CHAPTER 4: PRICE DISCRIMINATION

Background

Price discrimination occurs when like goods or services are provided to different persons at different prices, the difference in price being unrelated to the cost of providing the goods or services. Common examples occur when discounts or concessions are given to students or pensioners for the purchase of goods or services.

From 1974 until 1995, section 49 of the Act prohibited a corporation from discriminating between purchasers of goods of like grade or quality in relation to the prices charged or by other means such as discounts, allowances, rebates or credits. Section 49 was based on the provisions of the *Robinson-Patman Act 1936* in the United States.

In 1993, the Hilmer Committee recommended that section 49 be repealed. The Hilmer Committee's recommendation echoed the concerns of previous inquiries, including the Swanson Review in 1976 and the Blunt Review in 1979. The concern was that section 49 generally discouraged competitive prices and so worked against economically efficient outcomes. The Hilmer Committee concluded that price discrimination generally enhances economic efficiency, except in cases which might be dealt with by section 45 (anti-competitive agreements) or section 46 (misuse of market power). To the extent that section 49 had any effect, the Hilmer Committee thought that it had diminished price competition. It recommended that a provision such as section 49 should form no part of a national competition policy. Section 49 was repealed in 1995. The second reading speech for the amending legislation, the *Competition Policy Reform Act 1995*, said:

> 'The prohibition against price discrimination is to be repealed as the provision is largely redundant, and the conduct it is designed to address is adequately covered by other provisions of the Act.'

Issues

A number of parties involved in the wholesale and retail grocery industry expressed concerns to the Committee about price discrimination in that industry, which they submitted was anti-competitive. Their complaint was that independent wholesalers (who sell wholesale to independent retailers) are not able to obtain goods at prices comparable to those charged by suppliers to the

two major chains, notwithstanding that their central distribution warehouses are, in comparison with the facilities of the major chains, of comparable size and capable of like performance. They submitted that this constituted a failure on the part of suppliers to provide 'like terms for like customers' at this level of the grocery distribution chain, namely, the central warehouse level. This meant, they said, that the independent wholesalers' prices to the independent retailers were such that there could be no fair competition between them and the major chains at the retail level, only the latter being able to reflect the benefit of lower wholesale prices in their retail prices.

Accordingly, they submitted that there should be an amendment of the Act to re-introduce a version of the repealed section 49, extending its reach to the provision of services as well as goods. An amendment of section 46 was also proposed to bring price discrimination specifically within its terms and to introduce an effects test.

In contrast, other parties claimed that the existing provisions of the Act are adequate to deal with anti-competitive price discrimination without jeopardising the full benefits of the competitive process. They argued that apparent price discrimination may often be explained by differences in underlying costs, due to purchases of larger volumes and superior and greater levels of marketing support. In addition, it was put that price discrimination was more often pro-competitive than anti-competitive.

International context

United States

In 1936, the United States introduced a specific law to govern price discrimination (*Robinson-Patman Act 1936*). The original aim of the legislation was to protect small businesses from powerful buyers, particularly food chain stores, who might demand price concessions.[1]

In recent decades, this legislation has been widely criticised as being too complex, deterring price competition and promoting price uniformity. Although originally directed at large retailers, in practice it has been applied mainly against small sellers who grant discounts in order to compete against large sellers and against businesses engaging in vigorous competition. The only recent litigation has been private, an incentive being provided by the

1 Gellhorn & Kovacic 1994, *Antitrust Law and Economics*, p. 433.

prospect of treble damages.[2] The FTC now only takes action against price discrimination under the broader competition law (for example, section 2 of the *Sherman Act 1890*), and then only if the practices involved can be considered to form part of an attempt to monopolise.

Canada

Canada has a number of provisions governing price discrimination. There are criminal provisions and civil provisions. When introduced in 1935, the purpose of the criminal provisions was to protect small businesses from large buyers with market power seeking to secure unfair discounts from suppliers. As in the United States at that time, there was particular concern about the impact of such practices on the grocery industry.[3]

The criminal provisions prohibit sellers from granting price concessions to one buyer but not to competing buyers of the same article in like quality and quantity. Excluded are discounts for particular purposes and of short duration (for example, in response to a competitor's behaviour). The granting of volume discounts is permitted.

In recent years, the criminal provisions have been rarely used with only three convictions having been recorded since 1983. More often applied is the civil offence of 'price squeezing' as a form of abuse of a dominant position in a market. This offence focuses on injury to competition, rather than specific competitors.

