AUSTRALIAN FOOD & GROCERY COUNCIL

AFGC SUBMISSION

OPTIONS TO STRENGTHEN THE MISUSE OF MARKET POWER LAW

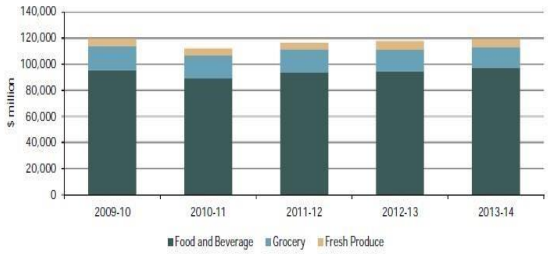
Sustaining Australia

PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, drink and grocery manufacturing industry.

The membership of AFGC comprises more than 190 companies, subsidiaries and associates which constitutes in the order of 80 per cent of the gross dollar value of the processed food, beverage and grocery products sectors.

Figure 3.1: Composition of the defined industry's turnover ($2013-14)[11]



Source: Based on ABS, catalogue number 8221.0, 8159.0 and 8155.0

Australia's food and grocery manufacturing industry takes raw materials and farm products and turns them into foods and other products that every Australian uses every day. With an annual turnover in the 2013-14 financial year of $118 billion, Australia's food and grocery manufacturing industry makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity. It adds over $32 billion to the value of the products it transforms.

Manufacturing of food, beverages and groceries in the fast moving consumer goods sector is Australia's largest manufacturing industry. The diverse and sustainable industry is made up of over 26,651 businesses and represents 30% (almost one third) of the total manufacturing industry in Australia.

The food and grocery sector accounts for over $61.7 billion of the nation's international trade in 2014-15, with a trade surplus worth over $10 billion to the Australian economy in 2014-15. These businesses range from some of the largest globally significant multinational companies to family-based small and medium enterprises.

The food and grocery manufacturing sector employs more than 322,900 Australians, paying around $16.1 billion a year in salaries and wages.

Many food manufacturing plants are located outside the metropolitan regions. The industry makes a large contribution to rural and regional Australia economies, with over 40% of the total persons employed being in rural and regional Australia. It is essential for the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies.

The contribution of the food and grocery sector to the economic and social well-being of Australia cannot be overstated. Australians and our political leaders overwhelmingly want a local, value-adding food and grocery manufacturing sector.

Data source: *AFGC and EY State of the Industry 2015: Essential Information: Facts and Figures*

1. SUMMARY

The Australian Food and Grocery Council (AFGC) provides this submission in response to the Treasury's consultation paper "*Options to strengthen the misuse of market power law*" (December 2015).

As noted in the consultation paper, the adequacy of the current prohibitions against misuse of market power in section 46 of the Competition and Consumer Act (CCA) was questioned in the recommendations of the March 2015 *Final Report of the Competition Policy Review* (the "Harper Report"). The Harper Report recommended that the law be amended to refer to conduct by an entity with market power that had the purpose, effect or likely effect of substantially lessening competition (the "effects test").

In summary, the AFGC –

- Agrees with the consultation paper that reform of section 46 is contentious, reflecting in the AFGC's view a disparity of opinion as to the nature and scope of problem the section is intended to address, and consequently differing views as to the appropriate regulatory solution;
- Supports the view that an effects test, as proposed in the Harper Report, would add costs and complexity, and have a chilling effect on corporate decision-making that may extend into the future;
- Notes with interest the range of options in the consultation paper for less radical reform to address one or more of the perceived enforcement difficulties with s.46 as it currently stands;
- Expresses its preference, *should reform be considered necessary*, for Options B, D and C in the consultation paper in that order, with some further amendment, as they minimise the risk of imposing additional cost and complexity on competitive decision-making.

2. COMMENTS

2.1 Defining the problem

The Australian Government Guide to Regulation identifies the first question to be answered as "*What is the policy problem you are trying to solve?"* Much of the contention in relation to the amendment of section 46 can be attributed to the lack of a common ground on this most fundamental question. The prevention of abuse of market power enjoys near universal approval as a theoretical construct, but agreement seems to quickly fracture the more the detail is explored.

As tempting as it may be to draw a divide between 'big' and 'small' business when it comes to an understanding of what constitutes 'abuse', such a dichotomy is unhelpful and fails to appreciate the breadth of commercial realities in the Australian market place. In particular–

(a) the accretion and maintenance of market power is not, and should not be, illegal – there is no call to penalise success.

