



## ALDI Stores

(A Limited Partnership)  
ABN 90 196 565 019

1 Sargents Road, Minchinbury, NSW 2770 AUSTRALIA

## CORPORATE

Locked Bag 56  
St Marys Distribution Centre  
NSW 2760

Telephone: (02) 9675 9000  
Facsimile: (02) 9675 9399

**Buying Department**  
Facsimile: (02) 9675 9299

### Treasury paper: *Creeping Acquisitions – The Way Forward* (6 May 2009)

#### Submission from ALDI Stores

#### 1. Executive summary

1.1 In August 2008, the Government nominated the implementation of a creeping acquisitions law as an important element of its initial response to the Report of the Australian Competition and Consumer Commission (ACCC) inquiry into the competitiveness of retail prices for standard groceries (*ACCC Report*). A 'creeping acquisition' refers either to a series of acquisitions of smaller competitors over time which, in aggregate but not individually, raise competition concerns, or the circumstance where an operator with existing market power makes a further small acquisition even though that acquisition does not substantially lessen competition in itself<sup>1</sup>. While the ACCC did not express a high level of concern with the acquisitions of smaller competitors by the Major Supermarket Chains (*MSCs*) in the years preceding the Report, it supported a general creeping acquisitions law and stated that the supermarket industry is one whose structural features make creeping acquisitions a potential area of concern. As is clear from the ACCC Report, these 'structural features' include the dominant position of the MSCs in the grocery sector, the high levels of market concentration in certain product categories (e.g. packaged grocery sales), and the high barriers to entry and expansion, including in particular difficulties in obtaining suitable sites.

1.2 ALDI Stores (*ALDI*) supports the introduction of an amendment to section 50 of the *Trade Practices Act 1974 (TPA)* to deal specifically with the issue of creeping acquisitions. ALDI shares the view of the Government and the ACCC that creeping acquisitions should be seen as a significant potential risk that could lead to a further concentration of market power in the grocery sector. It is ALDI's observation of the market over the last decade that the MSCs have aggressively expanded their offerings to capture a greater share of the consumer dollar within and without the traditional grocery sector and to create linkages between the two. This

<sup>1</sup> ACCC Report, page xxi

expansion has taken the form of both organic growth and acquisition and there is no reason to think that the MSC's expansionary strategies will be different in the years to come.

1.3 ALDI is concerned however that the two regulatory options put forward in the Government's paper, *Creeping Acquisitions – The Way Forward* dated 6 May 2009 (**Discussion Paper**), will not adequately address the issue in the context of the Australian grocery industry.

Specifically:

- (a) by imposing a market power threshold, the proposed creeping acquisitions amendment will not prevent corporations from obtaining market power in the first place through a series of small acquisitions;
- (b) the market power requirement is likely to be difficult to apply in practice, significantly complicating the merger analysis; and
- (c) it is unlikely that the proposed creeping acquisitions amendment will prevent mergers taking place that would not otherwise be opposed under the current section 50 test.

1.4 ALDI considers that the original aggregation model proposed by the Government presented a better solution for the regulation of creeping acquisitions. The efficacy of that model could be enhanced by combining it with a declaration power that introduced greater scrutiny of acquisitions in markets that raised particular competition issues.

## **2. Background**

2.1 ALDI's unique business model is focused on saving customers time and money by selecting products that compete with leading brands on quality, but at a significantly lower price. Each product in ALDI's grocery range has its own brand identity, like any of the leading market brands, which is a key point of difference to other retailers' generic lines. ALDI entered the Australian grocery retailing market in 2001 and has since expanded to 205 stores along the eastern seaboard in NSW, Queensland, Victoria and the ACT. The company is widely known for its low prices and high quality and is consistently 25-40% cheaper than other leading supermarkets for a comparable basket of goods. The ACCC Report acknowledged the key role ALDI has played in driving vigorous price competition.

