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CREEPING ACQUISITIONS

SUBMISSION TO COMMONWEALTH TREASURY BY METCASH LIMITED

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1. Summary

- 1.1 Metcash welcomes the opportunity to respond to the Government's second discussion paper relating to creeping acquisitions.
- 1.2 Metcash is pleased with the Government's commitment to implementing reforms to address the issue of creeping acquisitions in recognition of the existing regime's failure to adequately address this issue.
- 1.3 As Metcash has previously submitted to the Government, the *Trade Practices Act 1974* (Cth) (TPA) should not permit a corporation, which already has a substantial degree of market power, from increasing or entrenching its

market power through the acquisition of shares or assets.¹ Metcash submitted that legislation that gives effect to the 'substantial market power model' (SMP) model described in the Government's first discussion paper would be the most effective measure to rectify the issue of creeping acquisitions.

- 1.4 A viable independent supermarket sector is critical to the maintenance of competition at the retail level of the market, and over time, the relevant wholesale markets. The independent grocery retailers play a vital role in maintaining competition in this sector.
- 1.5 The Government has now proposed an amended version of the SMP model described in its first discussion paper. This amended model addresses the concerns set out in Metcash's first submission. Metcash is generally supportive of the new proposed model and would like to make the following comments about the new model that may assist the Government in addressing some of the issues identified in its second discussion paper.

2. The amended 'substantial market power' model – which market?

- 2.1 The Government's second discussion paper on creeping acquisitions observes that 'substantial market power' is a concept currently used in section 46, but has not previously been used in mergers and acquisitions provisions of the TPA. As set out in Metcash's previous submission, 'market power' is not merely a function of market share and is not attributable simply to market share.²

¹ See *Creeping Acquisitions: Submission to the Commonwealth Treasury by Metcash Limited (October 2008)* at <http://www.treasury.gov.au/documents/1422/PDF/Metcash.pdf>.

² Ibid, at paragraphs 6.16-6.17.

2.2 In the grocery industry, the market power of major supermarket chains is attributable also to a number of factors including:

- (a) their level of vertical and horizontal integration;
- (b) their economies of scale and scope;
- (c) their attractiveness as anchor tenants in shopping centre developments; and
- (d) their financial strength and ability to establish very large sites and engage in deep price discounting compared to an independent retailer.

Metcash submits that these factors, mean that an MSC can *project* market power into other markets, including other retail markets where it is yet to establish a site.

2.3 The MSCs have, for example, already expanded their retail offerings into areas such as petrol, liquor and banking.³ The number of convenience stores, general merchandise, electronic stores and hotels owned by Woolworths alone totals more than 1200.⁴ Woolworths operates approximately 780 supermarkets across Australia, and is the owner or joint owner of approximately 1058 liquor outlets.⁵ Coles operates approximately 750 supermarkets and approximately 862 liquor retail outlets.⁶ Between them, Coles and Woolworths control nearly half the retail liquor market. This expansion of retail offerings has enabled the MSCs to not only leverage

³ ACCC Report, p 177.

⁴ *Woolworths Annual Report 2008*, p 68. Woolworths owns approximately 271 ALH Group hotels (see <http://www.alhgroup.com.au/>)

⁵ See *Woolworths Annual Report 2008*, p 68 and ACCC Public Competition Assessment of Woolworths Limited – proposed acquisition of Karabar Supermarket (11 July 2008).

⁶ *Wesfarmers Annual Report 2008*, pp 12-13.

their size and scale, but significantly increases their buying power and attractiveness as tenants to landlords.

2.4 In *Rural Press Ltd v ACCC*,⁷ the court suggested that, in order to come within the prohibition in section 46 (as it was then framed), the relevant power of the corporation had to be used in *the market* in which the corporation had power. In 2007, amendments were made to the TPA to provide that a corporation with power in a market, may not use that power 'in that *or any other market*' for a proscribed purpose.