(b) Australia is a globally exposed economy, and perceptions of what might constitute 'abuse' can be coloured by participant's ability to engage in global and/or regional markets – an issue that has more to do with corporate culture than business size.

(c) Vertical integration of supply chains, especially in the food and grocery sector, creates 'double agent' situations where a retailer can be both a customer and a competitor to a supplier, creating a new class of relationship that defies the traditional "vertical vs horizontal' categorisation – with the corollary that traditional concepts around anti-competitive conduct become less helpful.

The second point is of particular relevance for Australia's commoditised agrifood sector where the competitive forces are global and cannot be adequately captured by analysis of the Australian market.

A further dimension in defining the problem lies in the inter-relation between s.46 and other offences in the CCA. In the food and grocery sector, for example, the Australian Competition and Consumer Commission (ACCC) has been active in enforcing the prohibition against unconscionable conduct, with a successful action in 2014 against Coles and current action against Woolworths. Both actions have been framed on the basis of the impact of behaviour by large retailers upon small to medium suppliers in light of the norms of acceptable commercial behaviour. It is noteworthy that these actions were ***not*** framed under s.46 because the conduct in question (vertical supply chain relationships involving demands for payments) did not have a prohibited 'anti-competitive' outcome (ie damage to competitors in the retail space).

This is a key point - section 46 reform is not a measure that will provide significant new safeguards for smaller businesses supplying larger businesses, because s.46 is directed to preventing damage to competitors (or competition, if you will), not suppliers. While s.46

extends to capture *behaviour* in relation to vertical supplier relationships, the *prohibited purposes* remain fixed on the impact on horizontal competition, not the impact upon suppliers. For example, imagine that a supermarket seeks to use market power to extract additional payments from, or place exceptional requirements on, its suppliers. That behaviour is only of concern under current s.46 if it has the purpose of damaging a competitor (ie another supermarket) or preventing entry of a new player into the supermarket sector. It would only be of concern under Harper's proposed s.46 if it had the purpose, effect or likely effect of substantially lessening supermarket competition.

Protection of vertical relationships in the supply chain is more directly addressed in the CCA by prohibitions around unconscionable conduct, as well as through more innovative arrangements such as the *Food and Grocery Code of Conduct*, a voluntary prescribed code under the CCA introduced in 2015 that establishes new rules and behaviour norms for supplier-retailer relationships.

This Code is an example of the newer approaches to the regulation of competition, being a 'light touch' regulatory intervention tailored to specific issues arising in supplier-retailer relationships. Notably, the Code was developed cooperatively by Government, suppliers and retailers which ensures it reflects the commercial realities of day to day operations in the highly competitive, fast paced consumer goods sector. It highlights how Government and industry can deal with specific sectorial market issues, *without* resorting to a blanket approach.

Importantly, the Code further illustrates the comments above in relation to asking the right regulatory question. It was too simplistic to say "the major supermarkets are harming competition in the market", the better question addressed in the Code is "how can we influence behavior by major players in the sector to better balance the relationship between suppliers and customers". The AFGC considers the Code goes a long way to answering that (better) regulatory question, raising again for consideration the question of what "problem" this process is seeking to address. If the answer is not in fact that a market problem exists across the entire economy, then more innovative approaches may be warranted.

The AFGC submits that clarity in the distinction between the normal and legitimate conduct of business affairs and the protection of legitimate corporate interests on the one hand, and the detrimental exertion of market power to achieve anti-competitive ends on the other, would significantly advance the debate on section 46 reform, together with clarity as to the role s.46 is to play within the overall scheme of Part IV CCA offences.

2.2 Comparison of Elements

The consultation paper usefully identifies the individual elements that might be incorporated into a revised s.46, combining them in a number of options (Option A being the existing law, Option F being the Harper Report proposal, and options B through E being various hybrids

of the two). While not a direct reflection of the wording of the current or proposed offence provisions, the AFGC summarises these options as follows -

	Element	Consultation Paper OPTION					
		A (Current Law)	B	C	D	E	F (Harper Proposal)
WHO	An entity with market power	Y	Y	Y	Y	Y	Y
ACTIVITY	Purpose	Y	Y	Y	Y		
	Take advantage	Y					
	Purpose, effect or likely effect					Y	Y
OBJECT	Harming a competitor	Y	Y				
	Substantially lessening competition			Y	Y	Y	Y
ISSUES TO BE TAKEN INTO ACCOUNT				Guideline	Mandated	Guideline	(Mandated)

2.3 The Benefit of Purpose

The consultation paper describes one objection to the Harper Report proposal as being the chilling effect on corporate decision making. The AFGC, in its consultations with its members, identifies this issue as being of significance.

