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Face-off in the Grocery Aisle: Retailers and Suppliers Go Head-to-Head in Canada

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Face-off in the Grocery Aisle: Retailers and Suppliers Go Head-to-Head in Canada

Mark Katz & Erika Douglas[1]

I. INTRODUCTION

Perhaps more than ever, tensions between suppliers and retailers have become the defining feature of the grocery industry worldwide. These tensions have also frequently formed the basis for interventions (or proposed interventions) by competition enforcement authorities in this sector.

Canada is no exception to this global trend. The Canadian retail grocery industry is intensely competitive, with retailers surviving on razor-thin margins. Not surprisingly, margins and pricing pressure at the retail level have led Canadian retailers to seek relief from suppliers. This has generated considerable tension and also provided the backdrop—or source—for calls for competition law intervention.

In recent months, for example, the Canadian Competition Bureau (the "Bureau") has completed two lengthy merger investigations in the grocery sector where retailer/supplier relations became a key issue of focus. Retailer/supplier tensions have also given impetus to a debate in Canada over how far the Bureau should go in "regulating" pricing conduct in the industry (and more generally), with particular sensitivities raised about the "price gap" between Canada and the United States. Finally, this ongoing dispute has generated the suggestion in some quarters that Canada should follow the U.K.'s lead and adopt a form of "code of conduct" to govern retailer/supplier relationships in the grocery industry. We consider these developments below.

II. MERGER REVIEW: SOBEYS/SAFEWAY AND LOBLAWS/SHOPPERS DRUG MART

A. Sobeys/Safeway

On June 12, 2013, Sobeys Inc. ("Sobeys") announced the proposed acquisition of the following assets from Canada Safeway ("Safeway"):

- 213 grocery retail locations, which included 199 in-store pharmacies and 62 co-located fuel stations;
- 10 liquor stores;
- 4 primary distribution centers and the related wholesale businesses; and
- 12 food-manufacturing facilities.

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Both Sobeys and Safeway were full-line grocers that competed with one another in the retail sale of grocery products. Full-line grocery stores typically carry a wide variety of food items, such as bread and dairy products, refrigerated and frozen food and beverage products, fresh and prepared meats and poultry, produce (including fresh fruits and vegetables), shelf-stable food and beverage products (including canned and other types of packaged products), and staple foodstuffs. Full-line grocery stores typically also carry non-food items, such as household products. At the retail level, many full-line grocery stores also offer additional products or services, either in-store or in a location adjacent to the store. These may include pharmacies, gas bars, and liquor stores.

The Bureau's analysis (as reflected in its public statement regarding the transaction) focused on whether the proposed transaction would (a) provide Sobeys with enhanced market power in the retail sale of grocery products, and/or (b) provide Sobeys with enhanced market power in the wholesale supply of full-line grocery products to independent retailers. With regard to the latter, the Bureau concluded that existing and prospective competition would generally be sufficient to prevent the exercise of market power arising from the proposed transaction. With regard to the former, however, the Bureau concluded that the proposed transaction would lead to a substantial prevention or lessening of competition in the retail sale of a full-line of grocery products in several markets in Western Canada. Sobeys agreed to divest 23 retail stores to resolve the Bureau's concerns.

Although supplier issues do not appear to have been at the core of the Bureau's analysis of the Sobeys/Safeway transaction, these issues soon gained prominence in the transaction’s aftermath. According to media reports, shortly after closing the Safeways deal, Sobeys dispatched letters to its suppliers with several demands, including a one percent retroactive price reduction and a freeze on price increases in 2014. Our understanding is that this step generated complaints to the Bureau, thereby adding to the growing contentious atmosphere surrounding retailer/supplier relations in the Canadian grocery industry.

B. Loblaws/Shoppers Drug Mart

While the Bureau was investigating the Sobeys/Safeway transaction, it was also examining another major merger affecting the grocery sector, the proposed acquisition of Shoppers Drug Mart Corporation (“Shoppers”) by Loblaw Companies Limited (“Loblaws”).

Loblaws is Canada's largest retail grocery chain. Shoppers was Canada's largest drugstore chain. Loblaws announced on July 14, 2013 (one month after the announcement of the proposed Sobeys/Safeways transaction) that it proposed to acquire all of the outstanding common shares of Shoppers for a total purchase price of CDN$12.4 billion. The merged entity would have approximately 2,738 stores and 1,824 pharmacies across Canada.

On March 24, 2014, the Bureau announced that it had entered into a Consent Agreement with Loblaws to remedy its concerns about this proposed acquisition. These concerns focused on two theories of competitive harm: (i) that Loblaws would be able to exercise market power in its retail operations which could lead to higher prices for consumers, and (ii) that Loblaws would become the largest purchaser of many of the overlapping products sold by both companies and could use its buying power to disadvantage suppliers.

To address the Bureau’s concerns about horizontal market power, the Consent Agreement required Loblaws to divest 18 retail stores and 9 pharmacies within Loblaws stores to an independent operator. To address the Bureau's concerns about the exercise of buyer power, the Consent Agreement also imposed restrictions on Loblaws’ agreements with suppliers insofar as they related to products affected by the transaction.

In the latter regard, the Bureau was particularly concerned with Loblaws’ programs/agreements that require suppliers to compensate Loblaws on the basis of lower prices advertised by competing retailers for those suppliers' products. The Bureau determined that, given Loblaws’ market position following the transaction with Shoppers, the continued operation of these programs/agreements would likely lead suppliers to charge competing retailers higher prices for specific products, thereby preventing/lessening competition for those products at the retail level and resulting in higher retail prices for consumers.

There were two specific types of Loblaws’ programs/agreements that concerned the Bureau in this regard, one called the "Ad Collision Program" and the other known as the "Threshold Deal.”

- The “Ad Collision Program” refers to Loblaws’ programs or policies under which Loblaws requests financial compensation from a supplier “on the basis that Loblaws has identified a product in another retailer's flyer promotional materials that is advertised or promoted at a lower retail price than the same product is advertised or promoted in Loblaws' flyer promotional materials within the same or an overlapping time period.”
- The “Threshold Deal” is similar in concept to the “Ad Collision Program” except that the compensation to be paid by the supplier to Loblaws is based on a pre-determined amount or formula that is designed to ensure that “Loblaws achieves a stated [i.e., minimum] margin for the volumes of its sales as affected as a result of Loblaws adjusting its price based on the flyer promotional price of another retailer.”

The Bureau was concerned that, by effectively making suppliers financially responsible for the competitive pricing decisions of other retailers, these Loblaws’ programs/agreements would increase the incentives of suppliers to influence upwards and impose restrictions on competing retailers' pricing decisions to the detriment of competition. For example, the Bureau believed that, in this context, these Loblaws’ programs/agreements would: incentivize suppliers to penalize competing retailers for vigorous price competition, diminish supplier incentives to continue to offer promotions to competing retailers, and align supplier interests with Loblaws to increase wholesale prices to competing retailers.