Despite their apparent ineffectiveness, the potential application of the criminal provisions has been of concern to the business community. The Competition Bureau issued *Price Discrimination Enforcement Guidelines* in 1992 but they could not offer a binding statement about the Attorney-General's exercise of discretion in a particular situation. There remains concern that the uncertain operation of the provisions may be discouraging pricing strategies with no anti-competitive effect and that business is incurring unnecessary compliance and monitoring costs.[4] In 1995, the Competition Bureau's proposal to remove the provision was rejected as some small business sectors claimed that the provisions served as a key bargaining tool in their negotiations. Recently, a Canadian Parliamentary Committee recommended that the criminal

2 ibid., p. 434.
3 VanDuzer, J.A. 2000-01, 'Assessing the Canadian Law and Practice on Predatory Pricing, Price Discrimination and Price Maintenance', *Ottawa Law Review,* Vol. 32:2, p. 195.
4 See VanDuzer at p. 196.

provisions for price discrimination be repealed and included in the existing provisions for abuse of dominant position.[5] The Committee found that price discrimination is commonplace, often not anti-competitive and current prohibitions risk chilling legitimate pricing practices.

European Union

In the European Union, the practice of applying dissimilar price conditions for equivalent transactions may constitute an abuse of dominance position, as recognised in Article 82(c) of the European Commission Treaty (the abuse of dominance provision under European Union law corresponds with a misuse of market power under the Australian Act). This would require proof that a trading party was placed at a competitive disadvantage that may have affected trade between Member States and also that there was no objective business justification for the practice. In practice, most cases of such behaviour are only brought where there is suspected predatory pricing.

The European Union also prohibits the practice of applying dissimilar price conditions where companies do not have a dominant position if the practice has the purpose or effect of distorting competition within the European Union. However, such practices may be exempt if they do not substantially eliminate competition and improve production or distribution processes or promote technical progress while allowing consumers a fair share of benefits.

United Kingdom

The United Kingdom's price discrimination provisions are based on the European Union model. In practice, the Competition Commission has not brought any recent cases. More cases may follow the recent introduction of the right of private parties to seek damages through the *Enterprise Act 2002* for contraventions of the *Competition Act 1998*.

Analysis

Price discrimination may be anti-competitive or pro-competitive. Price discrimination will be anti-competitive when it is used to create a barrier to entry to the market or to force competitors from the market. On the other hand, price cutting, even if it is in favour of a large buyer and hence discriminatory,

5 Report of the House of Commons Standing Committee on Industry, Science and Technology April 2002, *A Plan to Modernise Canada's Competition Regime*, Recommendation 23.

may be more pro-competitive than anti-competitive. It may engender competition from rival suppliers or in the market generally. As the Swanson Committee observed in 1976, it is price flexibility which is at the heart of competitive behaviour and a general prohibition against price discrimination would substantially limit price flexibility.

The Committee heard conflicting views about pricing practices, for the most part in the grocery industry. Whilst lower prices charged by suppliers to their larger customers may indicate price discrimination, it does not follow that this is necessarily anti-competitive. The differences in price may simply reflect discounts negotiated on wholesale prices for a variety of factors including volume and promotional support of the supplier's product. Price discrimination must therefore be considered on a case-by-case basis to distinguish whether it conflicts with the aims of the Act.

Section 46 of the Act does not proscribe price discrimination as such, but its terms are apt to enable the prosecution of anti-competitive price discrimination. To contravene section 46, a corporation is required to have market power and must take advantage of its market power. A corporation needs some degree of market power for price discrimination to occur. Successful price discrimination would not otherwise be possible because it would be too easy for competitors to undermine the pricing structure. Under section 46 a corporation must also have a proscribed anti-competitive purpose. This requirement allows pro-competitive behaviour to be distinguished from anti-competitive behaviour.

The introduction of an effects test into section 46 is dealt with in Chapter 3, but it is relevant to note here that the operation of an effects test, in part to counter anti-competitive price discrimination, would not necessarily be confined to large concerns, but could extend to small business as well. An effects test could, in the view of the Committee, discourage legitimate competitive practices by small businesses having the effect of injuring a competitor or discouraging a potential competitor, in the same way as with larger businesses.

Other sections of Part IV may also be relevant in relation to price discrimination arrangements between buyers and suppliers that are anti-competitive. Arrangements between wholesalers and retailers could amount to an exclusive dealing arrangement under section 47 or an agreement that substantially lessens competition under section 45.

Part IV of the Act is concerned to protect the competitive process. By doing this it facilitates the achievement of economic efficiency and enhances the welfare of the community. However, competitors do not necessarily enter into

competition on exactly the same footing. The provisions of Part IV are not intended to handicap competitors who have an advantage in the marketplace unless that advantage is being used in an anti-competitive manner. The Act cannot protect competitors from the process of competition.

Most of the material relating to price discrimination that was put to the Committee concerned the grocery industry. In that industry there is strong competition involving both large and small participants. The Committee was told that margins are accordingly low in comparison with the retail grocery industry in other countries. It was said that consumers are benefiting from the competitive environment and have responded to the opportunity to shop in the major supermarkets that has been afforded by the deregulation of shop trading hours. In 1999, the Baird Committee found that consumers were benefiting from the competitive forces in the grocery industry. At the same time, that Committee made a number of recommendations intended to enhance competition in that industry.