2.5 In the Explanatory Memorandum to the *Trade Practices Legislation Amendment Bill (No.1) 2007*, the Government observed that a firm that has substantial market power in one market (e.g. the manufacture of a good) may be able to prevent the entry of a firm into another market (e.g. the retail market for that good). Consequently, it considered it would be appropriate for section 46 to proscribe the leveraging of substantial market power from one market into another.⁸ The Government stated:

*'Any reduction in competition may lead to reduced choice and higher prices for consumers. Australian markets may become progressively concentrated. This detrimental impact on competition may lead to smaller gains in efficiency and productivity, less innovation and fewer employment opportunities.'*⁹

2.6 Metcash agrees with this analysis and submits that the Government should give consideration to incorporating the words 'in that or any other market' into the proposed new SMP model.

⁷ [2002] FCAFC 213.

⁸ at paragraphs 2.84 and 3.19.

⁹ at paragraph 2.93.

3. 'Enhancing' or 'increasing' market power

3.1 Under the proposed new SMP model, a corporation that has a substantial degree of market power would be prohibited from making an acquisition 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 Section 2 of the TPA provides:

*The object of this Act is to **enhance** the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection*

3.3 The word 'enhance' is defined in the Macquarie dictionary as:

'to raise to a higher degree; intensify; magnify'

3.4 The Courts have considered whether a corporation's market power is 'enhanced' or 'increased' in a number of instances. In *Dowling v Dalgety Australia Ltd* (1992) 34 FCR 109, Lockhart J stated:

*'It is important to recognise that a corporation can gain a position of substantial market power through its agreements, arrangements or understanding with others; and market power gained through acting in concert with others must add to the corporation's individual market power. Additional market power thus gained must **enhance** a corporation's individual market power. An individual corporation may have, as one of the weapons in its armoury, gained through agreements, or understandings, a facility to **increase** its market power and this must be considered as relevant to the factual matrix involved in determining the extent of that corporation's market power in a market. [Emphasis added]'*

- 3.5 In *Australian Competition And Consumer Commission v Universal Music Australia Pty Ltd (formerly known as PolyGram Pty Ltd) and Others* (2001) 201 ALR 502, Hill J stated that:

*'In merger cases the key issue is whether the acquisition permits the acquiring firm to achieve or **enhance its market power.**'*

- 3.6 Metcash acknowledges that, although the courts have given consideration to whether or not certain conduct will 'enhance' a corporation's market power, there is still a degree of uncertainty as to the precise meaning of the term and the dictionary meaning adds to this uncertainty.
- 3.7 The replacement of the word 'enhance' with 'increase' on the other hand, may provide a clearer benchmark. 'Increase' is defined in the Macquarie dictionary as *'to make greater in any respect; augment; add to'*.

4. Is there a difference between the effect of the words 'enhance market power' or 'increase market power' and the words 'lessen competition'?

- 4.1 As submitted by Metcash in its October submission, the previous SMP model described in the Government's first discussion paper on creeping acquisitions can be reduced to the following proposition: 'A firm which has a substantial degree of market power, should not be permitted to entrench or increase that market power through the acquisition of shares or assets'. Accordingly, Metcash considers that the previous SMP model may in effect, give the same result as the new SMP model. This is because the existence of market power will generally equate to a lessening of competition in a market

- 4.2 This was the position of Northrop J in *Trade Practices Commission v Ansett Transport Industry (Operations) Pty Ltd*:¹⁰

*'... Section 50 is concerned with the power to control or dominate a market. The unexpressed major premise contained in the section is that **it is undesirable for a body corporate to be in a position to control or dominate the market** or in other words to have the power to control or dominate a market **since the existence of that power tends to lessen competition in that market...** [Emphasis added]'*

- 4.3 The explanatory memorandum to the *Trade Practices Legislation Amendment Bill 1992*, in relation to section 50(3)(c), provided that:

*'Almost all mergers result in some increased concentration in the hands of a participant in the relevant market... A merger which results in a large increase in concentration in the relevant market may reduce competition in the market by increasing the market power of the merged firm or increasing the scope for tacit collusion or co-ordination among the remaining competitors.'*¹¹

- 4.4 However, the ACCC, in its 2008 Merger Guidelines, recognises that mergers can lessen competition through either unilateral effects, or coordinated effects. A merger will have unilateral effects when it removes or weakens competitive constraints in such a way that a firm's unilateral market power is increased. However, according to the ACCC, a merger will also:

'have coordinated effects when they assist firms in the market in implicitly or explicitly coordinating their pricing, output or related commercial decisions. A merger may do so simply by reducing the number of firms among which to coordinate, by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely. Coordinated effects may occur in addition to unilateral effects so that the merged firm is able to achieve even higher prices than it would on its own. In some cases,

¹⁰ (1978) 32 FLR 305 at 318.