The Bureau was also concerned with the impact on smaller suppliers of certain other compensation requirements imposed by Loblaws:

- **Fill Rate Penalties**: Financial charges levied by Loblaws on suppliers for “short deliveries” (i.e., when suppliers failed to achieve established "fill rate" standards by only delivering a percentage of the quantity ordered by Loblaws over a certain period of time).
- **Supply Chain Fees/Penalties**: Financial penalties levied by Loblaws on suppliers for failing to achieve defined supply chain logistics standards.

- **Other Financial Requirements**: Obligations on suppliers to reduce the current costs of products or to provide other types of non-promotional financial commitments.

The Consent Agreement imposed the following restrictions on the various Loblaws supply programs/agreements described above:

- Loblaws cannot, for a period of five years, enter into a Threshold Deal for specified categories of products sold at both its Loblaws and Shoppers stores.
- Loblaws cannot, for a period of five years, enter into any new Threshold Deal; amend or renew any pre-existing Threshold Deal; or require or induce any supplier to enter into, amend, or renew a Threshold Deal, for all other products to be sold in Shoppers stores. Loblaws is also prohibited for a period of five years from including the volume of products purchased from a supplier for sale in Shoppers stores when calculating any financial compensation it may be owed under Threshold Deals applying to other parts of its business.
- Loblaws cannot, for a period of five years, apply its Ad Collision Program in respect of purchases of products for its Shoppers stores.
- Loblaws cannot, for a period of two years, charge Fill Rate Penalties to any suppliers that, during Loblaws' previous fiscal year, supplied products to Loblaws at a total cost of less than CDN$4 million ("Exempt Suppliers").
- Loblaws cannot charge Supply Chain Fees/Penalties to any Exempt Supplier for a period of two years.
- Loblaws cannot require Exempt Suppliers, for a period of two years, to reduce the current cost of a product or to pay any other non-promotional financial commitment, unless this is related to a reduction in the Exempt Suppliers' cost of producing the product or is intended to ensure that Loblaws pays the same wholesale price for the product across its business.

Finally, the Consent Agreement obliged Loblaws to ensure that all of these programs/agreements are provided or made available to suppliers in writing, and to confirm with suppliers which programs/agreements apply to them.

The Bureau's approach to the Loblaws/Shoppers Drug Mart transaction is interesting for two reasons:

1. The Bureau's typical remedy for merger transactions is to require the divestiture of assets (as it did in this case). It is less common for the Bureau to impose "behavioral remedies" such as remedies governing the types or terms of supply programs/agreements. However, it is apparent that the Bureau's approach in this case was influenced by complaints it received from suppliers about the impact of the proposed Shoppers acquisition on their future dealings with Loblaws and Shoppers.
2. The Bureau's announcement also reflects the recent interest by other competition authorities in the competitive implications of "contracts that reference rivals" or "CRRs" (such as the Threshold Deals and Ad Collision Programs at issue in the

Loblaws/Shoppers case). Typically, the potential concern arises where a dominant party with market power uses a CRR either to disadvantage competitors or as a vehicle to collude with competitors. In the Loblaws/Shoppers case, the Bureau's concern was principally with the former, i.e., that the Threshold Deals and Ad Collision Programs would induce suppliers to charge more to Loblaws' competitors (or take other steps harmful to competition between these retailers and Loblaws) in order to avoid having to pay financial penalties to Loblaws.

What is even more intriguing is that the Bureau used the occasion of the Loblaws Consent Order to announce that it is also engaged in a more general investigation of Loblaws' "policies, agreements and conduct relating to pricing strategies and programs with suppliers that reference rivals' prices." Publicly announcing an inquiry is an unusual and surprising step for the Bureau. By doing so, however, the Bureau has signaled that its concerns about retailer/supplier relations in the grocery industry extend beyond the specific circumstances of this one transaction to practices employed more generally in the sector.

III. PRICING ISSUES

A. Price Maintenance

Since 2009, and the repeal of the *Competition Act*'s criminal pricing offenses (price maintenance, price discrimination, predatory pricing, geographic price discrimination, and promotional allowances), the only element of pricing conduct remaining subject to an express prohibition in Canadian law is the civil "reviewable practice" of price maintenance. This provision authorizes the Bureau to seek remedies in a variety of circumstances, including where a supplier "influences upward or discourages the reduction of" the price at which customers re-sell the supplier's products at retail. Significantly, however, the provision only applies if the conduct in question has had, is having, or is likely to have an "adverse effect on competition in a market." The establishment of a competitive effects standard is an important change from the pre-2009 situation, when price maintenance was a *per se* criminal offense.

The shift in Canadian law on price maintenance is consistent with current economic and legal thinking, which recognizes that price maintenance (and other types of previously prohibited pricing conduct) can be pro-competitive and thus should not be automatically prohibited. The switch from a *per se* criminal offense to effectively a rule-of-reason approach was designed to give suppliers more flexibility to impose resale pricing restrictions that previously would have been strictly prohibited, such as minimum advertised pricing ("MAP") policies and minimum retail pricing ("MRP") policies.

This light-handed approach is confirmed by the Bureau's draft enforcement guidelines on the civil price maintenance provision (the "Draft Guidelines"), which were issued for comment in March 2014. The Draft Guidelines identify several scenarios in which the Bureau is likely to take the view that there has been an adverse effect on competition. The common feature of all of these scenarios is that they involve conduct where price maintenance practices are being used to inhibit or exclude competition between competitors. None truly captures the classic unilateral price maintenance scenario in which a supplier is solely interested in controlling the price at which its products are sold at retail.

The liberalized price maintenance laws in Canada are providing another battleground for grocery retailers and suppliers. More and more suppliers (both in the grocery sector and otherwise) are trying to take advantage of the new regime in Canada by introducing programs that limit the freedom of retailers to set pricing as they see fit. Many retailers, in turn, are unhappy with this turn of events, arguing that MAP and MRP policies have constrained their ability to implement competitive pricing strategies and have inevitably resulted in higher prices for consumers. What will be interesting to see is whether these complaints about the negative impact on consumers of Canada's liberal pricing laws will influence the Bureau to "reset" its enforcement stance towards price maintenance in Canada.

B. Country Pricing

Another issue that has aggravated retailer/supplier relations is the so-called question of "country pricing," i.e., the alleged practice by certain cross-border suppliers of charging more for products sold in Canada than in the United States.

Concerns about the gap between Canadian and U.S. pricing have grown in the last several years, spurred on by complaints from consumers and retailers alike. Most notably, the Canadian Senate conducted hearings on the matter that culminated in a report that was issued in February 2013. The Senate reached the tentative conclusion that the segmentation of the Canadian and U.S. markets "reduces competition and allows some manufacturers—even some Canadian ones—to practice country pricing between the Canadian and the American markets, which may contribute to the price discrepancies between the two countries."

