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10 October 2008
Scott Rogers
Competition and Consumer Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
by email: scott.rogers@treasury.gov.au

Dear Scott

Submission on Creeping Acquisitions Discussion Paper

The IGA National Board is pleased that the Government is taking action to address the problem of creeping acquisitions and welcomes the opportunity to make a submission on the Government's Discussion Paper.

This submission is made by the National Board of IGA. IGA is a brand that unites over 1,000 independent supermarkets across Australia. The supermarkets in the IGA network are all independently owned. The members of the National Board represent the owners and operators of these supermarkets. These independent supermarkets are the main competitors to the two major supermarket chains that have come to dominate the supermarket industry and which now have a combined market share of 70 to 80%.

Summary of our submission

Creeping acquisitions are a serious problem for the supermarket sector. Creeping acquisitions do occur, and the supermarket sector is particularly vulnerable to them because of the structure of the industry. Creeping acquisitions are not currently dealt with by the Trade Practices Act and recent ACCC decisions show that acquisitions of individual supermarkets will rarely be covered by the current prohibitions.

The ACCC has recognised that the supermarket sector is not as competitive as it should be and that the major chains currently have little incentive to compete with each other, meaning that consumers are not getting the best deal possible. If action is not taken to prevent the major chains from strengthening their market power by creeping acquisitions, then this already weakened level of competition will be reduced even further.

We support the Government's proposed 'market power' model. It will be an effective solution to creeping acquisitions. We consider that the 'aggregation model' is unlikely to be effective in the supermarket sector, primarily due to the way that the ACCC defines the relevant markets.



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We conclude this submission by suggesting some possible refinements to the market power model.

Creeping acquisitions are a serious problem for the supermarket sector

Background to creeping acquisitions

The Discussion Paper succinctly describes creeping acquisitions as conduct that comprises the accumulated effect of a number of small individual transactions which, when considered in isolation at the time that each transaction occurred, would not breach section 50 of the Trade Practices Act 1974 (*Cth*) (**TPA**).

Creeping acquisitions have been considered by several previous inquiries, including the Parliamentary Joint Select Committee on the Retailing Sector in 1999, the Dawson Committee in 2002, the Senate Economic Reference Committee in 2004, the ACCC's Grocery Inquiry in June 2008 and the Senate Standing Committee on Economics in August 2008. We are pleased that, after years of inquiries and debate, action is finally being taken to address this problem.

Creeping acquisitions do occur, and the supermarket sector is particularly vulnerable to them

As the Discussion Paper notes, creeping acquisitions typically arise where a supplier with a substantial degree of market power acquires a small competitor. Supermarkets are regularly cited as the prime example of an industry where a series of creeping acquisitions can be used to acquire or strengthen market power without breaching the TPA.

Creeping acquisitions are not simply a theoretical concern. They do occur in practice and they have occurred in the supermarket sector. There have been a number of acquisitions of independent supermarkets by the major chains in recent years. Some recent examples are discussed below.

The supermarket sector is reasonably unusual in that there are two very large supermarket chains that each have 30 to 40% market share and then a large number of operators with very small market shares. This type of market structure encourages creeping acquisitions because there are many small independent supermarkets that can be individually targeted by the major chains.



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Creeping acquisitions are not dealt with by the current section 50

Scope of section 50

Section 50 of the TPA prohibits an acquisition that would have the effect or likely effect of substantially lessening competition in a market.

The ACCC recognised in its Grocery Inquiry that it does not currently have the power under section 50 to address creeping acquisitions.¹ Creeping acquisitions are not covered by section 50 because that section requires each acquisition to be assessed individually.

Creeping acquisitions of individual supermarkets will not be prevented by section 50

These limitations in section 50 mean that if the major chains acquire independent stores one-by-one, then it is very unlikely that those acquisitions will breach the TPA.

In order to understand the ACCC's approach to previous section 50 decisions, it is important to first explain the approach the ACCC takes to market definition in those decisions. Under section 50, an acquisition must substantially lessen competition in a market. The ACCC assesses supermarket acquisitions in relation to three markets. Those markets are the local retail supermarket market (**local retail market**), the state-wide market for the procurement of products sold in supermarkets (**procurement market**) and the state-wide market for the wholesaling of products sold in supermarkets (**wholesale market**).

An acquisition by one of the major chains of an individual supermarket will only have a very small effect on the chain's market share in the state-wide procurement market or wholesale market. As a result, an individual acquisition is unlikely to be rejected under the current tests because it substantially lessens competition in those markets and the ACCC usually does not give detailed consideration to those markets.

