Unconscionable conduct in the context of competition law with special reference to retailer / supplier relationships within Australia

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Introduction

Not only in Japan, but also in Australia and around the world, the word 'Abenomics' has become a famous epithet for the Japanese Government's current policies to revive and increase the competitiveness of the Japanese economy. One of the three key elements (or 'arrows') of Abenomics is microeconomic reform. Microeconomic reform has also recently become a major public policy issue in Australia, with policymakers looking to strengthen the Australian economy as the country experiences the end of the boom in mining investment, and as the commodity prices for many of the country's key export products have fallen sharply.

In Australia, the renewed focus on microeconomic reform has been pursued through the Competition Policy Review recently undertaken for the Australian Government. The Review was conducted by a Panel, which was chaired by an economist, Professor Ian Harper. Consequently, the Review is commonly referred to as the Harper Review. The Harper Review took 12 months (from March 2014 to March 2015) to conduct a wide-ranging review of Australia's competition policy, law and institutions. It recommended, among many other matters, significant changes to important areas of the Australian economy, such as health and education, which are currently subject to competitive forces only to a limited degree.

Despite the broad nature of its inquiry, the most controversial aspect of the Harper Review has related to the long-standing complaints regarding the dominance of Australia's two major supermarket chains, Coles and Woolworths. This is a major political and public policy issue in Australia. As discussed below, the two major supermarket chains account for approximately 70% of all sales by grocery stores in Australia. There have been a wide variety of complaints about their conduct, including in relation to their much smaller suppliers.

This paper provides an overview of the current status of the retail grocery industry in Australia. We then consider the arguments for and against the proposition that the dominance of the major supermarket chains is a problem for which something must be done. On the assumption that at least some aspects of the current situation are undesirable, we then consider a range of potential policy responses. They are: divestiture, merger law, price control, cartel laws, misuse of market power, unconscionable conduct, industry codes and other legal measures.

In relation to these potential policy responses, there have recently been two significant developments in Australia. The first is the Harper Review's re-ignition of

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the long-running debate about the Australian law on misuse of market power (s 46 of the *Competition and Consumer Act 2010* (Cth)). The Review has recommended a complete re-write of that law to address difficulties in its application. This recommendation has largely been interpreted as directed at the major supermarket chains, although that interpretation is not supported by a close reading of the Harper Review's final report.

Further, the proposed new law seems unlikely to prohibit much of the conduct by the major supermarket chains that is commonly complained of. That is because some of that conduct is, on a conventional economic understanding, prima facie pro-competitive and other conduct, whilst being arguably unfair towards particular suppliers, is not likely to substantially lessen the level of competition in the market.

The second significant development in recent years has been in the law relating to unconscionable conduct. Unconscionable conduct, also known as 'unconscientious conduct' or 'unconscientious dealing', is a concept that comes from the old English Courts of Chancery and has religious overtones. Despite this unlikely background, unconscionable conduct is now at the forefront of the law relating to consumer protection and, more controversially, the law relating to fair dealing between businesses in Australia. This has culminated in the recent success by the Australian competition regulator, the Australian Competition and Consumer Commission ('**ACCC**'), against Coles in relation to Coles' conduct towards its suppliers.[1] We consider this litigation in detail below as a case study. In short, Coles admitted late last year that it had engaged in unconscionable conduct by pressuring its suppliers to agree to pay Coles for various rebates and other amounts that Coles was not entitled to. Interestingly, the ACCC pursued this case not as a misuse of market power, but as unconscionable conduct. This area is, however, controversial because of the concern that the law may unduly interfere in the operation of trade and commerce and the market.

Overview of the retail grocery industry in Australia

Current level of market concentration

The Australian retail grocery industry is highly concentrated and dominated by Coles and Woolworths. Both Coles and Woolworths are part of large corporate conglomerates that, in addition to groceries, supply many other products such as stationery, liquor, gaming, hospitality, clothing, home wares and resources.

The precise market shares of Coles and Woolworths are controversial, and depend upon whether the market is confined to products sold through grocery stores or includes the same products sold through other channels. Applying the more limited market definition, Coles and Woolworths' combined market share has increased:[2]

- from approximately 30% in the mid-1970s;

[1] *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405 ('***ACCC v Coles***').
[2] Alexandra Merrett and Rhonda L Smith, 'The Australian Grocery Sector: Structurally Irredeemable?', paper presented at *Supermarket Power in Australia: A Public Symposium*, Melbourne, 1 August 2013, 9.

- to 46% in the mid-1980s;
- to 58% in the mid-1990s;
- to 74% in the mid-2000s;
- to about 80% by 2011/12, comprising 37% for Coles and 43% for Woolworths.

By comparison, the recent Harper Review relied on the market share figures in the ACCC's 2008 report into the grocery industry. That report found that the percentage market shares of the two largest players was '30+' and '≈ 25'. The same report also found that Independent Grocers of Australia ('**IGA**') had a market share of approximately 15% to 17%. IGA is a banner group for independent grocery stores, supplied by the wholesaler Metcash.

In late 2014, it was agreed in the settlement of *ACCC v Coles* that Coles supplied approximately 30% of the grocery products supplied for retail sale to customers in Australia and that, together with Woolworths, Coles supplied approximately 60% to 70% of grocery products at a retail level in Australia.[3]

In 2001, the German-based discount supermarket chain ALDI entered the Australian market. According to recent research by credit ratings agency Moody's, ALDI's entry has been mainly at the expense of independent retailers, including IGA.[4] Moody's considered that ALDI's current share of the Australian grocery market is approximately 8%, and that ALDI represents a long-term strategic challenge to Coles and Woolworths.

In 2008, the ACCC carried out an extensive public inquiry into the competitiveness of retail prices for standard groceries.[5] The inquiry held hearings around Australia and received over 250 public submissions. The ACCC concluded that grocery retailing in Australia was 'workably competitive' but there were a number of factors that limit price competition, such as high barriers to entry and expansion (particularly in finding new development sites), the limited incentives for Coles and Woolworths to compete aggressively on price and the limited price competition that Coles and Woolworths face from the independent sector.

The ACCC's 2008 findings have not silenced the concerns regarding the market dominance of Coles and Woolworths.

Factors leading to the current situation

The current level of concentration can be attributed to a number of factors. First, there have been a number of mergers allowed by competition authorities. These include the Coles and Myer merger in 1985 and the Woolworths and Safeway merger in the same year.[6]

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[3] *ACCC v Coles* [2014] FCA 1405, app 1, [9].
[4] Peter Ryan, 'ALDI Threat Growing for Coles, Woolworths: Moody's', *ABC News*, 5 March 2015, www.abc.net.au/news/2015-03-05/aldi-threat-growing-for-coles2c-woolworths/6282558.
[5] ACCC, *Report of the ACCC Inquiry into the Competitiveness of Retail Prices for Standard Groceries* (2008).
[6] Allan Fels, 'The Regulation of Retailing: Lessons for Developing Countries' (2009) 15(1) *Asia Pacific Business Review* 13, 14.

In the 1990s, there was also a series of mergers at the wholesale level in which Davids took over Composite Buyers, Queensland Independent Wholesalers ('**QIW**') and Independent Holdings, as well as the Jewel supermarket retail chain.[7] Davids was subsequently acquired by Metcash, a firm from South Africa. This consolidation resulted in one dominant firm with near monopoly in the wholesale sector, which was of course a shrinking sector.

Second, Franklins, which was the main competitor to Coles and Woolworths, decided to pull out of the Australian market in 2001 as a result of a decision by its Hong Kong-based owner, Dairy Farm. Like ALDI, Franklins was primarily a discount grocery retailer. The Franklins brand and a network of Franklins stores in New South Wales were purchased by the South African retail group Pick 'n' Pay. Coles and, in particular, Woolworths acquired many of the larger Franklins stores.[8]

Third, consumer preferences have changed over time, favouring the larger supermarkets typically run by Coles and Woolworths over smaller grocery stores typically run by independents.

Petrol and 'shopper dockets'

Another development has been the expansion of the major supermarkets into the retail sale of petrol. Woolworths opened its first retail petrol station in 1996, and began routinely offering a discount of 4 cents per litre on petrol to consumers who produced a receipt or 'shopper docket' of at least $30 in value from a Woolworths supermarket or other retail store.[9] In July 2003, Coles announced an alliance with Shell, under which Coles took over the management of Shell's core franchise network of petrol stations in Australia, which were re-badged as 'Coles Express' service stations. In August 2003, Woolworths and Caltex announced a joint venture under which Woolworths would operate approximately 500 petrol stations, all branded as both Caltex and Woolworths, with Woolworths owning the majority of the sites and Caltex owning the balance.

Following the arrangements with two of the four major petrol companies (the other two being BP and Mobil), both Coles and Woolworths offered 'shopper docket' discounts on petrol. The ACCC allowed these arrangements to be put into place, believing that they would lead to greater competition in the fuel sector and ultimately lower petrol prices for consumers. These arrangements have been controversial, however, with claims that they have effectively destroyed small independent petrol retailers.