The Senate report offered the following recommendations to address the Canada-U.S. price gap: (1) a comprehensive review of Canada's tariffs, (2) continuing efforts to harmonize product standards without compromising safety, (3) increasing the monetary threshold for low-value goods to be exempt from custom duties, and (4) examining a reduction of the permissible mark-up for Canadian exclusive book distributors of American books.

The cross-border pricing issue was next raised in the Canadian government's October 2013 "Speech from the Throne" which set out the government's agenda for the 2014 legislative year. Without getting into specifics, the government stated that Canadian consumers "should not be charged more in Canada for identical goods that sell for less in the United States" and committed to take "further action to end geographic price discrimination against Canadians."

At the time, the scuttlebutt surrounding the Speech from the Throne was that the government was examining several legislative options, including possible amendments to the *Competition Act*. This was confirmed with the release of Canada's federal budget for 2014 in February of this year. In the 2014 budget, the government indicated that it was considering a new provision for the *Competition Act* that would allow the Bureau to seek remedies against companies with "market power" that cannot "justify" charging higher prices for products sold in Canada.

An assessment of the full scope and implications of the Canadian government's "country pricing" proposal will have to await release of the actual draft legislation. That said, all indications have been that the Canadian government intends to move forward with this proposal and to require at least certain multinational companies to justify cross-border differentials resulting in higher prices in Canada. If so, this would reverse direction from the 2009

amendments to the *Competition Act* referred to above, which repealed the then-extant price discrimination offenses.

Interestingly, if the "country pricing" proposal is adopted, one by-product may be to affect the relative flexibility now afforded suppliers under Canada's price maintenance provision.

For example, if a supplier mandates that its retail customers in Canada price at a level that is higher than in the United States, it could conceivably be investigated for engaging in unjustified cross-border price discrimination, even though its unilateral pricing program may not raise issues under the price maintenance provision. This could effectively tip the balance back in favor of retailers over supplier pricing flexibility.

IV. NEXT UP: A GROCERY CODE OF CONDUCT?

The various tensions and conflicts between retailers and suppliers in Canada's grocery industry have led some parties (both suppliers and smaller independent grocers) to suggest the adoption of a retailer/supplier "Code of Conduct" for the industry. Although details are sparse, presumably these parties are suggesting that Canada establish a code that is similar to the one issued by the U.K. competition authorities following a lengthy "market investigation" into alleged anticompetitive conduct by U.K. retailers targeted at suppliers. As an example, retailers governed by the U.K. code may not:

- vary supply terms retroactively unless permitted under a supply agreement,
- require suppliers to contribute to a retailer's marketing costs or to predominantly fund a promotion,
- charge listing or shelf allocation fees except in limited circumstances (e.g., for promotions),
- require suppliers to pay for shrinkage or wastage, and/or
- de-list suppliers except for "genuine commercial reasons" and only with reasonable notice and opportunity to discuss.

In contrast to the United Kingdom, the Bureau cannot unilaterally inquire into the state of competition in a market and issue an order imposing mandatory remedies, including a code of conduct. In a recent speech discussing the topic,[2] Canada's Commissioner of Competition, John Pecman, acknowledged the limitations on his authority with respect to a grocery code of conduct and did not express enthusiasm for the idea. However, in a tantalizing aside, he also made the following statement: "If the Government expresses a desire to move in the direction of a Code of Conduct, and if we are asked to participate, we would certainly implement it and include it as another tool in our enforcement kit."

Although we have no reason to believe that the Canadian government has any plans to introduce a grocery "code of conduct," it seems clear that the issue of retailer/supplier relations in Canada's grocery industry will continue to attract attention from enforcement authorities as the two sides struggle for position in a very intense competitive environment.

[2] *Available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03719.html.

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Merger Enforcement in U.S. Food Industry Markets

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Merger Enforcement in U.S. Food Industry Markets

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I. INTRODUCTION: INCREASED ATTENTION IN AGRICULTURAL SECTORS

During the Obama Administration, the U.S. competition authorities have made food and agriculture a priority for antitrust enforcement. These efforts, undertaken by both the Antitrust Division of the Department of Justice ("DOJ") and the Bureau of Competition of the Federal Trade Commission ("FTC"), have concentrated primarily on preventing anticompetitive harm to buyers and sellers in food industries through merger enforcement mechanisms. While antitrust authorities can, and have, investigated other anticompetitive conduct such as price-fixing, bid-rigging, and market allocation, recent enforcement actions have made clear that mergers are of primary importance in the agricultural space.

In August 2009, Attorney General Eric Holder organized a series of cooperative workshops between DOJ and the United States Department of Agriculture ("USDA") exploring competition issues in the agriculture industry. Those workshops brought together industry participants at all levels of manufacturing and distribution and were designed to enhance the U.S. antitrust authorities' understanding of competition issues facing these markets. As a result of those workshops, DOJ identified two main areas of concern in the agricultural sector that could be addressed by the antitrust laws: (1) anticompetitive mergers and (2) unlawful acquisitions or maintenance of monopsony power.

II. CHALLENGES BASED ON BOTH BUYER AND SELLER POWER

Following the conclusions drawn from the workshops, the U.S. antitrust agencies have vigorously investigated and challenged mergers in various agricultural markets. In October 2008, DOJ and a number of states filed a challenge to the acquisition of National Beef (the nation's then fourth-largest beef processor) by JBS (the third-largest beef packer) for $560 million. The complaint alleged that the transaction would lessen competition among packers for cattle in two important geographic markets. In addition to concerns about buyer power, DOJ also alleged that the transaction would give the combined company inappropriate power as a seller in the nationwide market for boxed beef. Following months of litigation, the parties decided to abandon the transaction, demonstrating DOJ's focus on both buyer- and seller-power in food industry markets.

Challenges are no less likely when companies enter into joint ventures that reduce competition in agriculture markets through a combination of assets. In *Conagra*,[2] DOJ challenged a joint venture among (i) ConAgra Foods, Inc., (ii) Cargill, Incorporated, and (iii)

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[2] United States v. ConAgra Foods, Inc., et al., No. 1:14-cv-00823 (D.D.C.)

CHS Inc., which combined the companies' wheat flour milling assets into a joint venture known as Ardent Mills. As a part of the consent agreement settling the lawsuit, the joint venture was required to divest four flour mills, as well as institute measures designed to prevent the parent companies from disclosing non-public competitive information regarding wheat sales and usage to the combined entity.

III. SMALLER TRANSACTIONS NOT EXEMPT

Tellingly, government agencies have not just focused their efforts on large-scale transactions. In *George's Food,*[3] DOJ challenged George's Food's ("George's") purchase of a single chicken processing plant from Tyson Foods, Inc. ("Tyson") in western Virginia for $3.1 million. Despite the small size of the transaction, DOJ observed that the merger would decrease the number of competitors in the chicken-purchasing market from three to two in the fifty- to seventy-five-mile area surrounding the purchased facility, effectively giving George's monopsony power that it could abuse in the form of lower prices or degradations of other contract terms. George's entered into a consent decree with DOJ requiring the company to make capital improvements at its processing facilities that would increase its capacity, thereby ameliorating some of the harm to chicken growers caused by the decrease in competition.