2.2 Compared to the other markets in the world, ALDI considers the Australian grocery market to be particularly concentrated. There is no need for ALDI to provide detailed statistics on the degree of dominance by the MSCs or the barriers to entry and expansion that exist in the Australian market for non-incumbent players – this has been comprehensively analysed in the ACCC Report.

- 2.3 In ALDI's view, the measure and extent of the MSCs' dominance is also properly assessed by reference to their conduct in extending their reach into areas of retail beyond the traditional grocery sector. The MSCs have, in recent years, extended their retail businesses to encompass a range of retailing activities and to leverage common ownership from one sector to the other in terms of maximising consumer spend. Through their increasingly broad and diverse portfolio of retail formats – covering food, alcohol, fuel, non-food, DIY/homewares and specialty/deli foods – the MSCs exert an increasingly significant influence on consumer spending in Australia. As a recent example, ALDI also notes with concern the mid-2009 acquisition of Macro Wholefoods by Woolworths, which represents a clear statement of intent by that MSC to target the independent grocery and organic segments of the Australian grocery industry. It is clear that the MSCs seek ways in which to leverage their presence in one market sector (e.g. traditional grocery retailing) with that in another (e.g. fuel retailing) – in this regard, the MSCs gain a significant competitive advantage from shopper docket schemes and also loyalty card arrangements which encourage consumers to centralise their spend within a commonly-owned group of retail outlets.<sup>2</sup>
- 2.4 ALDI contends that the continued expansion of the MSCs into new retail formats enhances the opportunity for them to create linkages between various retail categories, increasing barriers to entry and expansion, and in turn reinforcing their position of dominance. The expansion of the MSCs into other retail activities also has the potential to increase their already strong bargaining power with landlords to the detriment of competitors and new entrants.<sup>3</sup>
- 2.5 A creeping acquisitions law should enable the full scope of this retailing activity and its impact on competition to be taken into account in assessing the competitive dynamics of relevant markets, including the market power of the MSCs, and the likely effect of a specific proposed acquisition.

### **3. Reform proposal**

- 3.1 In the Discussion Paper the Government has put forward a proposed amendment to section 50 of the TPA that would impose an additional merger test for corporations with a substantial degree of market power (referred to as the *SMP model* in the Discussion Paper). The proposed amendment is as follows:

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<sup>2</sup> Since the ACCC Grocery Inquiry, the MSCs have increased their attempts to leverage their position across different retail markets by expanding their loyalty programs and, most recently, significantly increasing the level of fuel discounts available via their shopper docket programs.

<sup>3</sup> This was seen as a significant competition issue by the ACCC when the ACCC reviewed Woolworths Limited's proposed acquisition of Kmart and Officeworks (Public Competition Assessment, 17 October 2007).

*“A corporation that has a substantial degree of power in a market must not directly or indirectly:*

*(a) acquire shares in the capital of a body corporate; or*

*(b) acquire any assets of any person;*

*if the acquisition would have the effect, or be likely to have the effect, of enhancing that corporation's substantial market power in that market.”*

3.2 As an alternative to this approach, the Government has proposed that the Minister would have the power to declare a corporation or a product / service sector where there are competition concerns about creeping acquisitions (**declaration**). The SMP model would then only apply to corporations or industries that have been declared.

#### **4. Comments on the two regulatory options (Question 1)**

4.1 ALDI is concerned that the proposed amendment will not provide an effective means of addressing the issue of creeping acquisitions and, in particular, that it will add little to the current section 50 test.

4.2 First, the threshold requirement that a corporation must have a substantial degree of power means that the creeping acquisition amendment will only apply to corporations that are already subject to limited competitive constraints. The amendment will not assist in preventing a corporation from acquiring market power in the first place through creeping acquisitions.

4.3 Second, the requirement that a corporation must possess a substantial degree of market power imposes a very high threshold for the application of the creeping acquisition test. Market power is generally understood as the capacity of a corporation to act in a certain way free from the constraints of competition.<sup>4</sup> It has been difficult for the ACCC to establish that a corporation has a substantial degree of market power in section 46 actions.<sup>5</sup> Whilst the introduction of sections 46(3C) and 46(3D) may make it easier to establish that a corporation possesses a substantial degree of market power, the practical effect of these amendments are as yet untested by the Courts.