Over time, the size of the 'shopper docket' discounts increased until they reached up to 45 cents per litre in 2013. This prompted an ACCC investigation, as a result of which Coles and Woolworths gave enforceable undertakings to the ACCC under the *Competition and Consumer Act 2010* (Cth) that the discounts would be limited to 4

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[7] Simon Evans, 'The Struggle against Supermarket Giants', *Australian Financial Review*, 31 October 2013.
[8] ACCC, *Assessing Shopper Docket Petrol Discounts and Acquisitions in the Petrol and Grocery Sectors* (2004) 24–5
[9] ACCC, *Petrol Prices and Australian Consumers: Report of the ACCC Inquiry into the Price of Unleaded Petrol* (2007) 181.

cents per litre. In 2014, the ACCC sued both Coles and Woolworths for allegedly breaching their undertakings by offering discounts greater than 4 cents per litre. The ACCC's case against Coles failed, and the ACCC was only partly successful against Woolworths. The court held that the terms of the undertakings given did not prohibit the retailers from offering additional discounts conditional on the consumer purchasing a minimum value of non-petrol products at the petrol station.

There are arguments for and against whether the 'shopper docket' discounts are anticompetitive. However, in its eagerness to approve discounts on petrol for consumers, the ACCC arguably paid insufficient attention to the significance of the relationships being entered into between the major supermarkets and the major oil companies. It might be thought that there would have been much stronger competition in petrol retailing if major supermarkets and their 'shopper dockets' had been kept separate from the major oil companies.

Private label

There has also been concern regarding the major supermarkets' increasing promotion of private label products, rather than branded products. This has resulted in complaints that the choice of products available to consumers is diminishing.[10]

The use of private label products can also put suppliers in an invidious position where, if their branded product is not replaced entirely by a private label product, it may be promoted less favourably by the supermarket than the supermarket's own private label product. Further, in some cases, suppliers are themselves manufacturing the private label products for the major supermarkets, and hence manufacturing a product to compete against their own branded product.

Recent price wars

Over time, Woolworths was able to increase its market share without jeopardising its very healthy retail margins. This may have been attributable to deficiencies in the management of Coles over many years.

In 2007, Coles was bought out by Wesfarmers in the largest takeover in Australian corporate history. Wesfarmers is now credited with a substantial turnaround in Coles' financial performance, partly as a result of its well-known 'Down Down' low-prices campaign.

On Australia Day (26 January) 2011, Coles dramatically reduced the price of its private label plain white milk from $2.41 for a two-litre container to $1 per litre.[11] Woolworths, ALDI and some other competitors quickly matched the discounted price. The discounting resulted in a furious backlash from dairy farmers, who claimed that the pricing was unsustainable and would damage the dairy industry in the long-term. This led to an inquiry by the Senate (the upper house of the Commonwealth

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[10] Alice Dalley and Zoya Sheftalovich, 'The Situation on the Supermarket Shelves', *Choice Report*, 11 September 2014, www.choice.com.au/shopping/everyday-shopping/supermarkets/articles/choice-supermarket-specials.

[11] Esther Han, 'Milk Wars: Coles Admits to Errors in Ad Campaign', *Sydney Morning Herald*, 7 April 2014.

Parliament), at which the ACCC rejected the claims against Coles, and pointed out the significant savings consumers were enjoying as a result of the lower prices.[12] The price of private label plain white milk remains at $1 per litre to this day.

Despite the furore over the so-called 'milk wars', the pattern of discounting has continued. In September 2014, Woolworths, followed by Coles and ALDI, discounted the cost of a private label loaf of white bread from $1 to 85 cents.[13] The move was part of a new lower-prices campaign by Woolworths called 'Cheap Cheap'. This again led to claims that the major supermarkets would damage the baking industry, however, the ACCC again defended the discounting because of the benefits of lower prices for consumers.

According to analysts at UBS and Deutsche Bank, the favourable market conditions for Coles and Woolworths may be coming to an end, with the rise of ALDI and the milk- and bread-wars.[14] However, in March 2015, the ACCC Chairman, Mr Rod Sims, gave a media interview in which he stated that Woolworths' profit margins were still among the highest of any large supermarket chain in the world.[15] He also considered that the high profit margins of Woolworths and Coles were largely a result of a 'very cosy duopoly' which had expanded for decades but was now being challenged by ALDI.

Convenience stores

Recently, Coles and Woolworths have both begun opening smaller stores in the central business district ('**CBD'**) of major cities.[16] This is part of a new convenience store strategy, competing with 7-Eleven and other similar operators, given the increasing number of people living in apartments in the CBD, where there is not sufficient space for large format supermarkets. It therefore seems that the major supermarkets have given up just being supermarkets.

Industry code

On 26 February 2015, the Australian Government announced that it had prescribed a new food and grocery code of conduct to address issues between grocery retailers and suppliers. The code and the background to it are considered in further detail below.

Is the current situation a problem?

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[12] Henrietta Cook, 'Milk Wars Leave Sour Taste in Farmers' Mouths', *Sydney Morning Herald*, 21 January 2012.

[13] Sue Mitchell, 'The Truth Behind the Bread Wars', *Sydney Morning Herald*, 26 September 2014.

[14] Madeleine Heffernan, 'Supermarkets' brave new world', *The Age*, 7 March 2015. Woolworths' margins have come under increasing pressure in recent times, and it recorded its first quarterly profit fall in 20 years: Sue Mitchell, 'Woolworths to surrender fat margins under Coles, Aldi assault', *Australian Financial Review*, 7 May 2015, 1.

[15] Simon Evans, 'ACCC Chairman Rod Sims Says Woolworths Has Fatter Margins as Suppliers Fear Profits Shrinkage', *Sydney Morning Herald*, 9 March 2015.

[16] Carolyn Cummins and Julie-anne Sprague, 'Woolworths, Coles to take on convenience stores', *Sydney Morning Herald*, 6 October 2014; Simon Johanson, 'Retail Giant Woolworths Rolls out Small Convenience Stores in Melbourne' *Sydney Morning Herald*, 17 December 2014.

There are conflicting views as to whether the current state of the retail supermarket industry in Australia is a problem that requires a solution.

A recent survey, conducted on behalf of independent grocery retailers, indicated that 72% of consumers consider that Coles and Woolworths dominate the grocery market too much, and only 22% believe that there is healthy competition in the grocery industry.[17]

It is perhaps inevitable that smaller, less efficient competitors and suppliers are likely to complain that major supermarket chains have too much market share, too much market power and too much bargaining power. However, the difficulty is in determining whether these claims have a proper economic basis, or merely reflect disappointment at the outcome of the competitive process.

A degree of buyer power may also be a good thing, as it may result in retailers paying their suppliers lower prices, and the retailers therefore being able to deliver lower prices to consumers. Lower prices for consumers are a good thing, both from an economic perspective and a political one, given that 'cost of living' pressures are a significant political issue.

There are also features of the Australian grocery industry which make it more likely to be highly concentrated. The industry involves high fixed costs at both the wholesale and retail levels with the majority of those costs being common costs that are difficult to allocate across a large number of products.[18] This cost structure makes economies of scale extremely important, particularly in a country like Australia, which has a relatively small population spread relatively diversely over a large geographic area.

Further, the major supermarket chains have done a good job in giving consumers what they want: the convenience of a wide range of products, along with additional services such as car parking and strategic locations. Consumers have voted with their feet and their wallets.

There is also an argument that 'monopoly' profits resulting from greater efficiency are an important part of the competitive process. This is because the lure of such profits gives firms an incentive to innovate and invest.[19]

The Harper Review received many submissions in relation to the major supermarket chains. The concerns raised in those submissions included that major supermarket chains were engaging in predatory conduct, such as 'predatory capacity' to drive out independent retailers, that the prices that the major supermarkets pay to suppliers are too low and that this results in suppliers being forced to charge higher prices to other retailers, and that the major supermarket chains' treatment of their suppliers is unfair.[20]

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[17] Sue Mitchell, '75pc of Australians want more competition for Coles and Woolworths, Masters Grocer survey shows', *Sydney Morning Herald*, 31 March 2015.
[18] Merrett and Smith, above n 2, 3–4.
[19] *Verizon Communications Inc v Law Offices of Curtis V Trinko*, LLP 540 US 398, 407 (Scalia J).
[20] Competition Policy Review, *Final Report* (2015) 285.

Despite these concerns, the Harper Review did not find any particular problems with the state of competition in the retail supermarket industry. Rather, the Review was concerned that competition law should not be used as a means to restrain a big, effective or innovative competitor from providing benefits to consumers. As discussed below, however, the Review did recommend strengthening the misuse of market power law. The Review also noted that the ACCC had recent success in litigation against Coles and that the Food and Grocery Code of Conduct had recently come into effect. Both of those matters are considered below.