Similarly, in *Dean Foods*,[4] DOJ joined a group of states filing a challenge to undo Dean Food Company's $35 million acquisition of dairy processing plants in Wisconsin from Foremost Farms USA after the transaction had occurred. In its complaint, DOJ focused on harm to the downstream consumer market, arguing that the combination would substantially lessen competition in the sale of milk to school districts, supermarkets, and grocery stores in Illinois, Michigan, and Wisconsin. In March 2011, DOJ settled with Dean Foods and required it to divest a dairy processing plant and brand name to preserve competition in the market.

Both *George's Food* and *Dean Foods* demonstrate willingness on the part of antitrust authorities to challenge relatively small mergers that may affect competition in agricultural markets, even when those mergers do not meet the applicable merger reporting thresholds and have already been consummated. *George's Food* further demonstrates DOJ's willingness and ability to craft merger remedies that address the unique competitive concerns of relationships in the agricultural sector, above and beyond the standard remedy of divestment of assets in affected markets.

IV. SUPERMARKET MERGERS ALSO CHALLENGED

Mergers between upstream food processors and manufacturers are not the only targets of U.S. antitrust enforcement, with government agencies also bringing enforcement actions in several supermarket company mergers. Traditionally, mergers in the supermarket industry are investigated by the Federal Trade Commission. Unlike for some other industries, where the relevant market for analyzing effects on competition can be entire states, or even the entire country, government authorities draw narrow markets when analyzing supermarket mergers. For instance, in *Lone Star Fund*,[5] the FTC investigated Bi-Lo Holdings, LLC's ("Bi-Lo") $265

[3] George's Food United States v. George's Food, LLC, No. 5:11-cv-00043-gec (W.D. Va. May 10, 2011)

[4] United States v. Dean Foods Co., No. 10-00059 (E.D. Wis.)

[5] In the Matter of Lone Star Fund V (U.S.), L.P., et al., Docket No. C-4440.

million acquisition of 154 supermarkets from Delhaize America. The investigation found competitive harm in 11 different local markets that consisted of areas within a three- to ten-mile radius of the parties' stores, and the FTC required Bi-Lo to divest twelve supermarkets in the affected areas.

Similarly narrow markets can be seen in *AB Acquisition*,[6] in which the FTC reached a consent requiring the parent company of Albertson's LLC ("Albertson's") to divest two grocery stores in the local grocery markets of Amarillo and Wichita Falls, Texas following its acquisition of United Supermarkets LLC. In addition to the required divestures, the consent order also prohibited Albertson's from interfering with the hiring or employment of current employees in the two divested stores for one year. These additional restrictions were designed to make sure the divested supermarkets were well-positioned to compete in those local markets.

In addition to narrow geographic markets, the U.S. antitrust agencies may examine narrow product markets in grocery transactions. The FTC based its challenge to Whole Foods' acquisition of Wild Oats in 2007 on the premise that there was a separate market for "premium and natural organic supermarkets" that was differentiated from the market for regular grocery stores. The FTC and the parties eventually settled a long, contentious litigation by agreeing that Whole Foods would divest 32 stores in 17 geographic markets that were impacted by the acquisition. Whole Foods also agreed to divest the Wild Oats intellectual property, including unrestricted rights to the "Wild Oats" brand.

V. CONCLUSION

Recent enforcement actions have shown that U.S. antitrust authorities have made merger enforcement in agricultural sectors a priority. This focus is particularly stringent when mergers enhance the pricing power of large companies in situations where that power balance is already disparate, e.g. small farmers' relationship with large processing companies and consumers' relationship with large supermarket chains. Moving forward, DOJ and FTC show little sign of slowing this pursuit.

[6] In the Matter of AB Acquisition, LLC, Docket No. C-4424.

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Competition Law Enforcement in the U.K. Grocery and Food Sectors and at the EU Level

Mark Jones[1]

I. INTRODUCTION: SUPERMARKETS UNDER THE SPOTLIGHT

In recent years the U.K. grocery and food industries have been among the most scrutinized sectors by the U.K. competition authorities. This article reports on competition law enforcement activity in the United Kingdom under the antitrust rules and also the so-called market investigation regime (merger control is outside its scope). It ends with a brief review of initiatives in these sectors at the EU level.

Enforcement activity in the United Kingdom has focused mainly on grocery markets rather than upstream food markets, although the U.K. competition authorities have issued guidance on the application of competition law to farming co-operatives as well as informal views on two dairy industry codes of practice. They have also promoted the competition agenda in the development and reform of EU farming regulation under the EU Common Agricultural Policy and the EU Dairy Package Regulation.

The U.K. antitrust rules prohibit cartels and other anticompetitive arrangements, and also the abuse of a dominant market position. There have been several significant investigations under the cartel rules, but the prohibition on abuse of dominance has not been applied in these sectors since even the largest of the four major U.K. supermarket chains has a national market share below the level at which a dominant position is normally established. There have been two major sector-wide investigations under the market investigation regime, which allows for review of whole markets where competition is perceived not to be working well in order to assess whether there are market features—in terms of structure or conduct—which adversely affect competition, with the possibility of a wide range of remedies aimed at market participants generally rather than sanctions on individual firms.

This enforcement activity has been shared between the U.K.'s two principal competition agencies, the Office of Fair Trading ("OFT")—responsible for cartel enforcement and initial or phase I merger and market reviews—and the Competition Commission ("CC")—responsible for in-depth or phase II market investigations reviews following reference from the OFT. (As of April 1, 2014, the two authorities merged into a single agency, the Competition and Markets Authority, although the separation of phase I and II activities has been retained within this new organization.)

It is worth noting that a number of the issues addressed in the United Kingdom, including the effects of perceived buyer power on the part of the larger supermarket chains and

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the indirect exchange of competitively sensitive information between retailers via their suppliers, have subsequently been picked up by agencies in other jurisdictions and so the U.K. experience is instructive in that respect.

II. MARKET INVESTIGATIONS

The U.K. groceries sector has been the subject of two market investigations by the CC—in 2000 and then again in 2006. The outcome of the first one was a Supermarkets Code of Practice ("SCOP"), applicable as of 2002, which sought to regulate supermarkets' conduct in their relations with suppliers, with oversight by the OFT. However, continued complaints about supermarkets' behavior led to an audit of retailers' compliance with the SCOP in 2005. Although the OFT initially found insufficient grounds for a further market investigation, this decision was successfully challenged by an association of convenience stores and a further market investigation ensued, lasting two years and subject to considerable political and consumer interest.

The CC found that, generally speaking, the U.K. groceries market was working well for consumers: there were no concerns relating to oligopoly (tacit collusion), there were no significant distortions of competition as a result of price promotions or below-cost selling, and supermarket buyer power was not having an alleged "waterbed effect" whereby lower supplier prices to large retailers pushed up their prices to smaller competitors. However, other competition problems were identified.