In particular, the Harper Report proposal requires a corporate board to potentially obtain four distinct reports for every decision it makes –

(a) A description of the relevant market (largely economic in nature)

(b) Whether the entity has power in relation to that market (a combination of economic and legal factors)
(c) The effect or likely effect of the decision on competition (primarily an economic assessment)
(d) Whether such an effect or likely effect would represent a 'substantial lessening of competition' (primarily a legal assessment).

It is true that a negative answer to the second issue obviates the need for further consideration, but it is also true that entities may have varying degrees of market power in relation to different markets in which they engage, so it is highly unlikely that a 'one size fits all' approach would apply except in the instance of entities engaging in limited markets and with only small market shares.

By comparison, under the existing law a Board need only honestly determine its true purpose underlying a decision, a matter requiring little or no external advice. Only if the decision has a purpose of harming a competitor is further enquiry necessary. Such absence of any need for legal and economic advice enables flexible and responsive decision-making that would be slowed, and rendered significantly more costly, under the Harper Report proposals.

Further, corporate decision making is not restricted to Boards. The same considerations apply in relation to management decisions by staff that can be characterised as the conduct of the corporation itself. The chilling effect on decision-making must be understood in this wider context.

As Australian entities are globally exposed, flexible and responsive corporate decision-making becomes a critical issue for viability. Australian manufacturers already face very high regulatory and input costs compared to global competitors, and additional regulatory burdens need extraordinary justification lest they drive jobs, manufacturing and economic growth offshore.

The AFGC accepts that competition law, to function effectively, does need to impose burdens on corporate decision making, and that Australian industry can learn from international experience to better manage and improve corporate decision making practices. However, additional burdens should not be imposed lightly, and indeed should only be imposed when there is no other less burdensome path to a regulatory solution.

The AFGC is concerned that additional costs and complexity will be imposed on business from changes to the current s.46 that would require additional detailed legal or economic analysis to be undertaken to assess the impact of commercial decisions. This may have a chilling effect on normal competitive decision making. Legal uncertainty over the impact of revised regulatory language will have a further chilling effect in the short to medium term. The benefits of the changes are less clear and difficult to quantify.

2.4 Other Offence Elements

In discussions relating to the shortcomings of the existing law, attention has been focussed on the 'take advantage' element. This element has not featured in previous reviews of s.46 as detailed in Box 19.2 of the Harper Report – only the 1984 Green Paper suggested a move to an effects test, but on the basis that *purpose* was too difficult to prove, rather than *take advantage*.

If the focus of reform does switch to the simple removal of the 'take advantage' element, it is clear that normal commercial conduct may be caught by the offence provision if that conduct is undertaken for a prohibited purpose. There may be many purposes that can be served by a decision, and it may be appropriate to limit the operation of the offence to those circumstances where the anti-competitive purpose is dominant, primary, or similar language.

In considering 'damage to competitors' versus 'substantial lessening of competition', the AFGC understands the theoretical basis of the Harper Report's promotion of the latter. Competition policy should protect competition rather than provide for the continued existence of competitors. That said, it is somewhat paradoxical that the Harper Report formulation would permit conduct intended to significantly damage, or eliminate, a competitor provided the overall effect on competition was not one of substantial lessening. In this light, the proposal to have factors to which a regulator, tribunal or court must have regard may serve to mitigate such risks, as well as further explain and illustrate conduct that is considered to be socially beneficial or socially detrimental.

It is further noteworthy that seven of the eleven reviews identified in Box 19.2 consider that an effects test was unlikely to better distinguish between socially detrimental and socially beneficial conduct than the current law, and in fact may increase the risk of regulatory error.

3. CONCLUSION

If reform is considered necessary the AFGC favours Options B through D in the consultation paper. Option B is incremental reform addressing the primary obstacle to enforcement identified by the ACCC, but subject to the qualification that the anticompetitive purpose must needs be the primary or driving purpose of the decision. Options D and C with similar additional safeguards would also represent incremental rather than radical reform.