who claim that the major supermarkets discriminate in favor of their own private label products which will cost consumers in the long term as suppliers de-value their products, leading to consolidation and ultimately less choice for consumers.

D. Investigation Into Coles' Social Media Campaign—"Our Coles Brand Milk Story"

Another criticism of the major supermarkets by suppliers is the intensity of product-specific price wars. In the last five years, consumers have witnessed intense price wars between Coles and Woolworths especially in relation to every day household products. One of the most significant and heavily scrutinized price wars between the major supermarkets was in relation to home brand milk, where supermarkets have offered milk for as low as AU\$1 per liter since 2011.

While providing short-term benefits for consumers, dairy farmers have argued that the price wars have come at their expense and have caused an increase in prices of other products (by which the dairy farmers seek to recoup the downward price pressure on milk) and will have long-term negative impacts on competition by driving out smaller players, causing consolidation at the supply level.

E. ACCC Proceedings Against Coles for Unconscionable Conduct

The concerns raised by suppliers have not gone unnoticed by the ACCC. Following an investigation that commenced in late 2011, this year the ACCC commenced legal proceedings against Coles for engaging in unconscionable conduct with its suppliers. The unconscionable conduct alleged concerns Coles' strategy to increase its earnings by obtaining better trading terms with a group of 200 of its smaller suppliers, through a program of ongoing rebates which suppliers pay to Coles in connection with its "ARC program."

It is alleged that the strategy involved Coles providing misleading information about the savings and value to the suppliers of the ARC program, using undue influence and unfair tactics to obtain rebate payments, taking advantage of its superior bargaining position to obtain payment when it had no legitimate basis for payment, and requiring suppliers to agree to the ARC rebates without providing those suppliers time to consider the value of that program to their business. While this litigation relates to one scheme operated by Coles, the ACCC has publicly reported that it has received confidential complaints from a number of suppliers about a range of different conduct of the two major players, which could lead to further legal action.

F. Draft Voluntary Food and Grocery Code of Conduct

In addition to enforcement measures, the ACCC has expressed the view that it sees merit in a legally enforceable supermarket code of conduct, which could enable more effective enforcement of contracts, more appropriate sharing of risk, and allow for more effective dispute resolution.

In late 2013, the Australian Food and Grocery Council, which represents Australia's packaged food, drink, and grocery products manufacturers, announced it had signed a voluntary code with Coles and Woolworths. The code sets out a clear set of principles relating to key aspects of the trading relationship between retailers and suppliers. Calls have been made for the code to be prescribed by the relevant Minister as a voluntary code under the CCA. A supermarket signatory to the Code would then be subjected to the Code and Code breaches would amount to breaches of the CCA, which can be enforced by the ACCC.

V. CONCLUSION

The Australian competition law regime is currently subject to a comprehensive “root and branch” review, one of the terms of reference of which is to examine the competition provisions of the CCA “to ensure they are driving efficient, competitive and durable outcomes” and to specifically consider whether the misuse of market power provisions (our abuse of dominance provisions) effectively prohibit anticompetitive conduct.

The review will no doubt reignite the calls for laws to prevent creeping acquisitions—a number of submissions to the Review Panel published in June this year have called for such laws—and for more effective abuse of dominance provisions. As a result, this remains a “watch this space” issue pending the outcomes of the comprehensive review of competition law in Australia.