Instead, the ACCC's decisions usually focus on the local retail market. The geographic extent of the local retail market is usually defined by the ACCC as a radius of 3-5km from the location of the target

¹ *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, page 427 (electronic version)



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supermarket, although that radius may be wider outside of metropolitan areas. An acquisition will only be opposed by the ACCC if the ACCC considers that it substantially lessens competition within that local area.

The ACCC's approach in numerous decisions on section 50 in relation to acquisitions by Coles or Woolworths shows that an acquisition of an individual supermarket by one of the major chains will very rarely have the effect of 'substantially lessening competition' under section 50.

There are two important features of the ACCC's approach that contribute to this result. First, the ACCC generally sees an acquisition of an individual independent supermarket as removing a reasonably weak competitor and therefore not 'substantially lessening' competition in the local retail market. Second, contrary to the ACCC's comments in relation to the Grocery Inquiry, the ACCC's recent section 50 decisions treat Coles and Woolworths as each imposing an effective competitive constraint on the other. This second factor means that an acquisition by one of the chains of an independent supermarket will rarely be opposed if the other chain has a supermarket within the local retail market, and it is even enough if the other chain simply has plans to open a supermarket in that area.

This first feature is illustrated by the ACCC's decision last month not to oppose Woolworths' acquisition of the Food-Rite supermarket in Emerald.² Woolworths already operated two supermarkets close to Emerald. Ritchies Stores Pty Ltd (an IGA member) submitted to the ACCC that the acquisition should be opposed because Woolworths' market share in the local retail market would increase to over 80%. The ACCC nonetheless decided not to oppose the acquisition.

The ACCC has not yet published its reasons for this decision, but it provided a summary of its reasons in a letter to Ritchies. In that letter, the ACCC said that it had considered several geographic definitions of the local retail market, including the 10-12km market proposed by Ritchies in which Woolworths' market share would increase to over 80%. However, the ACCC still considered that there would not be a substantial lessening of competition. The ACCC's reasons for this view included the 'relatively limited turnover of the store being acquired and market inquiries which suggested that the store was not a vigorous competitor'.

² Woolworths Limited – proposed acquisition of Food Rite Supermarket and Liquor Licence in Emerald, see <http://www.accc.gov.au/content/index.phtml/itemId/842361/fromItemId/751046>



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The second feature is illustrated by the ACCC's decision in 2007 not to oppose Woolworths' acquisition of the Jindabyne IGA supermarket.³ In that decision, the ACCC defined the local retail market as extending to Cooma 60km away due to the rural location of the supermarket. Woolworths already owned two other supermarkets in the area, and the acquisition would mean that it owned all three of the major supermarkets in the market. However, the ACCC decided that the fact that Coles planned to open a supermarket in Cooma in the near future meant that Woolworths would be constrained. As a result, the ACCC considered that the removal of the only significant independent supermarket in the area would not substantially lessen competition.

This approach by the ACCC in section 50 decisions is in stark contrast to its comments in relation to the Grocery Inquiry. In that inquiry, the ACCC found that supermarket retailing is 'workably competitive' but that price competition between Coles and Woolworths is limited.⁴ The ACCC Chairman Graeme Samuel stated at the time of the release of the inquiry report:

Our inquiry found that overall the grocery market is, as the Minister has said, workably competitive. That term is used to describe a market in which competition exists but it is definitely not as competitive as it should be. In a workably competitive market there is sufficient competition to protect customers from monopolistic practices but there is a lack of the type of strong and vigorous competition that means consumers are getting the best deal.⁵

Creeping acquisitions harm competition and consumers

As the comments above illustrate, the dominance of the major supermarket chains has resulted in a market where competition is significantly lower than it should be. The major chains do not have a

³ Woolworths Limited – proposed acquisition of Jindabyne IGA Supermarket, Festival IGA Liquor and Porter's Liquor Licence, see <http://www.accc.gov.au/content/index.phtml/itemId/790158/fromItemId/751043>

⁴ *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, page xvi (electronic version)

⁵ *ACCC Grocery Inquiry Press Conference, 5 August 2008*, transcript available at <http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=transcripts/2008/039.htm&pageID=004&min=ceb&Year=&DocType=2>



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monopoly, but the lack of real competition between them seriously harms consumers.

In the Grocery Inquiry, the ACCC also stated that there was a 'lack of incentives for Coles and Woolworths to compete strongly across the board on prices' and that this lack of competition 'reflects the high levels of concentration in the industry'.⁶

The current section 50 allows the major chains to use a series of creeping acquisitions to increase their market power even further and reduce this already weakened state of competition. Under the current section, the ACCC allows acquisitions of individual supermarkets because the resulting lessening of competition from an individual acquisition is not sufficiently 'substantial'.