First, the CC found that excessive risk and costs were being passed to suppliers as a result of the deployment of buyer power by the supermarkets, with the adverse effect of reducing investment and innovation in the supply chain. To address this, the CC strengthened the regulation system of retailer-supplier dealings with an enhanced Groceries Supply Code of Practice ("GSCOP"), which came into force in 2010. This includes fair dealing requirements (e.g. as regards retrospective changes to supply terms and controls on de-listing), dispute resolution procedures, and in-house compliance obligations for the major retailers. At the CC's recommendation, the government also established a Groceries Code Adjudicator last year, to act as an independent regulator to oversee compliance with GSCOP through powers of investigation and enforcement and an arbitration role as regards disputes between suppliers and retailers.

Second, the CC found that there was significant concentration and barriers to entry, leading to higher prices in many local grocery markets. To address this, the CC made an order requiring supermarkets to remove certain restrictive covenants and exclusivity agreements affecting the use of land. It also proposed the introduction of a competition test as part of the planning process, but this recommendation was not accepted by the government.

III. ANTITRUST

The UK Competition Act 1998 contains a prohibition on anticompetitive agreements and concerted practices modeled on the equivalent EU prohibition in Article 101 of the EU treaty. Not long after this regime came into force the OFT initiated what became two high profile and long-running investigations in the groceries sector, which had a significant influence on the development of the law and procedure more generally for the U.K. antitrust regime.

In the first of these investigations, the OFT took action against co-ordination between supermarkets via suppliers on retail price increases for dairy products (milk and cheese) in 2002 and 2003—so-called "A-B-C" or "hub and spoke" indirect anticompetitive information exchanges. Ironically, these activities had started in the context of an industry initiative to improve the prices paid to farmers for raw milk, in response to concerns expressed about the threat to the U.K.'s domestic milk supply base and ultimately farmers' livelihoods in part as a result of supermarket buyer power. In 2011, the OFT imposed fines of nearly £50 million on the major supermarkets and milk processors that supplied them. The investigation saw the use of the leniency procedure to initiate it and the first widespread use of the OFT's settlement procedure, with the result that most parties received significant discounts on their fines (of up to 35 percent) and only one of the parties appealed the decision.

The potential concerns revealed about anticompetitive information exchange in the OFT dairy investigation apparently spilled over into other product sectors. The OFT undertook a Competition Act investigation into suspected price co-ordination involving a number of retailers and suppliers across a wider range of products in the U.K. grocery sector, although in late 2010 it announced that it had closed this investigation on the grounds of administrative priority.

The OFT also ran a second full antitrust investigation into the retail pricing of tobacco products where it alleged a novel theory of harm based on the two major tobacco manufacturers and the supermarkets entering into a series of bilateral agreements in 2000 to 2003 under which the retailers agreed to position the retail price of each manufacturers' product at the same level as, or a given differential to, their retail price for the equivalent brand of the other manufacturer. (There was also another allegation of A-B-C information exchange, although this was subsequently dropped.) Again, this case was a long running one, involving leniency and settlement procedures; but, unlike in the diary investigation, the eventual decision and record fines (totaling £225 million in 2010) were the subject of multiple appeals.

During the course of these appeals, before the Competition Appeal Tribunal in 2012, cross-examination of multiple witnesses did not support the OFT's findings on the facts and the OFT accepted that the theory of harm it had articulated in its decision could not be sustained. The Tribunal did not allow the OFT to redefine its case and instead quashed the OFT decision and fines. (This led the OFT to come under some criticism for the quality of its investigation, and the lessons drawn from the experience contributed to a number of changes in its procedures.)

As a footnote, one of the two tobacco manufacturers and a retailer, both of which had opted to settle and had not appealed the decision within the normal two-month time window for doing so, then made an application for an exceptional extension of that limitation period in order to bring a similar appeal in view of the circumstances in which the OFT's case had been completely overturned (i.e. they had admitted liability and paid substantial fines in respect of an infringement which had then been found not to have happened). This was finally rejected by the Court of Appeal in April this year

IV. THE BROADER EU PERSPECTIVE—AND THE ACTIVITIES OF THE EUROPEAN COMMISSION

One area of relevance in connection with retailing where the European Commission has issued guidelines is in relation to the practice of category management, whereby a retailer obtains

the advice and support of a supplier—the category leader or captain—for the marketing of the product category concerned (e.g. the layout of the shelf space allocated for the category in its stores), including all of its competitors' products as well as its own products. The European Commission's guidance identifies the potential competition problems that can arise with this practice, principally the category captain exploiting this position to foreclose rivals' products and the facilitation of anticompetitive information exchange and collusion as a result of the category captain's access to its competitors in managing the category. However, it balances this against the potential consumer benefit in allowing more efficient management of the category and more effective response to consumer needs based on the category captain's greater marketing expertise and customer understanding.

More generally at the EU level, there has been a greater focus on food and drinks markets, where the European Commission has completed a number of antitrust investigations. Since 2004, there have been six cartel cases, which have focused on the markets for beer, carbonated soft drinks, bananas, and shrimps. The most recent fines by the European Commission were in November 2013, when it imposed fines totaling EUR 28.7 million on participants in the North Sea shrimp cartel case.

It is worth noting that, across the European Union, cartel enforcement in the food sector has often been more rigorous at the national level within EU Member States, no doubt in a large part because of the local scope of food and retail markets, where national competition authorities may be better positioned to act. Indeed, between 2004 and 2011 EU national competition authorities conducted 182 antitrust cases in the food sector.

There has, nevertheless, been considerable political pressure for closer antitrust scrutiny of the food supply chain at the EU level. Over the past five years, the European Parliament has passed a number of resolutions calling for stronger antitrust enforcement in these markets. The European Commission has reacted to this pressure by implementing a number of initiatives. First, in January 2012, its Directorate for Competition created its own dedicated "Task Force Food" within its enforcement team.

Second, in May 2012, the European Commission actively participated in and promoted a report by the European Commission Network: *Competition Law Enforcement and Market Monitoring Activities by European Competition Authorities in the Food Sector*. This report summarized the key enforcement and monitoring actions undertaken by national competition authorities across the European Union and the European Commission from 2004 to 2011. It concluded that they would continue to act to ensure that food markets remain competitive to the benefit of European consumers.

Third, in late 2013, the European Commission commissioned a study into competition in food retail markets. This is being prepared by a consortium, which includes Ernst & Young, Arcadia International, and Cambridge Econometrics, and will examine whether increased concentration of retailers and food manufacturers, as well as other factors such as the role of private labels, have hampered choice and innovation in the European food supply chain. It will cover the eight-year period starting in 2004, and will focus on a sample of EU Member States. The results of the study have been expected for some time, and current indications are that the report will be published in the summer of this year (2014).

There has also been speculation that the European Commission could launch a sector inquiry into the food sector, e.g. if it concluded that rigidity of prices or other circumstances suggest that competition may be restricted in these markets. Unlike market investigations in the United Kingdom, the European Commission's sector inquiries are essentially fact-finding exercises, but they can lead to antitrust investigations where problems are found. However, more recent reported statements from European Commission officials, while not conclusive, appear to indicate that there will not be a specific sector inquiry.