The Harper Review also rejected concerns that the move of large supermarket chains into regional areas had reduced amenity and had adverse effects on local communities. The Review considered that these issues reflected structural changes in the market, such as a change in consumer preferences away from 'main street' retail trading towards shopping centres, and that while these changes have the potential to damage individual businesses, it should ultimately be a matter for consumer preferences and choice to determine which businesses succeed and prosper in a market.[21]

The Harper Review did not deal with the concern found by the UK Competition Commission in its 2008 report into the grocery sector, that the behaviour of grocery retailers involved a 'transfer of excessive risk and unexpected costs' to suppliers that had the potential to have 'an adverse effect on investment and innovation in the supply chain, and ultimately on consumers.'[22] As noted above in relation to the 'milk wars', one complaint is that the major supermarkets' discounting is unsustainable, and that this will have an adverse effect on the food industry in the long-term. The Harper Review seemed largely content to leave these issues to be addressed by the competitive process, subject to a revised law on misuse of market power to protect that process.

Further, as shown by the *ACCC v Coles* case study below, it appears that the major supermarkets' market dominance can enable them to engage in various types of 'unfair practices' with impunity. Their suppliers are simply not in a position to challenge the major supermarkets' conduct, because of the suppliers' fear of retribution from their most important customer(s). The major supermarket chains may not enter into long-term supply contracts with their suppliers, or at least not contracts that require the major supermarkets to acquire a minimum volume of products. As such, suppliers remain heavily dependent on the continuing goodwill and support of the major supermarket chains to continue buying their products. In many cases, this is notwithstanding that the suppliers have, with the knowledge and encouragement of the supermarket chains, made significant investments in scaling up their operations in order to meet the requirements of the major supermarkets. If the major supermarkets decide no longer to purchase such a supplier's product, the supplier is left with a stranded asset.

The Harper Review also did not consider whether the major supermarkets face a lack of competition because of the high degree of concentration, and whether that

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[21] Ibid 287.

[22] United Kingdom Competition Commission, *The Supply of Groceries in the UK Market Investigation* (2008) 6.

means that the gains the major supermarkets are able to exploit from their suppliers are not passed on, but instead result in higher margins to the retailers. Despite the debate over the correct level of market concentration, and the growing presence of ALDI, it does seem that the Australian supermarket sector, dominated as it is by only two major supermarket chains, is more concentrated than would be desirable for effective competition.

In summary, while some of the complaints against the major supermarkets in Australia appear to relate to pro-competitive and efficient conduct that should not be discouraged, the high level of concentration does appear to create problems, in particular in relation to the major supermarkets' ability to charge high margins and their conduct towards much smaller suppliers. We turn now to consider potential policy responses to address these problems.

Potential policy responses

1 Divestiture

If the fundamental problem is too much market concentration, then a standard textbook solution would be to break up the existing firms. This type of remedy is commonly referred to as 'divestiture'. It has been used in the United States in relation to oil, cigarettes and telephone services. In the United Kingdom, divestiture has recently been used in relation to airports.

Divestiture may be an appropriate remedy in some circumstances. However, in the present context, it presents a number of legal and practical difficulties. There may also be some special difficulties in applying divestiture as a remedy to retail.

Unlike the US and some other jurisdictions, divestiture is not an available remedy for a breach of Australian competition law, except for breach of the law that prohibits anticompetitive mergers.[23] There have been repeated political calls for divestiture to be introduced as a remedy for misuse of market power. Those calls were recently rejected by the majority of a Senate committee.

The Harper Review also recommended against making divestiture a remedy for misuse of market power. The Harper Review took this position because of the practical difficulties of a court dividing an organisation, and because such a division may result in a loss of scale efficiencies. The Harper Review suggested that, if some form of industry reorganisation is desirable, it may be better for Parliament, rather than a court, to undertake that process. However, it is debatable whether divestiture is better managed by a court applying a legal process or by Parliament applying a political process.

2 Merger law

Australian competition law prohibits a merger or acquisition that would or is likely to have the effect of substantially lessening competition.[24] This test replaced an earlier,

[23] *Competition and Consumer Act 2010* (Cth) ss 81 and 81A.
[24] *Competition and Consumer Act 2010* (Cth) s 50.

weaker prohibition, which was in force up to 1993, against mergers that gave rise to dominance or increased dominance. It was under that earlier prohibition that the Coles-Myer and Woolworths-Safeway mergers took place.

One of the first tests of the stronger prohibition came in 1994, when the ACCC successfully blocked an attempted takeover of Foodland by Rank (a New Zealand company) and Coles-Myer. Foodland was the largest grocery wholesaler in Western Australia. Foodland supplied independent supermarkets and controlled some supermarkets itself. Rank proposed to acquire Foodland, and then sell Foodland's Australian assets to Coles-Myer under a collateral agreement. The takeover would have meant Coles-Myer had approximately 75% of the wholesale grocery market in Western Australia. The ACCC was concerned about Coles-Myer increasing its buying power in relation to suppliers, and its competitive power against small retailers to whom it would have been both their supplier and their competitor.[25] The ACCC obtained an injunction to prevent the takeover, showing that it would not let the big retailers take over wholesalers. It is doubtful the takeover could have been stopped under the previous 'dominance' test, given the existence of Woolworths as another major competitor.[26]

More recently, in 2011, the ACCC failed in its bid to prevent Metcash's acquisition of Franklins from Pick 'n' Pay.[27] The court rejected the ACCC's argument that Metcash and Franklins were each other's only real competitors for the wholesale supply of packaged groceries in New South Wales. The court held that, rather than being in separate market, Coles and Woolworths were a genuine competitive constraint on Metcash and Franklins. On the evidence, the ACCC also failed to establish its 'counterfactual' — that, if Franklins was not acquired by Metcash, it would have been acquired by another identified consortium of retailers. The case has left considerable uncertainty as to the standard of proof that applies when the ACCC tries to prove its counterfactual.

In the same year, the merger law was strengthened further to deal with so-called 'creeping acquisitions'. This was intended to deal with the situation where a firm made a series of acquisitions, each of which was not in itself significant, but which were significant when considered in total.

After the 'creeping acquisition' laws were introduced, the ACCC agreed with Coles a streamlined assessment protocol for supermarket acquisitions for a six-month trial period.[28] A key aspect of the protocol was that the supermarkets would be obliged to notify the ACCC of an acquisition, whereas such notifications are otherwise voluntary under Australian competition law. The ACCC failed to reach a similar agreement with Woolworths, and Coles did not continue with the protocol after the trial period.

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[25] Allan Asher (ACCC), 'Win/win with the ACCC', *Allen Allen & Hemsley Trade Practices Seminar Series*, Sydney, 13 October 1998, 3–4.
[26] Allan Fels (ACCC), 'The Change from a Dominance to a Substantial Lessening of Competition Test in Australia's Merger Law', *2002 Fordham Corporate Law Institute Conference: Roundtable on Substantive Standards for Mergers and the Role of Efficiencies*, 31 October 2002, 11.
[27] *ACCC v Metcash Trading Limited* [2011] FCAFC 151.
[28] ACCC, 'Only Limited Acceptance by the Major Supermarket Chains of ACCC's Proposed Streamlined Acquisition Assessment Protocol', *ACCC Media Release NR257/12*, 7 December 2012.

3 Price control

Another possible approach is to attempt to regulate retail prices directly by imposing legal maximum prices. This approach was used in Australia in the 1970s, however, it was extremely complex and does not appear to have been effective.

Given the increased complexity of retailing since the 1970s, price control does not appear to be a viable option, although there are, from time to time, increased demands placed on the ACCC to monitor pricing in particular industries. Recently, the ACCC has been required to increase its monitoring of petrol pricing and to issue regular reports on that issue.

4 Cartel laws

Based on the analysis above of the supermarket sector, it does not appear that lack of competition is due to cartel conduct, which is subject to both criminal penalties and civil penalties under the *Competition and Consumer Act 2010* (Cth) (although no criminal cartel prosecutions have been brought since the criminal prohibitions came into force in 2009). Further, as with price control, there are simply so many products that it would appear difficult to run a retail supermarket cartel effectively.

That said, there have been cartel cases successfully brought against Coles and Woolworths, although not for engaging in a cartel with each other. In 2005–06, Liquorland (a subsidiary of Coles) and Woolworths were fined $4.75 million and $7 million respectively for each entering into restrictive agreements with a number of parties as a condition of Liquorland or Woolworths withdrawing their objections to the other parties' liquor licence applications.[29] The restrictive agreements prevented, for example, the restricted parties from selling takeaway liquor, operating a drive-through bottle shop or expanding their business beyond a certain size.

The ACCC is also presently running a case in which it alleges that Woolworths and three large suppliers (Colgate, PZ Cussons and Unilever) engaged in cartel conduct in relation to the supply of laundry powders.[30] It is alleged that those firms colluded in relation to the introduction into the market of a new type of product (ultra concentrate laundry powders), so as to ensure that the savings resulting from lower production, transport and storage costs (compared to standard concentrate laundry powders) were not passed on to consumers.

5 Misuse of market power

As well as trying to prevent the accumulation of market power, another major policy option is to attempt to regulate the behaviour of firms that have already acquired market power. Australian competition law does this primarily through the prohibition on misuse of market power.[31] The law, as it currently stands, prohibits a corporation

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[29] ACCC, 'Woolworths penalised $7 million for anticompetitive liquor deals', *ACCC Media Release MR 328/06*, 22 December 2006.