We consider that it simply does not make sense that the major supermarket chains should be allowed to make acquisitions that lessen competition, regardless of whether the lessening resulting from any individual acquisition is 'substantial'. As the ACCC's own statements demonstrate, the actions of the major chains have already reduced competition so much that the market cannot bear any further lessening of competition.

The 'market power model' is the best solution to creeping acquisitions

The Discussion Paper proposed two potential models to address creeping acquisitions. The first proposal is referred to as the 'aggregation model'. The second proposal is referred to as the 'market power model'.

We support the Government's proposed market power model. It will be an effective solution to creeping acquisitions.

We consider that the aggregation model is unlikely to be effective in the supermarket sector. Our concerns about this model are primarily due to the way that the ACCC defines the relevant markets, which mean that the aggregation model might never apply in practice.

⁶ *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, page xvi (electronic version)



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We support the 'market power' model and consider that it will be effective

The 'market power' model proposes adding a new provision to section 50. Under this new provision, a corporation would be prohibited from making an acquisition if it already has a substantial degree of power in a market and if the acquisition would result in any lessening of competition in that market.

This new provision would involve a two-step test. First, it would be necessary to determine whether the corporation has a substantial degree of power in a relevant market. If it does, then the test for acquisitions would be whether the acquisition results in *any* lessening of competition. If the corporation does not have a substantial degree of market power, then the corporation is only subject to the current test of whether the acquisition results in a *substantial* lessening of competition.

We consider that this model will be effective in preventing creeping acquisitions in the supermarket sector. If one of the major chains seeks to purchase an independent supermarket then it will be prohibited if there is any lessening of competition. We consider that if this test had applied to previous ACCC decisions then some of those decisions would have been made differently.

We recognise that the market power model involves a more radical change to the TPA, but we consider that a more radical change is required to address the threat that the dominance of the two major chains poses to supermarket competition and consumers.

The 'aggregation model' is unlikely to be effective

The 'aggregation model' involves a corporation being prevented from making an acquisition if, when combined with other acquisitions made by the same corporation within a specified period, the acquisition would be likely to substantially lessen competition in a market. The aggregation model is essentially the same as the amendments set out in Senator Fielding's Trade Practices (Creeping Acquisitions) Amendment Bill 2007. The Discussion Paper does not discuss the length of the 'specified period'. In Senator Fielding's Bill, the specified period was 6 years.

The aggregation model has the benefit of simplicity. It looks appealing at first sight and in theory it could benefit some markets. However, we



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consider that the aggregation model is unlikely to be effective in the supermarket sector.

Our concern with the aggregation model is that the ACCC's approach to market definition makes that model very hard to apply to supermarket acquisitions. In order for the aggregation model to apply, there must be multiple acquisitions by the same person in the same market within the specified period.

The ACCC's previous assessments of supermarket acquisitions have all focussed on the local retail market. That market is generally only 3-5km wide in metropolitan areas. Because the area of that market is so small, there is very little chance that there will be more than one supermarket acquisition by the same person in that market within the specified period. As a result, the aggregation model may never be applicable to the local retail market. Given that this market is generally the critical market when applying section 50, any change to the TPA needs to be capable of being applied in this market.

In the Grocery Inquiry, the ACCC stated that it has not been able to identify any supermarket acquisitions in the last five years where the result would have been different 'had the ACCC been able to take into account other acquisitions *in the same market*' (emphasis added).⁷ This statement is not evidence that creeping acquisitions are not a problem. Instead, it shows that any solution to creeping acquisitions must be designed in a way that reflects the issues caused by market definition. There is no point amending the TPA to insert a provision dealing with creeping acquisitions if it may never be used in practice.

For these reasons, we do not support the aggregation model. If a model along these lines was to be pursued by the Government, it would need to be modified in some manner so that it could apply to the local retail market.

Some refinements to the market power model may be appropriate

Our suggested wording for the new provision

We recommend that the new provision should prohibit an acquisition by a corporation that has a substantial degree of power in a market if that

⁷ *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, page 427 (electronic version)



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acquisition would have the effect, or be likely to have the effect, of lessening competition in a market.

This wording creates a two-step test. The first step is to assess whether the corporation has a substantial degree of power in a market. We consider that the wording for that first step should match the wording of section 46 of the TPA. Given that there is a significant amount of case law on the meaning of 'substantial degree of power in a market' in relation to section 46, it would be preferable to use exactly the same wording in the new section so that this case law applies.

The second step is to assess whether there is a lessening of competition. We consider that the wording for this second step should match the current wording of section 50(1), except for deleting the word 'substantially'.