Nevertheless, it remains clear that the European Commission retains an appetite to pursue individual antitrust infringement cases at the EU level where appropriate. At a conference in Rome in February this year, the director for cartels in the European Commission's Directorate for Competition is reported to have stated that the food sector would see increased cartel enforcement activity in 2014. Currently, there is at least one active cartel investigation being led by the European Commission in the food sector, which is in the market for canned mushrooms.

V. CONCLUSIONS

It will be clear from the above that in recent years grocery and food markets have been the subjects of extensive competition law scrutiny in the United Kingdom and more generally across Europe. A number of the issues arising have been new or specific to these sectors.

A relevant factor in much of the competition analysis relating to this enforcement activity has been the strong position of the major supermarkets at the retail end of the grocery supply chain. Buyer power on the part of these supermarkets can be characterized as pro-competitive in driving value for consumers, with pass-throughs of buying efficiencies in an intensively competitive retail market. Indeed, although merger control is outside the scope of this review, it is worth noting that buyer power has been routinely cited as a competitive constraint to rebut any horizontal concerns about merger cases involving concentration between food producers.

On the other hand, the strength of the large retailers has led to concerns about pressure on suppliers and complaints from small retailers unable to compete with them. These issues contributed to the reference of the grocery market for investigation by the CC in 2006 (although they were not fully substantiated in the findings of that inquiry). Likewise, concerns about primary producers not receiving a sufficient share of the value in the supply chain lay behind the origins of the practices which led to the OFT's dairy price-fixing investigation.

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Competition in the Australian Grocery Industry

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Competition in the Australian Grocery Industry

Paul Schoff, Sarah Moritz, & Eric White[1]

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.

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Antitrust and the Grocery/Food Sector in New Zealand

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Antitrust and the Grocery/Food Sector in New Zealand

Andrew Matthews & Gus Stewart[1]

I. INTRODUCTION

Antitrust issues are very much alive in the New Zealand grocery sector, arising in a number of contexts, including: (i) merger approvals, (ii) abuse in relation to demand-side market power, and (iii) fair trading, each of which is discussed below. And given an established supermarket duopoly in New Zealand, we expect continued scrutiny for this sector.

The grocery sector in New Zealand is characterized by two main supermarket chains, one of which is currently being investigated by the New Zealand Commerce Commission ("NZCC") in relation to alleged anticompetitive conduct. The two large players in New Zealand are Foodstuffs and Progressive Enterprises ("Progressive"). Foodstuffs is NZ-owned, and its main retail brands are "New World," "PAK'nSAVE," and "Four Square." Progressive is ultimately owned by the Australian Woolworths Group, and following the rationalization of its three brands ("Countdown", "Foodtown," and "Woolworths") in 2009 its main retail brand in New Zealand is Countdown.

A few years ago The Warehouse (a large general merchandise retailer) tentatively began expanding its operations into grocery products with its "Extra" stores. However, following failed attempts by both Foodstuffs and Progressive to gain regulatory approval to acquire The Warehouse (as discussed further below), we have not seen the Extra stores having any material impact on the grocery sector.

II. THE MERGER CONTEXT: GROCERY MERGERS IN NEW ZEALAND

In late 2006 and early 2007, Foodstuffs and Progressive each submitted (voluntary) applications for NZCC clearance to acquire The Warehouse Group. Both applications were declined as the NZCC was "not satisfied" that the acquisitions would not have, or would not be likely to have, the effect of substantially lessening competition in a number of local supermarket markets. The parties appealed the NZCC's decisions to the High Court, which allowed the appeal and granted the clearances. The NZCC further appealed the High Court's decision to the Court of Appeal, which allowed that appeal and then set aside the clearances (i.e. the applications were declined).

Progressive's acquisition of Woolworths New Zealand in 2001

There is interesting history to these proposals, which may have suggested that the NZCC would be unlikely to grant the clearances.

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In 2001 (prior to its acquisition by Woolworths Australia in 2005), Progressive sought clearance to acquire Woolworths New Zealand (which was then owned by Hong Kong-based Dairy Farm Group). (Woolworths Australia and Woolworths NZ were separate, independent entities at the time, albeit with the same brand.) At the time, this was a proposal for a "three to two" merger. Progressive's application was lodged the day before the merger test under the Commerce Act 1986 was changed from a "dominance" test to a "substantial lessening of competition" ("SLC") test. The NZCC considered the application under the dominance test and clearance was granted.

Foodstuffs challenged the NZCC's decision to consider the merger under the "old" test, which was more permissive, focusing only on single-firm market power. It argued that Progressive's application should have been determined under the law in force on the date on which the application was decided, i.e. the "new," tougher, SLC test, which looked at a lower level of single-firm market power as well as coordinated effects risks.

Foodstuffs failed in the High Court but succeeded on appeal to the Court of Appeal. Progressive lodged a fresh clearance application, which the NZCC considered under the SLC test and declined clearance.

Ultimately, however, the Privy Council found that the NZCC was correct to have applied the dominance test and, in 2002, Progressive was able to complete its acquisition of Woolworths New Zealand.

Clearly against that backdrop further acquisitions will likely be problematic and market power issues could be a concern. That proved to be the case as the discussion below shows.

The "flip side" to the concentrated supermarket industry structure has been that it has been possible to obtain clearance for mergers involving supermarket suppliers, due to the supermarkets' considerable countervailing buyer power. For example, this was a factor in the NZCC's 2004 clearance for Colgate-Palmolive to acquire Campbell Brothers' laundry additive, laundry detergent, and dishwashing detergent businesses.

III. THE DEMAND-SIDE MARKET POWER CONTEXT: THE NZCC'S INVESTIGATION INTO ALLEGED ANTICOMPETITIVE CONDUCT BY COUNTDOWN

The NZCC is investigating a complaint against Countdown for alleged anticompetitive practices. The investigation was prompted by a letter it received from then MP Shane Jones from the Labour party (who ironically was then offered a job by the National-led government, resulting in MP Jones exiting parliament).

The letter, which was released under parliamentary privilege, asked Dr. Mark Berry (NZCC chair) to investigate Countdown's "anti-competitive and allegedly extortionary behaviour." It accused Countdown of abusing its market power by demanding large payments from suppliers "allegedly to defray margins or losses on earlier transactions." Non-compliant suppliers would allegedly have their products black-listed at the supermarket. It was also alleged that any suppliers who revealed the arrangement would have their supply contracts with Countdown terminated.

MP Jones noted, "Such allegations are significant of themselves but of extra concern given the market power that currently exists in the New Zealand supermarket sector."

Clearly supermarket buyer power is getting attention in New Zealand, and continued scrutiny can be expected, especially in light of similar concerns offshore. But just as in other jurisdictions where these issues arise (such as the United Kingdom and Australia), demand-side market power issues are complex given the usual presumption that downward pricing pressure is pro-competitive.