[30] ACCC, 'ACCC takes action against alleged laundry detergent cartel', *ACCC Media Release NR 297/13*, 12 December 2013.

[31] *Competition and Consumer Act 2010* (Cth) s 46.

that has a substantial degree of power in a market from taking advantage of that power for one of three prohibited purposes:

(a) eliminating or substantially damaging a competitor;
(b) preventing the entry of a person into a market; or
(c) deterring or preventing a person from engaging in competitive conduct.

Although the section speaks of conduct that may damage a competitor, the High Court of Australia has made clear that the object of the section is to protect the interests of consumers, and that the courts accept that:[32]

> Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to "injure" each other in this way. This competition has never been a tort … and these injuries are an inevitable consequence of the competition s 46 is designed to foster.

It will be noted that the section requires proof of one of the three proscribed anticompetitive purposes. Therefore, it is not sufficient, in order for there to be a breach of the section, for the corporation's conduct to have an anticompetitive effect or likely effect. Whether this should be the case has been a long-running debate in Australian competition law. The purpose test means that a corporation that has a substantial degree of market power does not need to fear breaching the section, so long as it is acting for legitimate commercial purposes that are not anticompetitive. On the other hand, if the conduct of a corporation with a substantial degree of market power will have a significant adverse effect on competition, then it is little consolation that the effect was not intentional.

Further, as a practical matter, it is difficult for a putative plaintiff to commence an action for misuse of market power without knowing what the putative defendant's purposes were for its conduct. The plaintiff may only have the ability to determine conclusively what those purposes were once the plaintiff has obtained discovery of documents from the defendant. That is a risky approach in entering into what would be very difficult litigation against a large and well-resourced company. The legislation attempts to address this issue somewhat by expressly providing that purpose may be ascertained by inference from the corporation's conduct alone.[33]

There has also been considerable debate regarding the 'taking advantage' element of the prohibition. That element requires consideration of how the firm with a substantial degree of market power would have behaved if it had not had that degree of market power. The legislation attempts to clarify this issue by stating that the court may have regard to matters such as whether the conduct was 'materially facilitated' by the corporation's market power, whether the corporation relied on its market power, whether the corporation would have engaged in the conduct if it did

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[32] *Queensland Wire Industries Pty Limited v Broken Hill Pty Co Limited* (1989) 167 CLR 177, 191 (Mason CJ and Wilson J).
[33] *Competition and Consumer Act 2010* (Cth) s 46(7).

not have market power, and whether the conduct is otherwise related to the corporation's market power.[34]

In addition, there have been difficulties proving that predatory pricing contravenes the law on misuse of market power. The ACCC famously lost a predatory pricing case where a corporation with market power was selling below cost in order to meet the market in a price war due to excess production capacity in the market.[35]

As a result of these difficulties, a specific prohibition on predatory pricing was introduced in 2007.[36] Under that specific prohibition, a corporation that has a 'substantial share' of a market must not supply goods or services for a 'sustained period' at a price that is less than the 'relevant cost' to the corporation of supplying those goods and services for any of the same anticompetitive purposes referred to in the primary prohibition on misuse of market power. Despite various criticisms of the drafting, and concerns that the prohibition would have a chilling effect on competition, the specific prohibition on predatory pricing has never been used in litigation, or considered by the courts.

Notwithstanding the difficulties associated with the present law, the ACCC has had some success in prosecuting cases for misuse of market power.[37] Relevantly, the ACCC successfully prosecuted Safeway (then owned by, and now part of, Woolworths) for misuse of market power in 2003.[38] This is discussed in the following case study.

Case Study: The ACCC's misuse of market power case against Safeway

Safeway sought to ensure that it was the price leader in premium branded bread, which was one of the key products which consumers used to determine whether a supermarket was price-competitive with other supermarkets. Safeway adopted a policy that, if any of its competitors were paying a lower price for a particular premium branded bread, Safeway would ask the baker to sell that bread to it at the same price that the competitor was paying.

Safeway was initially successful in persuading the main corporate bakers, which supplied the vast majority of plant-baked bread in Victoria, to give Safeway a price equivalent to the price being paid by Safeway's competitors. However, Safeway later expanded its policy to provide that if a satisfactory deal could not be done with the baker, then the relevant product would no longer be stocked by Safeway's supermarkets.

Safeway argued that its purpose was to ensure that it appeared price-competitive and not to punish the bakers for discounting when they sold to Safeway's competitors. However, Safeway removed from its stores more than simply the particular product that was being sold at a lesser price to competitors and, in some

[34] *Competition and Consumer Act 2010* (Cth) s 46(6A).
[35] *Boral Besser Masonry Ltd v ACCC* (2003) 215 CLR 374.
[36] *Competition and Consumer Act 2010* (Cth) s 46(1AA).
[37] For example, *ACCC v Ticketek Pty Ltd* [2011] FCA 1489 and *ACCC v Cabcharge Australia Ltd* [2010] FCA 1261.
[38] *ACCC v Australian Safeway Stores Pty Ltd* (2003) 129 FCR 339.

cases, Safeway ceased stocking a product before seeking a better deal from the baker.

On appeal, the Full Federal Court held (by a 2:1 majority) that in four incidents Safeway's purpose in deleting the products was to deter the bakers from supplying cheap generic bread to independents and, in those incidents, Safeway had misused its market power.

The court imposed a substantial fine of $8.9 million.

Despite the relatively limited circumstances in which the current law on misuse of market power applies, Australian politicians have generally been wary of expanding its application because of a fear that this may create a 'chilling effect' on competition. However, the recent Harper Review has recommended a complete re-write of the prohibition. Under the Harper Review's proposal, the law would prohibit a corporation with a substantial degree of market power from engaging in conduct that has the purpose, effect or likely effect of substantially lessening competition. The proposal would therefore introduce what is referred to as an 'effects test', in the sense that an anticompetitive effect could be proved rather than an anticompetitive purpose. The proposal would also eliminate the requirement to prove a 'taking advantage' of market power.

The Harper Review's proposal regarding misuse of market power has been heavily criticised by the major supermarket chains, and the Chief Executive Officer of Coles' parent company in particular, on the basis that the proposal would stifle competition. The Commonwealth Government received the Harper Review's final report on 31 March 2015 and has commenced a further round of public consultation on the final report. We are awaiting the Government's response as to whether it supports the Harper Review's proposal. If it does, the Government will likely require the support of minor parties in the Senate as the Opposition has already indicated its intention to oppose the changes for fear of an adverse effect on competition and creating a 'lawyers' picnic'.

6 Unconscionable conduct

In this section of the paper, we consider the development of the concept of unconscionable conduct in Equity, the subsequent importation of the concept into statutory form, and then its consideration by the courts.

In Equity

The law of unconscionable conduct operates as an exception to the importance the law traditionally attaches to 'freedom of contract'. Historically, the law derives from the old English Courts of Chancery, which were courts exercising jurisdiction in Equity, whereas separate courts adjudicated cases under the common law. The Chancery was originally the Royal Secretariat and appears to have functioned like a department of a state.[39] The Chancellor, who was the head of the Chancery, had several important roles in Government. As far as it is known, the earliest

[39] Rohan Havelock, 'The Evolution of Equitable 'Conscience' (2014) 8 *Journal of Equity* 128, 131–2.

Chancellors were monks who acted as clerical advisers to the King. In the medieval period, Chancellors were usually bishops.

The word 'unconscionable' may be defined as:[40]

> 1. Showing no regard for conscience; not in accordance with what is right or reasonable; unreasonably excessive; … egregious, blatant. … 2. Having no conscience; not controlled by conscience; unscrupulous.

The word 'conscience' derives from the Latin '*con*' (with) and '*scientia*' (knowledge, from '*scire*': to know), and means 'knowledge with (God)' or 'to know as God knows'.[41]

The concept of 'conscience' has been used since at least the late 14th century.[42] The concept appears to have had different meanings in different contexts throughout its long history; at some times referring to the conscience of the Chancellor personally; at other times referring the King's conscience, or a party's individual conscience; at other times an 'impersonal and external standard of judgment'.[43]

Originally, Equity was intended to be a jurisdiction that countered the strictness of the common law. However, over time, the flexibility of Equity became the cause of heavy criticism. In 1617, John Selden famously criticised Equity as arbitrary, using the analogy of the Chancellor's foot:[44]

> Equity is a roguish thing; for law we have a measure, know what to trust to; equity is according to the conscience of him that is Chancellor, and as that is larger or narrower, so is equity. 'Tis all one as if they should make the standard for the measure we call a foot, a Chancellor's foot; what an uncertain measure would this be? One Chancellor has a long foot, another a short foot, a third an indifferent foot; 'tis the same thing in a Chancellor's conscience.

As a result, Equity began to be systemised into a body of rules and principles very similar in character to the common law.