There are two major supermarket chains with vertically integrated operations and a range of other wholesale and retail suppliers. Measures of concentration in the industry indicate that the two major chains account for around 68 per cent of the scanned grocery market[6] which covers 35 per cent to 40 per cent of the goods sold by the major chains.[7] The major chains have about 50 per cent of the more broadly defined 'food, liquor and grocery' market which covers more than 90 per cent of the goods they sell.[8] These measures of concentration do not, of course, reflect the position at regional and local levels. Importantly, there have been a number of recent entrants to the industry at both the wholesale and retail level. These include substantial international operators that have been attracted to the opportunities that are apparently available in the Australian market, but as yet they have only a small proportion of the market.

The main issue raised by those who put submissions to the Committee, apart from the two largest grocery chains, was the provision of 'like terms for like customers'. It appears that in the grocery industry wholesalers may not always obtain the same price from suppliers as the major chains for the supply of particular goods and services. However, a number of factors might result in unlike terms. The final price paid to suppliers will depend on many factors including the volume purchased, the advertisement of the product by the

6 Nielsen, A.C. 2002, *Grocery Report*.
7 Woolworths Limited, Submission No. 171, p. 9.
8 ibid, p. 9.

purchaser, the style of advertising used (for example, in a catalogue or by television), the placement of the product within the store (shelf space) and the supplier's desire to compete with other suppliers. Price differences arising from all but the last of these considerations result in a discernible and justifiable cost benefit for the supplier which is passed back to the buyer.

The issue of like terms for like customers and other issues related to pricing in the grocery industry have been the subject of continuing debate. Most recently, the issue of like terms has been dealt with by the ACCC in a report to the Senate on pricing practices in the grocery industry (see Box 4.1). The ACCC's report has been questioned by some because it is based upon information provided voluntarily by the industry and because only a proportion of the suppliers participated in the survey which was conducted. Nevertheless, the data which the ACCC was able to examine constituted a significant sample. The ACCC was unable to conclude that there was evidence of anti-competitive price discrimination.

The Committee notes that the ACCC's report also suggests that the principle of like terms for like customers is not clearly understood and does not offer a suitable basis for regulating prices. While the debate about grocery prices will no doubt continue, the Committee does not consider that a case has been made for changes to the competition provisions of the Act. Concerns raised with the Committee which relate to the issue of the preservation of small businesses or independent grocery wholesalers and retailers are best dealt with as a matter of industry policy. The focus of the Act should continue to be upon the regulation of competition rather than the protection of any particular class of wholesaler or retailer.

Nevertheless, the Committee recognises that the retail grocery environment is complex, concentrated and evolving and that behaviour in the sector should be carefully monitored. The Retail Grocery Industry Code of Conduct and Retail Grocery Ombudsman Scheme, which commenced in September 2000, seem to be appropriate mechanisms for dealing with practices perceived to be unfair by the independent retailers and wholesalers. In addition, Part IVA of the Act contains other provisions which are available to deal with certain practices.

Box 4.1: ACCC report into the Australian grocery industry

In September 2002 the ACCC released its Report to the Senate by the Australian Competition and Consumer Commission on Prices Paid to Suppliers by Retailers in the Australian Grocery Industry. The report contained an extensive consideration of possible anti-competitive price discrimination in the grocery sector. The ACCC offered the interim conclusion that:

> '… price differences in the sale of groceries by suppliers to the major chains and to independent wholesalers do not appear to exhibit anti-competitive conduct …'[9]

It also found that the major chains do not always get the best price from suppliers.

The report considered claims by the independent wholesalers and retailers that 'like terms for like customers' should be a principle that underlies all pricing considerations. The Report noted that there is no consensus amongst industry participants as to the meaning of like terms.

The report also noted that some suppliers expressed the view that more a relevant determinant of price was 'like terms for like performance' where the key feature of performance would be the degree to which the marketing objectives of buyers and suppliers align to meet the requirements of consumers.

Conclusions

- The effect of price discrimination on competition needs to be assessed on a case-by-case basis.

- Section 46 of the Act provides an appropriate means to tackle anti-competitive price discrimination. There is no case for the reintroduction of a prohibition against price discrimination. The principle of like terms for like customers does not of itself offer a suitable basis for regulation in the grocery industry.

9 ACCC 2002, *Report to the Senate by the Australian Competition and Consumer Commission on Prices Paid to Suppliers by Retailers in the Australian Grocery Industry,* p. 39.

- There are reasons for differences in prices in the grocery industry which do not involve anti-competitive practices. The most recent survey of suppliers does not indicate the need for further regulation of price discrimination.

Recommendation

4.1 No change should be made to the Act in relation to price discrimination.