In particular, there could be inherent challenges with applying New Zealand's misuse of market power (monopolization) test in s36 of the Act given that, among other things, the *prohibited purpose* must be to restrict, prevent, or deter competition. The prohibition on anticompetitive arrangements under s27, while still challenging, may be a more fruitful approach for the regulator to take as it may be arguable that the conduct has exclusionary effects.

It is interesting that apparently only one of the two supermarket chains is being investigated. Nor are we aware of any allegations of collusion between the two chains. The outcome of the NZCC investigation is awaited with interest, although it appears unlikely that enforcement action will be taken given the challenges with the s36 test and the NZCC's past record of enforcement action (having brought only a handful of successful s36 cases since the enactment of the Commerce Act in 1986 and having publicly signaled its dissatisfaction with the current test).

It has been suggested by some politicians (particularly from the opposition) that it may be time to introduce a code of conduct governing supermarket behavior. It is also worth noting that the New Zealand Productivity Commission has very recently recommended a review of whether or not s36 is achieving its purpose of preventing the anticompetitive exercise of market power.

Despite the challenges discussed above in relation to section 36, the NZCC seems to be increasingly considering the potential harm from demand-side market power in the merger context. Its June 2013 *Merger & Acquisition Guidelines* has a new section devoted to mergers between competing buyers, commenting:

> Buyer market power is, in many ways, the mirror image of market power on the selling side. In particular, it is the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of input sold is reduced. That is, the price of the product is depressed so low that (some) suppliers no longer cover their supply costs and so withdraw supply (or related services) from the market. Such an outcome reduces the amount of product being supplied damaging the economy.

IV. THE FAIR TRADING CONTEXT: THE RELEVANCE OF CONSUMER PROTECTION LAWS

As is the case with many other jurisdictions, over the past decade or so the NZCC has increasingly seen consumer protection laws as a useful tool in ensuring well-informed and competitive markets.

Supermarkets, like all other persons "in trade," are subject to the Fair Trading Act 1986 ("FTA") which, among other things, prohibits certain misleading and deceptive conduct. The FTA is enforced by the NZCC and supermarkets have naturally been subject to considerable scrutiny for their advertising.

For example, in March 2013 the NZCC issued a media release noting that it had warned Progressive about misleading advertisements about beer sale promotions. The release noted that Progressive claimed customers could save "at least 20%" or "at least 25%" off all beer at its supermarkets.

The NZCC believed that consumers had expected the 20 percent- to 25 percent-off claim to mean either:

- that they would save 20 percent to 25 percent off the price at which the beer was offered for sale immediately prior to the promotion, OR
- that they would save 20 percent to 25 percent off the usual price of the beer.

In fact, the NZCC's investigation indicated that, in many cases, the discount was calculated off neither of these prices, but the "standard shelf price" for the products. Further, that it had often been a lengthy period of time since the beer had been offered at the standard shelf price.

The Consumer Guarantees Act 1993 ("CGA"), as its name implies, provides statutory warranties to consumers. While not enforced directly by the NZCC, it is a breach of the FTA to mislead consumers as to their rights under the CGA, and the NZCC can take enforcement action for that conduct.

V. CONCLUSION

In summary, like many other jurisdictions, supermarket conduct is subject to considerable scrutiny. The issues being considered in New Zealand seem to reflect broader concerns considered internationally by antitrust regulators. We can expect continued focus on demand-side market power issues and vigilance on advertising by supermarkets. It is possible that we may see further enforcement action against supermarkets or perhaps some form of regulatory regime.

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The Promotion of Competition in the Food Sector in Israel

Tal Eyal-Boger, Keren Cohen, & Amit Zac[1]

I. INTRODUCTION

The past couple of years have seen many significant and influential developments in Israeli competition law and in the enforcement authorities of the General Director of the Israeli Antitrust Authority (the "General Director"), *inter alia*, against the backdrop of unprecedented social protest against the increase in the cost of living. One such significant development is a new and revolutionary law, enacted in March 2014, which is aimed at bringing about a reduction in food retail prices, mainly by regulating the relationship between suppliers and retailers in the food sector.

In this paper we will review the background of this new legislation. We will then follow with a detailed description of some of the new legislation's prominent provisions, and will conclude with some critical comments.

II. BACKGROUND: THE ISRAELI SOCIAL PROTEST AGAINST THE INCREASE IN THE COST OF LIVING

In the summer of 2011, an acute public social protest arose in Israel against the increase in the cost of living. The roots of this social protest, which also became a synonym for the protest, lay in the "Cottage Cheese Protest," a consumer boycott to obtain a significant reduction in the prices of cottage cheese. Later on, the social protest expanded to other areas, focusing on food and housing prices. In 2012, public pressure regarding the prices of food products continued (although it lessened somewhat), existing to a certain extent still today.

The protest against the cost of living brought about a change in consumer consciousness and enhanced awareness of the pricing of products. In addition, the protest created a new governmental regulatory discourse and a new agenda, whose avowed purpose was to reduce the cost of living for consumers—and, in particular, the price of food products. The full impact of the protest is yet to be understood, but it can be easily marked as an important turning point in Israeli antitrust law, especially with respect to the food sector.

Following the protest, a public committee was set up to effect social and economic change, headed by Prof. Manuel Trajtenberg (the "Trajtenberg Committee"). In September 2011 the Trajtenberg Committee published a detailed report, which was soon adopted by the Israeli Government. The Trajtenberg Committee's recommendations included proposals for reducing the cost of living. With regard to the food industry, the Trajtenberg Committee determined that

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there was a high level of both economic concentration in the manufacturing/import sector and protections against competition (quota-based and other protections).

The Committee also recommended transferring the findings to a specific team that would analyze competitiveness in the food and consumer product market. The team (the "Kedmi Committee") was headed by Mr. Sharon Kedmi, at the time the Director General of the Industry, Trade and Labor Ministry (currently named the Economy Ministry). It was set up to formulate recommendations for enhancing competition and reducing prices of food and consumer products.

The Kedmi Committee published its report in July 2012. The report included recommendations, *inter alia*, concerning: the removal of trade barriers (such as customs duties), the opening up of the market to parallel imports, increased regulation in respect of supplier–retailer relationships, enhancing the level of awareness of the Israeli Antitrust Authority (the "IAA") with regard to mergers and acquisitions in the sector (which may have an adverse effect on competition), and providing assistance to small manufacturers in competition over shelf space at food chains, etc. In October 2012 the Government approved the implementation of some of the recommendations of the Kedmi Committee.

These recommendations formed the basis for new legislation that followed soon thereafter, as addressed below.

III. THE NEW LEGISLATION: THE PROMOTION OF COMPETITION IN THE FOOD INDUSTRY LAW

Further to the Kedmi Committee's work, the Government placed before the Knesset (the Israeli Parliament) the Promotion of Competition in the Food Industry Bill, 5774-2013 (the "Bill"). The Bill was enacted in the Knesset in March 2014 (the "Law"). The discussions of the bill took place in a Joint Committee of the Economy Committee and the Finance Committee of the Knesset, which was set up for the purpose of promoting competition in the food sector.