¹¹ See paragraph 21.

*coordinated effects, either alone or in conjunction with unilateral effects, may amount to a substantial lessening of competition.'*¹²

4.5 Metcash submits that any proposed legislative amendments to address creeping acquisitions must capture acquisitions that result in a lessening of competition through both unilateral effects *and* coordinated effects. Metcash is concerned that the SMP model proposed in the Government's second discussion paper may not capture the second proposition. This is because a creeping acquisition may lessen competition as a result of coordinated effects (especially when the major supermarket chains co-exist in the same market) without *necessarily* resulting in an increase in, or enhancement of, the market power of the individual corporation that undertakes the creeping acquisition.

5. Effect on sectors other than the grocery sector

5.1 Australian markets often tend to be highly concentrated. In an economy the size of Australia's, there is a compelling case for a law that prevents companies which already have a substantial degree of market power from increasing or entrenching their market power through creeping acquisitions. Accordingly, there is merit in applying a broader SMP model, rather than limiting its application to 'declared' corporations or industries.

5.2 Metcash recognises that the SMP model has the potential to affect other industries in Australia, especially industries that are highly concentrated. Examples of such industries include petrol, banking and energy retailing. However, Metcash considers that legislation directed specifically at creeping acquisitions has the potential to deliver significant benefits to consumers in

¹² See ACCC Merger Guidelines (November 2008) at <http://www.accc.gov.au/content/item.phtml?itemId=809866&nodeId=7cfe08f3df2fe6090df7b6239c47d063&n=Merger%20guidelines%202008.pdf>, at para 6.1.

each of these three markets by preserving and promoting competition. For example:

(a) *Petrol*

Petrol retailing is dominated by the four refiner/marketers, with smaller retail chains (such as United, Liberty, Matilda and Gull) providing the only independent competitive pressure on the majors. Legislation directed towards creeping acquisitions will preserve competitive conditions in this market and help guard against increased consolidation and the creation of an entrenched oligopoly between the refiner/marketers;

(b) *Banking*

While the ACCC remains committed to the 'four pillars' policy (and has flagged its opposition to further bank mergers) competition in the banking market will be threatened if the TPA is not amended to prevent major banks from continuing to acquire smaller banks and non-bank lenders;

(c) *Gas and electricity*

Gas and electricity retail markets are dominated by a small number of major suppliers (eg. Origin, AGL and TRUenergy) at a time when jurisdictions such as Victoria are removing retail price regulation and relying on competition to deliver lower energy prices to consumers. Legislation directed towards creeping acquisitions will keep competitive pressure on the major suppliers at a time when vigorous competition is more important than ever before.

- 5.3 Metcash recognises that there may be some unintended consequences with a test applying of broad application. However there are other mechanisms under the TPA that adequately deal with those unintended consequences. A corporation with substantial market power, that wishes to acquire shares or assets, can seek authorisation under the TPA for such an acquisition.
- 5.4 That said, Metcash acknowledges that concerns about the unintended consequences of the amended SMP model may lend to the view that this test should be applied to declared corporations or declared industries only. If this is ultimately the preferred option of the Government, Metcash submits that the grocery industry should be the first industry declared under the new legislation.

6. Conclusion

- 6.1 Metcash is encouraged by the Government's commitment to implement changes to the TPA to respond to the issue of creeping acquisitions. While Metcash believes further improvement could be made to the revised SMP model, Metcash generally supports the Government's proposal and urges the Government to press ahead with its commitment to implementing legislative change to address this issue.

Metcash would be pleased to elaborate upon this submission, or to provide further comments on legislative proposals as they are developed.

A handwritten signature in black ink, appearing to read 'Andrew', enclosed within a large, hand-drawn oval.

Andrew Reitzer

METCASH LIMITED

11 JUNE 2009