4.4 Perversely, in the grocery industry there is likely to be a real question as to whether the MSCs have a substantial degree of market power and, if so, in what markets:

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<sup>4</sup> *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13

<sup>5</sup> For example, *Boral Besser Masonry Limited v Australian Competition and Consumer Commission* [2003] HCA 5

- (a) At the retail level, the approach taken by the ACCC has been to define the relevant markets as being a series of local grocery markets. Whilst ALDI believes that competition in local retail markets is often limited (in particular due to the difficulties experienced by competitors such as ALDI obtaining suitable sites), it is unlikely the MSCs would be found to have a substantial degree of market power in local retail markets for the purposes of the TPA. In those markets where an MSC has a substantial degree of market power, the SMP model is unlikely to add anything to the existing section 50 test.<sup>6</sup>
- (b) At the wholesale level, the analysis is likely to be complex and time consuming. Whilst the ACCC's approach in merger matters in the grocery industry has been to define the relevant market as State-wide markets for the acquisition of products sold in supermarkets<sup>7</sup>, there are difficulties with applying this approach to market definition to an analysis of whether or not an MSC has market power. Given the numerous suppliers and product categories in wholesale grocery markets, it is difficult to see that any generalised analysis could be undertaken as to whether or not an MSC had a substantial degree of market power in a broad wholesale market for the acquisition of grocery products.<sup>8</sup>

4.5 The difficulties in determining whether or not a corporation has market power at the wholesale level are illustrated by the *ACCC v Safeway* case.<sup>9</sup> As noted in the Discussion Paper, Safeway was found to possess a substantial degree of market power in the wholesale market for the acquisition of bread, notwithstanding its relatively limited market share.<sup>10</sup> This finding, however, was the result of extensive and detailed analysis of the wholesale bread market (including expert economic analysis), that took into account a range of factors, including Safeway's actual behaviour (namely, its practice of deletions of bread lines supplied by particular suppliers in particular areas) and particular features of the wholesale bread market (including the over-capacity of suppliers and the low level of brand loyalty).

4.6 To establish that a corporation has a substantial degree of market power requires an extremely detailed legal and economic analysis. There is a real issue of practicality as to the extent that

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<sup>6</sup> If an MSC has a substantial degree of market power in a local retail market then it is likely that any acquisition by that MSC would be opposed by the ACCC under the existing section 50 test on the basis that such an acquisition is likely to result in a substantial lessening of competition in that local retail market.

<sup>7</sup> For example, ACCC Public Competition Assessment, Woolworths Limited proposed acquisition of Karabar Supermarket, 11 July 2008

<sup>8</sup> As can be seen from the ACCC Report, there are significant differences in market characteristics across the different supply chains for grocery items.

<sup>9</sup> *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Ltd and Anor* (2003) 129 FCR 339

<sup>10</sup> As above at [298] – [324]

such an analysis could be readily incorporated within the ACCC's current informal merger clearance process and, in particular, the demands of the commercial timeframes associated with that process.