In Australia, the modern law of unconscionable conduct applies where a party to a transaction was under a 'special disability' in dealing with the other party, and that disability was sufficiently evident to the stronger party to make it unfair or 'unconscientious' for it to accept the weaker party's consent to the transaction.[45] The types of 'special disability' cannot be exhaustively listed, however, they include 'poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary'.[46]

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[40] *Shorter Oxford English Dictionary* (6th ed, 2007) vol 2, 3417.
[41] Havelock, above n 39, 136.
[42] Ibid 136, citing J L Barton, 'Equity and the Medieval Common Law' in R A Newman (ed), *Equity in the World's Legal Systems* (1973) 139, 146.
[43] Ibid 130.
[44] F Pollock (ed), *Table Talk of John Selden* (1927) 43.
[45] *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447, 474 (Deane J).
[46] *Blomley v Ryan* (1954) 99 CLR 362, 405 (Fullagar J).

Under statute

As well as being prohibited in Equity, unconscionable conduct is now also prohibited by statute under the *Australian Consumer Law* (a schedule to the *Competition and Consumer Act 2010* (Cth)). The statute prohibits not only unconscionable conduct 'within the meaning of the unwritten law' (that is, unconscionable conduct in Equity) but also a broader, statutory form of unconscionable conduct.[47]

The chief reason for the introduction of unconscionable conduct in statute was to broaden the range of remedies available compared to the situation in Equity, which allowed only for rescission of the relevant contract.[48] The *Australian Consumer Law* provides for a wide variety of remedies, including awards of damages, injunctions and corrective advertising.

Another advantage of including unconscionable conduct in the legislation is that it allows the ACCC to take action for unconscionable conduct. The latter consideration is particularly important given that a weaker party is usually not in a position itself to take legal action against the stronger party.

It may appear unusual for an economic regulator such as the ACCC to have responsibility for enforcing a law such as unconscionable conduct. However, there are advantages in this. The law must be applied in the context of the market and consumer protection. The ACCC should be familiar with, and understand, the issues in the market and therefore enforce the law in a way that makes economic sense. If the responsibility of enforcement was given to another body, not concerned with the operation of the market and trade and commerce, there may be greater concerns that the law would be used to wreak havoc on trade and commerce and business certainty.

At one stage, the legislation contained different prohibitions for unconscionable conduct against consumers[49] and businesses.[50] The latter section was designed specifically to address problems faced by small businesses with retail tenancy, franchising and finance agreements.[51] One statutory form of unconscionable conduct now covers both consumers and businesses.

The legislation makes clear that a court is to assess whether conduct is unconscionable 'in all the circumstances'. This is a very fact-intensive process.

The legislation also provides that the courts may have regard to a non-exhaustive list of matters, which include:

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[47] See *Australian Consumer Law* ss 20 and 21.
[48] Commonwealth, *Parliamentary Debates*, House of Representatives, 3 November 1992, 2407–8 (Michael Duffy, Attorney-General).
[49] *Trade Practices Act 1974* (Cth) s 51AB.
[50] *Trade Practices Act 1974* (Cth) s 51AC.
[51] See Peter Reith, Commonwealth of Australia, *New Deal: Fair Deal — Giving small business a fair go* (30 September 1997), reproduced in Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1997, 8765–71.

- The relative bargaining strengths of the parties;
- Any requirement that the weaker party comply with conditions that were not reasonably necessary to protect the stronger party's legitimate interests;
- Whether the weaker party would understand any documentation relating to the transaction;
- Any undue influence or pressure or unfair tactics;
- The price of the goods or services acquired, and the price for which they could have been acquired from another supplier;
- Whether the stronger party's conduct towards the weaker party was consistent with the stronger party's conduct in relation to other parties in similar transactions;
- The requirements of any applicable industry code;
- Any material non-disclosure by the stronger party of the stronger party's intended conduct or any risks to the customer from that conduct;
- Whether the stronger party was willing to negotiate the terms and conditions of the contract; and
- The extent to which the parties acted in good faith.

The express inclusion of these matters was designed to ensure that the courts find unconscionable conduct in circumstances that are not as restricted as in Equity.

It seems strange for Parliament in modern legislation to resort to an ancient legal and religious concept such as 'conscience'. However, in doing so, Parliament has deliberately sought to take advantage of the history and longevity of this concept, which, along with its moral overtones, gives the law a measure of legitimacy and authority.[52]

It also appears that Australian politicians have been more prepared to increase the scope of unconscionable conduct over time, rather than increase the application of the law against misuse of market power. This is perhaps because unconscionable conduct is perceived as less of an interference in the workings of trade or commerce and the market.

Application by the courts

Despite Parliament's intention that the statutory form of unconscionable conduct be available more broadly, the courts have exercised considerable restraint in finding unconscionable conduct — at least until recently. For example, in one case, the High Court of Australia (Australia's highest court) held that a shopping centre

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[52] See further Matthew Lees, 'Contract, Conscience, Communitarian Conspiracies and Confucius: Normativism through the Looking Glass of Relational Contract Theory' (2001) 25 *Melbourne University Law Review* 82, 120.

landlord had not engaged in unconscionable conduct when it required, as a condition of renewal of the tenant's existing lease, that the tenant release the landlord from various claims under the existing lease.[53]

The courts have repeatedly emphasised that unconscionable conduct means something more than just hard bargaining. This led one judge to conclude that a finding of unconscionable conduct imports 'a pejorative moral judgement'.[54] In another decision, a judge emphasised the danger of 'rearrang[ing] the legal rights of persons on the basis of vague general standards which are capable of misuse unless the application is carefully confined' and held that unconscionability 'is a concept which requires a high level of moral obloquy.'[55]

'Obloquy' is not a word commonly used in English and may be defined as 'the discredit or disgrace resulting from public blame or revilement' (*Macquarie Dictionary*) or 'verbal abuse directed against a person; detraction, calumny, slander' (*Oxford English Dictionary*).[56]

There is currently a debate about whether 'moral obloquy' is required in order for there to be unconscionable conduct.[57] The Victorian Court of Appeal has held that, although it should not be used as a substitute for the word 'unconscionable', the notion of 'moral obloquy' is appropriate.[58] On the other hand, the concept of 'moral obloquy' has been criticised for being itself ambiguous, and not necessarily providing any clearer guidance to the resolution of a particular case than the word 'unconscionable'.[59]

A different approach to unconscionable conduct has recently been taken by the Full Federal Court in a case concerning door-to-door sales of vacuum cleaners to a group of elderly women.[60] The court explained its approach as follows:[61]

> The task of the Court is the evaluation of the facts by reference to a normative standard of conscience. That normative standard is permeated with accepted and acceptable community values. In some contexts, such values are contestable. Here, however, they can be seen to be honesty and fairness in the dealing with consumers.

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[53] *ACCC v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51. See also *Kavakas v Crown Melbourne Ltd* (2013) 298 ALR 35, where the High Court dismissed an unconscionable conduct claim by a problem gambler against a casino, and the following case note: Rick Bigwood, 'Still Curbing Unconscionability: *Kavakas* in the High Court of Australia' (2013) 37 *Melbourne University Law Review* 463.
[54] *Qantas Airways Ltd v Cameron* (1996) 66 FCR 246, 267 (Lindgren J).
[55] *Attorney-General (NSW) V World Best Holdings Ltd* (2005) 63 NSWLR 557, [119]–[122] (Spigelman CJ). This was a case under s 62B of the *Retail Leases Act 1994* (Cth), another piece of legislation that uses the concept of 'unconscionable'.
[56] Cited in *PT Ltd v Spuds Surf Chatswood Pty Ltd* [2013] NSWCA 446, [103] (Sackville AJA).
[57] See, eg, Robert Baxt, 'What Place Does 'Moral Obloquy' Have in the Evaluation of Statutory Unconscionable Conduct?' (2014) 88 *Australian Law Journal* 396; Russell V Miller, *Miller's Australian Competition and Consumer Law Annotated* (37th ed, 2015) [1.S2.21.15].
[58] *Director of Consumer Affairs Victoria v Scully* [2013] VSCA 292.
[59] *Canon Australia Pty Ltd v Patton* [2007] NSWCA 246, [4] (Basten JA); *PT Ltd v Spuds Surf Chatswood Pty Ltd* [2013] NSWCA 446, [103] (Sackville AJA).
[60] *ACCC v Lux Distributors Pty Ltd* [2013] FCAFC 90 ('***ACCC v Lux***').
[61] Ibid [23].

Interestingly, the court drew upon consumer protection legislation and, in particular, the regulation of door-to-door selling, to discern what were the applicable norms and values to be applied.

In connection with the relationship between unconscionable conduct and morality, the court said:[62]

> Notions of moral tainting have been said to be relevant, as often they no doubt are, as long as one recognises that it is conduct against conscience by reference to the norms of society that is in question. The statutory norm is one that must be understood and applied in the context in which the circumstances arise. The context here is consumer protection directed at the requirements of honest and fair conduct free of deception. Notions of justice and fairness are central, as are vulnerability, advantage and honesty.

Here the court can be seen to move away from a conception of unconscionable conduct based on morality and towards a conception based on social norms and values. However, it should also be noted that, in the case in question, the door-to-door sales persons practised a 'deceptive ruse' to gain entry to the homes of the elderly women (promising them a maintenance check of their existing vacuum cleaners, which was undertaken to an extent), and that element of deception could be said to have satisfied any requirement of moral tainting.