It seems preferable to follow the current wording of section 50(1) and just delete the word 'substantially', rather than amending the wording to also add the word 'any'. The addition of 'any' may suggest an intention to lower the standard so far that it covers all acquisitions, even those where the effect on competition is negligible. Obviously there is no reason to prohibit an acquisition that will have no effect on competition, or that will only have a negligible impact.

If there is a concern that this wording may set the standard too low, then an option may be to state in the TPA that the new provision does not apply where the lessening of competition is negligible. We consider that this approach is preferable to trying to insert into the new provision a new standard that is higher than 'any' but lower than 'substantial'. Inserting a new standard into the provision would cause considerable uncertainty about its interpretation.

This proposed wording also differs slightly from that in the Discussion Paper in that it refers to lessening competition 'in a market'. In contrast, the Discussion Paper refers to a lessening of competition 'in *that* market' and implies that the same market must be used for the market power test and the lessening of competition test.

We do not consider that it is appropriate to depart from the current wording of section 50 and refer to 'that market' instead of 'a market'. The lessening of competition should not need to be in the same market as the market in which the corporation has substantial power. This approach is important to address the fact that supermarket acquisitions involve several markets. It is also consistent with the approach taken in section 46. The recent Federal Court decision on section 46 in *Baxter*⁸

⁸ *ACCC v Baxter Healthcare Pty Ltd* [2008] FCAFC 141



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illustrates how a corporation can act anti-competitively by leveraging its market power in one market to limit competition in another market.

It may be appropriate to limit the new provision to certain defined industries

We consider that the market power model will be an appropriate and effective response to competition concerns in the supermarket sector. However, we recognise that the problems currently faced in the supermarket sector may not be faced by other industries and it is possible that introduction of the market power model could have unintended consequences for other industries.

If there are significant concerns about the effect of the new provision on other industries, then it may be appropriate to limit the new provision to certain highly concentrated industries or those that are at risk of becoming highly concentrated due to creeping acquisitions. One option may be to include a Ministerial declaration process or other mechanism for specifying the industries to which the new provision applies. However, the risk of unintended consequences in other industries is not a reason to do nothing and leave the problems in the supermarket sector unresolved.

Possible mechanisms for clarifying who has market power

It will be critical that industry participants know whether the new provision applies to them – ie whether they have a substantial degree of power in a relevant market. It will also be necessary for the ACCC to be able to continue to decide informal clearance applications in a short timeframe. We have some concerns that the current tests for market power do not provide sufficient certainty to achieve those objectives.

The Discussion Paper does not provide details about the test that would be used to assess market power, but it appears that the test would be similar to the current test under section 46. The Discussion Paper also refers to assessing market power in light of the factors in section 50(3). However, it is not clear how some of those factors would be relevant to an assessment of market power. As noted above, we recommend that the market power test should be the same as under section 46 so that the existing case law about the interpretation of that section applies. Using different language is likely to cause increased uncertainty as to the meaning of the new provision.

We consider that the Government should also consider new mechanisms in order to simplify the process for assessing market power. The complexities of market definition in the supermarket sector mean that the requirement to assess market power could result in significant costs and delays if market power has to be assessed afresh



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for each proposed acquisition on the basis of the relevant local retail market.

One possibility to address the issues around the assessment of market power would be to include a form of two-stage process. The new provisions could allow or require the ACCC to make a decision in advance about which corporations have substantial market power. That assessment could be made on a state-wide or national basis and determine which corporations have market power in that wider market. The ACCC could then apply the new test to those corporations as and when acquisitions are proposed.

This type of two-stage process would provide maximum certainty for all parties as to whether the new provision applies to them. It would also allow the ACCC to assess each proposed acquisition quickly, as it would not need to reconsider the market power issue each time and it could just focus on the lessening of competition question (which it could continue to assess using the same three markets as it currently does).

If the new provisions only applied to certain specified industries, then this two-stage approach would be particularly easy to implement. The decision on which corporations are covered by the new provisions could be made at the same time as the decision on which industries are covered. Alternatively, it could follow immediately after that decision but before the new prohibition comes into effect in relation to those industries.

In addition, if the two-stage process was not adopted, the ACCC could be required or encouraged to publish guidelines on its approach to the market power assessment.



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Concluding remarks

The IGA National Board reiterates its support for the Government's action to address creeping acquisitions. The issues identified above should not deter the Government from progressing amendments to the TPA to address this issue. The comments that we raise in relation to the market power model are all simply refinements to a model that we consider to be the best way to address what is a very real problem that is reducing competition in the supermarket sector.

We would appreciate the opportunity to make further comments on this issue once the Government has decided on its preferred model and draft amendments have been prepared.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Michael Daly', written over a light grey rectangular background.

Michael Daly
Chairman, IGA National Board