A. Summary of the Main Points of the Law

The declared purpose of the Law is to bring about a reduction in retail prices by increasing competition in the food and the consumer goods sectors. The Law concerns a number of key matters: regulating suppliers' and retailers' activities, price transparency, powers of enforcement, penalties, and financial sanctions.

B. Activities of Suppliers and Retailers

The Law defines a "Large Supplier" as an entity (i) with sales turnover to retailers in Israel in the previous fiscal year exceeding NIS 300 million (approximately U.S. $86 million) or (ii) is a monopolist (holds more than 50 percent of a relevant market). It also defines a "Large Retailer" as an entity that maintains at least three brick-and-mortar or online stores, and whose sales turnover exceeds NIS 250 million (approximately U.S. $71 million). It sets forth a list of prohibitions for these suppliers' and retailers' activities, including:

1. Prohibition on intervention by a supplier regarding either retail prices or the terms and conditions of a product which another supplier supplies (a broader prohibition than the common RPM rules);

2. Prohibition on a Large Supplier from engaging or intervening in the shelf arrangement for goods at the store of a Large Retailer;
3. Prohibition on a Large Supplier from dictating, recommending, or intervening in: (i) the retail price of the supplier's product; (ii) the allocation of sales space for the product; (iii) the amount purchased, whether from the retailer's total purchases, or the total amount of purchases of the product and substitute products; and/or (iv) the purchase or sale of the products of another supplier;
4. Prohibition on a Large Supplier from selling part of its product units, or part of its basket of products, for a price lower than the marginal cost of the product; or selling products, including a basket of products, at a price equal to, or lower than, the cost of an extremely limited product basket or the price for the purchase of less units (predatory pricing);
5. Prohibition on a Large Supplier from tying the sale of a certain product to the sale of another product; and
6. Prohibition on the transfer and receipt of payments from a supplier to a Large Retailer, in cash or cash equivalents but through certain discounts (namely quantity discounts);

The Law also empowers the General Director, in connection with products or substitute products, to instruct a Large Retailer that is selling the products of a Large Supplier regarding sale spaces, as well as to give instructions to a retailer that is selling private label products.

A Large Supplier is also required to give a report to the General Director once a year on its sales turnover to retailers in Israel or, alternatively, to provide a declaration that it satisfies the terms of the definition of a "Large Supplier." A Large Retailer shall provide a report on the stores which it maintains, and on its sales turnover.

In addition, according to the Law, the General Director will publish a list of "Very Large Suppliers" (suppliers whose sales turnover to retailers in Israel in the previous fiscal year exceeded NIS 1 billion (approximately U.S. $285 million)). A Large Retailer may not allocate shelf space to products from these Very Large Suppliers (all together) at a rate exceeding 50 percent of the total shelf space in each of its major stores. This is a temporary order, which shall take effect in January 2015, and which shall remain in effect for one year, and may be extended by one additional year each time, up until a total period of four years.

The Law also allows the General Director to define for each store of a Large Retailer the competition group in a relevant region. The General Director shall give written notice, once a year, to each retailer whose market share in the relevant region exceeds 30 or 50 percent. The retailers who receive such notice shall be subject to prohibitions and various instructions, such as a prohibition from opening an additional large store in the region without obtaining the General Director's permission. The General Director is also authorized to order the termination of activities at a large store, or to order the sale of the retailer's rights therein, and to prohibit real estate transactions in the said region. The Law also includes annual reporting obligations regarding the large stores and their sales turnover.

The Law further requires a Large Retailer to publish online, for each of its stores, the up-to-date prices of all of the products being sold there as well as additional data (inventory, sales promotions, and discounts, etc.).

C. Penalties and Enforcement

The new law includes some of the harshest sanctions in Israeli antitrust law.

The General Director is authorized to impose on a corporation with sales turnover exceeding NIS 10 million a monetary sanction in an amount of up to 8 percent of the sales turnover, but no more than NIS 24 million (approximately U.S. $6.8 million); and on an individual, a monetary sanction in an amount of up to NIS 1 million (approximately U.S. $285,000).

In addition, with respect to the breach of certain provisions, the Law authorizes the imposition of a penalty of three years' imprisonment or a fine in the amount of NIS 2.26 million, including an additional fine for each day of a continuing offense.

The Law also imposes a penalty of six months' imprisonment, or a fine of up to NIS 1.13 million, on a director, officer, partner, etc., for a failure to supervise his/her employee's breach of the Law, and sets forth an obligation to submit information and documents to the General Director. Anyone who breaches this last obligation will also be exposed to imprisonment or a fine up to NIS 8 million.

IV. COMMENTS AND CRITIQUE

While nobody questions the positive motivation to reduce the cost of living for consumers, including the price of food products, the Law raises noteworthy and significant concerns.

The Law is comprised of provisions that are precedent-setting, globally, with regard to competition regulation in the food sector. Moreover, some of the provisions in the Law deviate from well-established antitrust principles. Among the intrusive tools given to the General Director with regards to the termination of activities at a large store, or the retailer's sales practices, are (i) restrictions on price recommendations; (ii) restrictions on suppliers' participation in consumers' sales and promotions; and (iii) restrictions on suppliers' shelf arrangements. Against this background it is not surprising that the General Director himself has acknowledged the complexity of the Law and its implementation.

Respectively, some of the above mentioned restrictions in the Law may have a counterproductive effect on consumers' welfare, and inversely assist in perpetuating the market power possessed by a few.

For example, one possible counterproductive effect is the following: Allegedly, according to the law, a small competitor in the food sector with a high total annual turnover, or a big competitor entering a new market, will no longer be able to compete aggressively against existing monopolies with strong brands in the food sector by lowering the retail price of its products or by buying the shelf space needed to achieve minimum public exposure—until it reaches enough market share. In this sense, strong brands can become even stronger and the monopoly in power will stay uncontested.

Another possible counterproductive effect is the following: In light of the fact that, in general, suppliers have a higher motivation to promote their own products than retailers, restrictions on suppliers' participation in consumers' sales and promotions is likely to reduce the

volume and variety of these practices. This possible outcome is also likely to harm consumers' welfare.

It seems that in trying to fix the problems that were identified in the market, the authorities may have missed the mark. The surgical hand needed in such industry-specific regulatory interventions was replaced by a bulldozer trying to level the field. On top of this, the uncertainty regarding some the provisions of the Law may have a chilling effect (especially with respect to the harsh sanctions mentioned above) on the market, that could overshadow some of the positive influence expected.

It is hoped that in the first period of implementation of the Law, and even before the downsides mentioned here are shown, the Israeli Antitrust Authority and the General Director will review parts of the Law and clarify them (in guidelines, for example) or exempt certain entities and practices (in accordance with the General Director's powers in the law). This could assist the market to reach a needed balance.