It is this broader concept of unconscionability, based on social norms, that was applied in the ACCC's case against Coles for unconscionable conduct towards its suppliers.

Case Study: The ACCC's unconscionable conduct case against Coles

Investigation

The ACCC's unconscionable conduct case against Coles followed an intensive investigation that took approximately two-and-a-half years before proceedings were issued. The ACCC commenced an investigation in November 2011 after media reports that supermarket suppliers were being treated inappropriately by the major supermarket chains.

The ACCC sought information from market participants about these issues but suppliers were reluctant to speak to the ACCC because of a fear of adverse consequences of providing information to the ACCC.

In February 2012 the ACCC called on suppliers to provide information on the basis that the ACCC would seek to protect the confidentiality of the information provided. Following this announcement, approximately 50 market participants approached the ACCC on a confidential basis. The ACCC then commenced an in-depth investigation into the issues raised, and used its compulsory information gathering powers to require suppliers and Coles to provide information.

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[62] Ibid [41].

The ACCC commenced proceedings against Coles in May 2014. The ACCC ultimately issued two court cases against Coles for unconscionable conduct.

ARC proceeding

The first proceeding related to Coles' 'Active Retailer Collaboration' ('**ARC'**) program.

The ARC program related to various investments that Coles had made in its supply chain, including its distribution centre, network and systems and processes for ordering and distributing stock. Coles, together with the Boston Consulting Group, then developed a strategy for Coles to recover from its suppliers costs savings which Coles considered had been or would be achieved across its supply chain. Coles considered that the changes it had made would benefit both Coles and its suppliers by changing Coles' ordering patterns to order groceries in more economically efficient ordering quantities ('**EOQ**'), and by Coles introducing a 'supplier portal' which allowed improved data sharing between Coles and its suppliers.

Coles decided that it would seek an ARC rebate from so-called 'Tier 3 suppliers'. These were approximately 220 suppliers, who were Coles' smaller suppliers and who were reliant on Coles for a very significant part of their business. They were contrasted with 'Tier 1 suppliers', (Coles' largest suppliers such as Nestle, General Mills and Procter & Gamble) and 'Tier 2 suppliers' (large suppliers with 'simple' supply chains).

Coles determined that it would seek agreement from Tier 3 suppliers for an ARC rebate comprising a data sharing component of 0.7% of the price paid by Coles for a supplier's product and an 'EOQ component' calculated by Coles based on a series of assumptions about the Tier 3 suppliers' activities. This included a standard formula that was used for all Tier 3 suppliers regardless of each supplier's individual circumstances. Coles had also set a revenue target of $16 million for the amount that it would seek to obtain in ARC rebates from Tier 3 suppliers in the financial year ending 30 June 2012.

Coles then developed a plan as to how Tier 3 suppliers would be approached to secure their agreement to pay the ARC rebate. The plan involved, among other things, asking the suppliers to agree to pay the ARC rebate within a number of days and, if they did not agree, escalating the request to a person with higher authority within Coles. Coles personnel attended training in which they were told that the ARC rebate was not optional for suppliers, as Coles 'needed' to achieve its $16 million target, and that various prizes would be awarded to Coles personnel who 'landed' suppliers. Coles staff were also told that, if a supplier did not agree to pay an ARC rebate within one or two days, they were to consider using commercial leverage.

In summary, the ARC rebate was not an amount that Coles was entitled to under its contractual arrangements with its suppliers. Notwithstanding this, Coles demanded that suppliers pay the rebates to it. The rebates were calculated by reference to past orders, and Coles pressured suppliers to answer quickly, often suggesting adverse commercial consequences it could and would impose if the supplier refused.

In the case of some suppliers, Coles made threats to cease existing agreements with those suppliers, which would significantly impact the suppliers' businesses and ability to supply products to Coles in the future.

Claims proceeding

The second proceeding involved Coles seeking payment from suppliers outside of its contractual trading arrangements for so-called 'profit gaps', waste and mark downs, and short or late deliveries.

Coles awarded prizes to staff for meeting profit targets and set aside days that were referred to within Coles as a 'Profit Day' or 'Perfect Profit Day', when staff were to try to secure targets of money from suppliers.

The 'profit gaps' arose where Coles' profit in respect of a supplier's product did not increase in line with the supplier's sales growth. Even though this could be due to Coles' own actions, and outside the control of the suppliers, Coles encouraged its staff to seek payments or other funding from suppliers in order to make up the reported profit gap. Similarly, waste and mark downs may have been due to Coles' actions.

Coles also decided to impose 'penalties' or 'fines' on suppliers that Coles had recorded as not delivering the products ordered by Coles on time and in full. The penalties were not calculated by reference to any assessment by Coles of the cost to Coles (if any) of the short or late delivery.

Settlement and judgment

After first vigorously defending the ACCC's allegations, Coles reached a settlement with the ACCC shortly prior to Christmas in 2014. The matter then went before the court to make orders giving effect to the settlement.

In her Honour's judgment, Gordon J described Coles' conduct as follows:

Coles' misconduct was serious, deliberate and repeated. Coles misused its bargaining power. Its conduct was "not done in good conscience". It was contrary to conscience. Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings. Coles demanded payments from suppliers to which it was not entitled by threatening harm from suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold.

The settlement involved Coles paying penalties totalling \$10 million as well as \$1.25 million towards the ACCC's legal costs. Justice Gordon noted that the maximum available penalty for each contravention under legislation was \$1.1 million, and questioned whether that was sufficient for a corporation such as Coles, which has an annual revenue in excess of \$22 billion. Coles also agreed to undertake a program whereby it would compensate suppliers who had suffered as a result of its conduct.

The court applied the explanation of unconscionable conduct recently endorsed by the Federal Court in *ACCC v Lux* — namely, conduct against conscience by reference to the norms of society that is in question. It is significant that the same approach to unconscionable conduct was applied notwithstanding that the matter involved unconscionable conduct toward businesses, which were of substantial size and not unsophisticated, as opposed to consumers. There was, however, no change in the language used by the court in describing unconscionable conduct. The court emphasised repeatedly the size of Coles compared to its suppliers, each of which had annual revenue less than 1% of Coles' annual revenue.

Analysis

The ACCC has already promoted the case as a landmark victory and setting a new precedent for dealing with unfair conduct toward small businesses. In its stated priorities for 2015, it has also included seeking increased maximum penalties so that there is an even greater deterrent against this type of conduct.

As the matter settled, the legal issues involved in the case were not fully tested in court. Prior to the settlement with the ACCC, Coles had maintained that its conduct was consistent with ordinary business practice, in which rebates are commonly negotiated. It is only once the conduct is seen through the prism of Coles' market power, the high-pressure tactics employed and the practical inability of its suppliers to refuse Coles' demands, that Coles' 'requests' for payment took on a more sinister character.

It is doubtful whether this type of conduct by a dominant firm would be captured as a misuse of market power. This is true under either the existing Australian law or the revised law proposed by the Harper Review. Coles did not have the purpose of eliminating competitors or deterring them from engaging in competitive conduct. Similarly, it seems unlikely that this type of conduct — unless it was widespread and pervasive throughout the market — could result in a substantial lessening of competition. The issue is not so much the detriment to the competitive process, but rather the abuse of the absence of competitive constraint. However, when the court is assessing whether there has been unconscionable conduct, one of the matters that the court may take into account is the relative strengths of the bargaining positions of the parties. This enables courts to take into account issues such as market power in assessing whether there has been unconscionable conduct.

The case leaves open, however, how far unconscionable conduct can be stretched. In this case, Coles' justification for seeking payments seemed dubious at best. If Coles had been completely accurate about the reasons it was seeking payment then this would arguably have made it more difficult to find that the conduct was unconscionable, even though the suppliers would likely still have considered that they had little practical alternative but to agree to Coles' request. Whilst Coles' justifications for seeking the rebates may have clothed its requests with a degree of respectability, it was the underlying market dominance that was the real reason why Coles was able to press its case for payment of the rebates.

Further, the suppliers might have agreed to pay Coles if Coles had sought payment as part of some new contract or arrangement, and Coles was simply seeking to drive a hard bargain. In that situation, it would be much more difficult to say that Coles' conduct involved immorality or contravention of some well-accepted social norm.

Interestingly, the development of the law in this area has revealed that claims of unfair conduct against suppliers are not limited to Coles and Woolworths. Two suppliers to Metcash have now commenced proceedings alleging that Metcash engaged in unconscionable conduct by, among other matters, demanding its suppliers pay for business trips by its staff to Japan, Las Vegas and Hawaii, as well as demanding payment of large rebates.[63]

7 Industry codes

In March 2015, the Government announced that it had introduced the Food and Grocery Code of Conduct as a voluntary industry code prescribed under the *Competition and Consumer Act 2010* (Cth). The code was developed jointly by Coles, Woolworths and the Australian Food & Grocery Council (a representative body for processed food, drink and grocery manufacturers and suppliers).[64]

As a voluntary code, the code applies only to retailers or wholesalers that have agreed to be bound by the code. However, there have been suggestions that, if retailers fail to do so, the Government may introduce a mandatory code. ALDI signed up to the code straight away. Metcash / IGA has indicated that it will implement the provisions of the code on a trial basis over a twelve month period and was 'hopeful' of formally agreeing to the code after that.[65] Coles and Woolworths indicated that they would assess their position once the code had been considered by Parliament, which has the power to disallow the code.