- 4.7 Third, as illustrated by the Safeway case, the assessment of whether a corporation has a substantial degree of market power under section 46 occurs in the context of specific conduct which is alleged to amount to a misuse of market power. It is likely to be even more difficult to prove the existence of a substantial degree of market power in the context of a merger review, when all that is being assessed is a proposed acquisition and there may have been no suggestion that, to date, the corporation has sought to exercise what market power it has.
- 4.8 Fourth, there is likely to be uncertainty as to what is meant by "enhance" market power. "Enhance" is a new concept that has not been previously used in the TPA. Whilst the ordinary meaning of enhance is "*to raise to a higher degree; intensify; magnify*"<sup>11</sup>, it is unclear what this means in terms of market power. Is any increase in market power an enhancement? Or, will something more be required? Must barriers to entry be increased? If so, by how much?
- 4.9 Finally, assuming that "enhance" requires a real and not insubstantial increase in market power, in the grocery context it is unlikely that a small acquisition would result in an increase in an MSC's market power (assuming that they do have market power). In relation to wholesale markets, the acquisition of an independent supermarket which will only have a relatively small impact on wholesale volumes is unlikely to result in any increase in an MSC's market power in wholesale markets.
- 4.10 If, however, the Government decides to proceed with a market power model, ALDI submits that the SMP model articulated in the first discussion paper which has a test of 'any lessening of competition' is preferable. It applies a concept which is known to Australia's competition law regime, but lowers the threshold of 'substantial' which must be met in order for a breach to be established. ALDI disagrees with submissions by other parties that the SMP model would result in ambiguity in the application of the current test in section 50 by confusing 'any' lessening with a 'substantial' lessening. Rather, it is clear that this version of the SMP model would introduce a similar test, but with a lower threshold on the basis that the acquiring party possesses a substantial degree of market power.
- 4.11 To address the proportionality issue raised in the Discussion Paper, an amendment along these lines should be accompanied by a drafting note in the legislation to the effect that the test will be applied in accordance with the *de minimus* principle. Further guidance could also be inserted in the Explanatory Memorandum. This would confirm that the new section is not

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<sup>11</sup> Macquarie Dictionary

concerned with trivial acquisitions which have a negligible impact on the competitive dynamics of a market.

- 4.12 Given the issues discussed above with the SMP model, ALDI does not generally consider that the alternative SMP model set out in the Discussion Paper based on the declaration of a corporation or product / service sector offers a more appropriate solution to the creeping acquisition issue. However, if the Minister was given the power to make a declaration that a corporation does in fact possess a substantial degree of market power, this is likely to address some of the issues and difficulties set out above in relation to the SMP model.

## **5. Alternative options (Question 2)**

### *Aggregation model*

- 5.1 ALDI submits that, notwithstanding its difficulties, the aggregation model (such as proposed by the Government in the first discussion paper) is preferable to an SMP model. The current section 50 test focuses on the effect of a specific acquisition and does not allow the cumulative impact on competition of a series of small acquisitions to be considered as a whole. An aggregation model would directly address this limitation.
- 5.2 The aggregation model would involve a corporation being prohibited from making an acquisition if, when combined with other acquisitions made by the corporation within a specified period, the acquisition would be likely to substantially lessen competition in a market. The aggregation model would retain the current test of substantial lessening of competition and that test would be applied to the cumulative effect of an identified set of acquisitions made by the corporation.
- 5.3 The Discussion Paper notes that the aggregation model was deemed impractical by many. ALDI believes that some of these concerns may have been overstated. In particular, it has been suggested by some that the aggregation model would require the ACCC to identify the competitive effect of each acquisition.<sup>12</sup> There is however nothing inherent in an aggregation model that requires the competitive impact of each prior acquisition to be considered. An aggregation model allows for the analysis of the cumulative competitive effect of a set of acquisitions to be considered, with the analysis focusing on competition in the market before any of the subject acquisitions were made and competition in the market after the final proposed acquisition is made.
- 5.4 In the context of the grocery industry, any creeping acquisitions amendment needs to be able to take account of the cumulative impact of a series of acquisitions on competition in both

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<sup>12</sup> See, for example, the ACCC, *Submission regarding creeping acquisitions*, October 2008, at [31]

retail and wholesale markets. While there has been a focus on the impact of creeping acquisitions in wholesale markets, ALDI considers that the impact of creeping acquisitions on access to suitable sites is also an important consideration. As ALDI submitted to the ACCC's Grocery Inquiry, one of the largest barriers to grocery competition is the capacity of a retailer to access suitable sites for stores. ALDI considers that the cumulative effect of acquisitions by the MSCs of:

- (a) independent supermarkets / existing businesses;
- (b) existing sites / leases; and
- (c) new sites / leases,

when coupled with the restrictive covenants that are often in lease agreements<sup>13</sup> increase barriers to entry and expansion in grocery markets.