An earlier Retail Grocery Industry Code of Conduct was established as a voluntary, industry-run code in 2000. It was not prescribed under the *Competition and Consumer Act 2010* (Cth) and was later renamed the Produce and Grocery Industry Code of Conduct. That code took the form of voluntary guidelines that set out high-level principles — for example, terms and conditions of supply contracts were to be negotiated in clear, concise, meaningful and accurate terms, and the use of written agreements was encouraged.[66] There was also an Ombudsman who provided mediation services. However, the committee that administered this earlier code ceased meeting in 2011 after a number of the key participating organisations resigned in 2009.

The new code is designed to provide a range of protections for suppliers dealing with grocery retailers and wholesalers:

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[63] Madeleine Heffernan, 'Suppliers accuse Metcash of unconscionable conduct', *Sydney Morning Herald*, 5 February 2015.
[64] Australian Government, 'Improving Commercial Relationships in the Food & Grocery Sector', *Food and Grocery Code Consultation Paper* (2014) 1.
[65] Anna Vido, 'ALDI, Metcash on Board for New Voluntary Supermarket Code of Conduct', *ABC Rural*, www.abc.net.au/news/2015-03-02/supermarket-code-enacted/6273244.
[66] Australian Government, above n 64, 39–40.

- Supply agreements between a grocery retailer or wholesaler and supplier must be in writing, and must specify certain matters, such as delivery requirements, the circumstances in which groceries may be rejected by the retailer or wholesaler, and circumstances in which the agreement may be terminated.

- The retailer or wholesaler must not unilaterally vary the agreement without the supplier's consent, nor may the retailer or wholesaler vary the agreement retrospectively.

- Retailers are prohibited from requiring payments from suppliers for shrinkage, wastage, being a supplier, better positioning of groceries, the retailer's activities or funding promotions — except in certain circumstances including, broadly, that the payment is reasonable in the circumstances having regard to the likely benefits to the supplier and the likely benefits to the retailer.

- Retailers may only delist a supplier's grocery products in accordance with the terms of the supply agreement and for genuine commercial reasons.

- Retailers must publish or provide to their suppliers their ranging and shelf space allocation principles, and then act in accordance with those principles.

- There is also an express legal obligation on a retailer or wholesaler to deal with suppliers lawfully and in 'good faith'.

- The retailer or wholesaler is required to appoint a code compliance manager, to whom a supplier may direct complaints, and who must investigate complaints and give regular reports to the ACCC.

- Suppliers also have the ability to seek mediation or arbitration of disputes relating to matters covered by the code.

The prohibitions in the new code seem well-directed towards the types of complaints that have been commonly raised against the major supermarket chains. Further, the code gives additional power to the ACCC in relation to enforcement. However, the code has also been strongly criticised on the basis that there are no penalties for breaching the code, and that there should be an independent Ombudsman to investigate complaints by suppliers, rather than an investigation controlled by the retailer or wholesaler, given the practical inability of the ACCC to become involved in the myriad of day-to-day issues that arise between suppliers and retailers or wholesalers.[67] It is also doubtful whether the code will overcome the reluctance of suppliers to raise complaints in the first place, for fear of adverse consequences to their business.

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[67] Australian Broadcasting Corporation, 'Former supermarket watchdog warns new Food and Grocery Code gives all the power to major retailers', *Radio National*, 30 April 2015.

8 Other legal measures

Contract

The law of contract should provide suppliers with a degree of legal protection in their dealings with the major supermarkets. However, that protection appears to be severely compromised due to the suppliers' lack of bargaining power and inability to negotiate, let alone enforce, reasonable contractual protections of their interests.

Misleading or deceptive conduct

Section 18 of the *Australian Consumer Law* contains a broad prohibition against engaging in conduct, in trade or commerce, that is misleading or deceptive or likely to mislead or deceive. In many cases, the complaints against the major supermarkets' conduct towards their suppliers appear to involve some element of misleading or deceptive conduct.

For example, a major supermarket may have misrepresented, by words or conduct, that it would continue to acquire from a supplier over an extended period of time, or alternatively increase the volume of products it would acquire from the supplier, without contractually committing to such a position. If the supplier relies on such representations, which are later not honoured by the retailer, then the supplier is entitled to seek damages. However, again the supplier confronts the difficulty of bringing a legal claim against its major customer, as well as the difficulties associated with litigation against a large and well-resourced company.

It should also be noted that unconscionable conduct cases often seem to involve some element of misleading or deceptive conduct. For example, in *ACCC v Lux*, the door-to-door salespeople used a 'deceptive ruse' to gain access to the homes of the elderly women. In *ACCC v Coles*, it appears Coles did not have a proper basis for some of the claims it made to suppliers about how they would benefit from the ARC program.

Unfair contracts

The Commonwealth Government has also committed to extending the unfair contracts regime under the *Australian Consumer Law*, which currently only protects consumers, to protect small businesses as well. On 15 April 2015, the Government announced that it had received confirmation that the States and Territories of Australia would provide the required support to enable this reform.[68]

The new law will protect small businesses employing fewer than 20 employees and transactions under $100,000 in value or, for multi-year contracts, totalling less than $250,000.

Under the current regime that protects consumers, a court is able to declare that a term of a standard form contract with a consumer is unfair and therefore void. The

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[68] The Hon Bruce Billson MP, Minister for Small Business 'States and Territories commit to unfair contract protections', media release, 15 April 2015.

court is given wide discretion under this law.[69] The court can determine whether a contract is a 'standard form contract' based on matters such as:

- 'whether one of the parties has all or most of the bargaining power relating to the transaction';
- 'whether the contract was prepared by one party before any discussions relating to the transaction occurred between the parties'; and
- 'whether another party was given an effective option to negotiate the terms of the contract'.[70]

Key terms of the contract such as its main subject matter and price are excluded from the operation of the regime.[71]

A term is 'unfair' if it causes significant imbalance in the parties' rights and obligations, is not reasonably necessary to protect the legitimate interests of the party advantaged by the term and would cause detriment (whether financial or otherwise) to a party. In deciding whether a term is unfair, the court may take into account matters such as the extent to which the term is transparent and the contract as a whole. The legislation also lists a number of different types of terms that 'may be unfair', such as:

- a term that permits one party to avoid or limit performance of the contract;
- a term that permits only one party to terminate the contract;
- a term that penalises one party for breach or termination of the contract; and
- a term that permits only one party to vary the terms of the contract.

The Government's rationale for extending the unfair contracts regime to protect small businesses has been that if such protections are appropriate for consumers, then they are also appropriate for small businesses.

[69] *Australian Consumer Law* pt 2-3.
[70] *Australian Consumer Law* s 27.
[71] *Australian Consumer Law* s 26.

Conclusion

The problem of market dominance

The major supermarkets' market dominance in Australia has presented a significant legal and policy challenge. There is an ongoing debate about the extent to which that dominance reflects efficiencies of scale, which are highly desirable in the circumstances in the Australian market. However, it appears that there are also some legitimate grounds for concerns regarding the adverse effects that market dominance has, in particular in relation to the ability to charge high margins and unfair tactics used against suppliers.

Whilst the use of unfair tactics against suppliers may or may not create a significant economic problem, it appears clear that such conduct is not acceptable to the Australian community. The major supermarkets' market dominance is the fundamental reason why they are able to engage in such conduct. This means that, for example, suppliers that are heavily dependent on the major supermarkets are not in a position to negotiate or enforce contractual or other legal rights against the major supermarkets.

The analysis in this paper suggests that, once market dominance has arisen, it is not sufficient for policymakers to attempt to rely on the competitive process to address the problems that arise as a result of the market dominance. In that situation, the market cannot be expected to exercise on a dominant firm the competitive constraints that would apply to firms in a far more competitive market. Over time, market dominance may be eroded, as new technologies and competitors arise. However, in the interim, the Australian experience suggests that consumers and the public will not tolerate the type of conduct that may be engaged in by firms with market dominance.

The application and classification of appropriate policy responses

The focus then turns to the application of remedies. For a problem of this magnitude, it appears advantageous for one government body, such as the ACCC, to have available to it a range of potential policy responses that are able to be deployed, as the situation requires, subject to appropriate legal safeguards regarding the use of such policy responses. This has the advantage of ensuring a coordinated response to the problem, as well as making one particular government body accountable. Further, since the problem of market dominance is fundamentally an economic problem, it is important that each of the policy responses is used with a proper understanding of the economic situation, and with sensitivity to avoid unduly interfering with the operation of trade or commerce and the market.