5.5 In the ACCC's Grocery Report, the ACCC acknowledged that the supermarket industry is characterised by particular structural features including access to sites as a significant barrier; the existence of broader barriers to entry and expansion through the need to obtain economies of scale; and the existence of the two MSCs.<sup>14</sup>

5.6 In light of the above, ALDI proposes that any aggregation amendment be drafted so that, in addition to the current section 50(3) factors, regard must be had to specific issues that arise in the creeping acquisition context in determining whether a series of acquisitions has or is likely to have the effect of substantially lessening competition. Such matters could include:

- (a) restrictive terms in agreements forming part of or associated with the acquisitions;
- (b) the height of barriers to expansion (as well as barriers to entry) and the aggregate effect the acquisitions have had on those barriers;
- (c) whether the market is characterised by the need to obtain economies of scale in order to compete effectively; and
- (d) where the individual acquisitions take place in a series of separate but related markets (such as a series of local retail markets or in complementary retail markets), the cumulative impact of those acquisitions on competition in the affected markets.

5.7 ALDI submits that under this model, the appropriate time period within which acquisitions may be aggregated is 3 years.

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<sup>13</sup> Such covenants often prevent landlords from leasing sites to competitors, such as ALDI, for a specific and often lengthy period of time.

<sup>14</sup> ACCC Report, p. 430

## *Declaration*

- 5.8 ALDI supports the introduction of an aggregate-model creeping acquisitions law which is generally applicable to all corporations and acquisitions. It should not be necessary that industries or corporations be 'declared' to trigger the application of the creeping acquisitions law. Consistent with the underlying policy objectives of the TPA, a number of small acquisitions which, when combined, have the effect of substantially lessening competition should be prohibited in the same way that isolated acquisitions which have the same effect are currently prohibited.
- 5.9 Noting the above, ALDI does however see merit in introducing a formal declaration model, the effect of which would be compulsory notification to the ACCC of all acquisitions made by corporations who have been declared. The ACCC would then be obliged to conduct a public review of all such acquisitions in accordance with its *Merger review process guidelines*.<sup>15</sup> This declaration proposal is similar to the ACCC's current approach of informally putting industries or corporations 'on notice' that acquisitions be notified to the ACCC in advance of completion. ALDI considers the ACCC's informal 'on-notice' approach should continue alongside the declaration model. The advantage of declaration is it would increase the transparency of the processes – both for the corporations affected and interested parties. Declaration could also be utilised where there are concerns that parties are not willing to notify voluntarily.
- 5.10 ALDI considers key features of a declaration model should include:
- (a) Declaration of a corporation by the Minister on the recommendation of the ACCC.
  - (b) Factors the ACCC can take into account when making such a recommendation:
    - (i) the level of concentration in relevant market(s);
    - (ii) the level of recent acquisition activity and likely future acquisition activity in the market(s);
    - (iii) whether the corporation has a degree of market power in a market.
  - (c) The Minister must be satisfied declaration would be in the public interest, having regard to the objective of promoting competitive and efficient markets in Australia.

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<sup>15</sup> Such corporations would of course have the option of seeking formal clearance or authorisation of acquisitions

- (d) The Minister may make a declaration of his or her own accord if the Minister is satisfied declaration would be in the public interest, having regard to the objective of promoting competitive and efficient markets in Australia.
- (e) Once a corporation is declared, the corporation must notify the ACCC (or otherwise seek approval) well in advance of the completion of all acquisitions. For the avoidance of doubt, acquisitions would include the acquisition of sites and leases for the operation of retail premises, as well as existing businesses.
- (f) The ACCC must conduct a public review of acquisitions notified by declared corporations.
- (g) A declaration would be valid for 3 years.

## **6. Contacts**

- 6.1 Any queries in relation to this submission ought to be directed to: Mr Matthew Barnes, Managing Director – Buying, ALDI Stores, 1 Sargents Road, Minchinbury NSW 2770 (telephone: 02 9675 9221).