Australian competition law has adopted a range of policy responses in an effort to combat some of the adverse effects of market dominance. They can be categorised as follows:

<u>Category 1</u> Policy responses aimed at preventing the achievement of market dominance: • merger law • cartel law	**<u>Category 2</u>** Policy responses designed specifically to restrain the conduct of a dominant firm, sometimes in a particular industry: • misuse of market power • price control • industry codes
<u>Category 4</u> Policy responses aimed at destroying market dominance that has already been achieved: • divestiture	**<u>Category 3</u>** Policy responses based on laws of general application (or at least applicable not only to dominant firms), which may be able to restrain the conduct of a dominant firm: • unconscionable conduct • other legal measures, such as unfair contracts legislation

Each category of policy responses has its strengths and weaknesses and, we argue, a role to play in an effective competition law regime.

<u>Category 1</u> would ordinarily be the first preference, as it avoids market dominance being achieved in the first place. However, as we have seen with the supermarket sector in Australia, this category may not provide the answer because:

- market dominance has already arisen before the policy response (for example, stricter merger laws) became available;

- despite the availability of the policy response, market dominance arises anyway (for example, one or more major players exits the industry for financial reasons); or

- market dominance may be the inevitable consequence of efficiencies that are highly desirable from a broader welfare perspective.

Merger law applies a broad standard that evaluates the degree of lessening of competition. The application of such a standard to relatively rare transactions is appropriately carried out (at least in the first instance) by a regulatory agency, as happens *de facto* in Australia with the ACCC's informal merger clearance process.

By contrast, the cartel laws (at least in their present form in Australia) are drafted as very detailed, technical rules, in very broad and abstract terms, with severe sanctions applying. While the severe sanctions mean that the cartel laws should draw a clear line between legal and illegal conduct, and be applied independently and with due process by a court, this gives rise to the potential that certain types of undesirable conduct may not be captured by the laws.

<u>Category 2</u> policy responses, as with category 3 policy responses, attempt to restrain the conduct of dominant firms where market dominance has already arisen. However, category 2 is specifically targeted at dominant firms, or industries subject to market dominance. As such, it would be expected that policy responses in this category would be well-suited to restrain dominant firms. However, category 2 policy responses have been beset by a range of practical and legal problems and they do not appear to have been as effective as desired.

To understand why this is the case, it is important to note that category 2 contains laws based on broad principles (such as misuse of market power) and laws based on detailed regulation (price control). The current Food and Grocery Code of Conduct encompasses both types of rules, being very specific about what must and must not be included in a supply agreement, as well as imposing a broad, overarching duty to act in good faith.

The current Australian law on misuse of market power embodies a broad standard, but with several criteria that limit the operation of the law: the requirement to prove one of the proscribed anti-competitive purposes, and the requirement to prove a 'taking advantage' of market power. The Harper Review's proposed new law would avoid those practical and legal difficulties, and instead employ a broad standard of substantial lessening of competition. This is intended to encourage courts to focus on that fundamental economic issue. However, the flexibility of such a standard gives rise to concerns, including by the major supermarkets, about its operation being too 'uncertain'. It is presumably such concerns that led to the limiting concepts of purpose and 'taking advantage' being included in the law in the first place.

On the other hand, detailed regulation may not be practical in some situations. We have seen this difficulty with price control and the numerous products sold by retailers.

<u>Category 3</u> contains laws of general application, and it is in this area that there have been interesting recent developments in Australia, particularly in relation to unconscionable conduct. Laws in this category rely not on arguments about the economic impact of the prohibited conduct, but rather on other, commonly moral, considerations.

As such category 3 policy responses have a (moral) authority that the more economic policy responses lack, although it sometimes appears that the justification for laws such as misuse of market power and cartel conduct (particularly with the criminalisation of the latter) also involves an element of moral condemnation. As noted in the case study of *ACCC v Coles* above, unconscionable conduct may also prohibit unfair conduct that a dominant firm can engage in because of its market dominance, whereas other policy responses (such as misuse of market power) may not be available because of the limited impact on the competitive process.

However, there seems to be an unfortunate tendency with category 3 policy responses to use obscure words such as 'unconscionable' and 'obloquy' as if they are magical incantations with the power to overcome (or at least obscure) a lack of principled reasoning. Further, the difficulty of category 3 policy responses is that, because of their general nature, it is often not clear how they should be applied in an economic context. The courts have traditionally been very reticent to find that commercial conduct breaches these moral standards, particularly where the weaker party is sufficiently sophisticated to understand and act in its own best interest. The legislature has, however, directed the courts to expand this narrow understanding of what is unconscionable.

Although category 3 policy responses are not primarily based on economic matters, it is imperative that, when they are applied in an economic context, the economic context and commercial realities are properly understood. This is illustrated well by the recent unconscionable conduct cases in Australia:

- In *ACCC v Lux*, the court could have found that the elderly women knew what they were doing in buying the new vacuum cleaners, and not suffering any significant disadvantage in dealing with the salesperson who had invested considerable time and effort in attending their homes and performing the (albeit perfunctory) maintenance check of their existing vacuum cleaners. This was essentially the approach of the trial judge. However, the Full Court had a very different interpretation of the relationship between the 'helpful' vacuum cleaner 'maintenance persons' and the elderly women, and the subtle pressure that was applied to the elderly women in their homes.

- In *ACCC v Coles*, although the orders were made by consent, the court had no difficulty concluding that the Tier 3 suppliers' economic and commercial position made it practically impossible to refuse Coles' 'requests' for money. In other cases, however, it may be much more difficult for the court to determine whether to accept such conduct ought be prohibited, or whether the traditional presumptions about 'hard bargaining' and 'freedom of contract' should be applied.

In applying general concepts such as unconscionable conduct, an economic regulator and enforcement agency such as the ACCC has an important role to play in analysing the market and educating the court about the issues involved. It is also important for the regulator to educate the public, and build community consensus, about the seriousness of market dominance in a particular sector. That type of consensus helps support and explain decisions as to whether conduct is found to breach the law or not.

Category 3 policy responses are not, however, a complete solution to market dominance. Whilst unconscionable conduct may curb some of the more outrageously unfair conduct of dominant firms (such as baseless and brazen demands for money), it does not address the underlying market dominance, and it seems likely that the dominant firm may still be able to achieve similar results through more acceptable processes. For example, in *ACCC v Coles*, Coles may well have been able to extract similar concessions or value from other participants in the supply chain in the next round of contract negotiations.

Category 4 is the policy response of divestiture. As discussed above, divestiture has been used in a number of countries other than Australia. In Australia, divestiture is not an available policy response for misuse of market power, only for breach of the laws that prohibit anticompetitive mergers.

As noted by the Harper Review, divestiture may include a loss of scale efficiencies, and potentially higher prices or reduced services to consumers. There are also likely to be practical difficulties in applying divestiture to the retail sector. However, unlike the other categories of policy responses discussed above, which attempt to prevent market dominance arising (category 1) or to prevent certain types of conduct that dominant firms might otherwise be able to engage in (categories 2 and 3), divestiture is a policy response that aims to tackle what appears in many cases to be the root of the problem, which is the high market concentration and the existence of market dominance itself.

The difficulty of exercising legal rights

A final consideration with each potential policy response is the extent to which it relies on weaker parties, who may be dependent on the dominant firm, to exercise their legal rights against the dominant firm. For the Tier 3 suppliers in *ACCC v Coles*, the law of unconscionable conduct was neither necessary nor sufficient to prevent them paying Coles rebates that Coles was not entitled to. The suppliers could have relied on their rights under the law of contract but, in most cases, despite the law of unconscionable conduct, the suppliers did not feel able to do so because of the fear of commercial retaliation by Coles.

In that case, the significance of the law of unconscionable conduct was that it enabled the ACCC to investigate and prosecute the matter as a breach of the *Australian Consumer Law*, and enabled the court to award penalties. If the matter had been merely a breach of contract case, the ACCC would not have had jurisdiction to investigate and the court would not have been able to award penalties.

Similarly, as noted above, one concern expressed with the new retail grocery industry code is that it relies on suppliers exercising the various rights that they have under the code, but does not address the reasons why suppliers do not exercise their legal rights against the major supermarkets in the first place.

The commercial inability of suppliers to exercise their legal rights suggests three further conclusions. First, it underscores the commercial strength of market dominance and the limitations of the legal system in redressing it. Second, it demonstrates the need for an effective regulator to be able to take enforcement action against a dominant firm. Third, given the practical difficulty of a regulator becoming involved in a myriad of day-to-day operational matters, it suggests that appropriate dispute resolution mechanisms other than formal litigation may need to be created.

The importance of public opinion

There are few sources of power that can be used to combat market dominance. However, one of those powers is that of consumers. This suggests that the debates over the market dominance of the major supermarkets must continue to be fought out in the public arena, as well as in the courtrooms and offices of government regulators. This also suggests the importance of transparency, and therefore public accountability, regarding the conduct of dominant firms.

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There are no simple or perfect solutions to the problem of market dominance. However, the various potential policy responses described in this paper, both individually and together, may ameliorate some of the adverse consequences of what is likely to be an enduring problem.