
Casenote

ACCC v Metcash Trading Ltd [2011] FCA 967; BC201106415

Michael Bradley MARQUE LAWYERS

On 25 August 2011, the Federal Court dismissed the ACCC's application to prevent Metcash from taking over the Franklins group. An appeal to the Full Court of the Federal Court has been heard and is now awaiting judgment. This article reports on the first instance decision by Justice Emmett.

It is difficult to find any aspect of the ACCC's case against Metcash with which Emmett J agreed. It would be fair to describe his decision as a scathing indictment of the ACCC's approach to and understanding of the interplay between economic theory and Pt IV of the Competition and Consumer Act (CCA). Basically, he seems to have concluded that they really don't know what they're talking about. Which is pretty bad, given the ACCC's job description.

The background to this case is straightforward. Metcash wants to acquire all of the shares in Franklins from its South African owner, the Pick n Pay group. The ACCC says this acquisition would infringe s 50 of the CCA, because it would be likely to have the effect of substantially lessening competition in a market.

The elephants in the industry, Woolworths and Coles, take up about 80% of the grocery retail market between them. Their main competitors are Aldi and IGA. IGA is a network of independently owned stores, who use the IGA brand under licence from Metcash, which owns the brand. Metcash is a wholesaler of grocery products, and provides most of the supplies that IGA stores acquire. In addition, in NSW there is Franklins which operates 80 retail stores and also operates as a wholesaler.

Pick n Pay wants to divest itself of Franklins, which has not had a good run. Metcash wants to buy the whole business, to shore up its competitive position in both wholesale and retail as it and the independent store owners battle to remain viable against the super-aggressive expansion strategies of Woolworths and Coles. If the Metcash deal doesn't go ahead, Pick n Pay says it will sell the stores piece-meal and in fact it has already called for offers on a store by store basis.

The first issue in these cases is to define the market or markets said to be affected by the acquisition. The

ACCC contends that there is a distinct market for the wholesale supply of packaged groceries to independent supermarkets in NSW and the ACT, in which market the suppliers are Metcash, Franklins and to a lesser extent SPAR (a small wholesaler). Metcash says that the market is national and encompasses both wholesale and retail.

This dispute is at the heart of the case. Conventionally, in most goods markets, it is assumed that there are distinct wholesale and retail markets. The ACCC has always thought that to be the case with groceries. That is, there is a wholesale market in which the few wholesalers supply groceries to the independent retailers. Then there is a separate retail market in which the independent retailers, as well as the major retailers, sell the groceries to the public. The aspect that has always confused this simple analysis, and which the ACCC has really tended to ignore, is that the majors, ie Woolworths and Coles, are their own wholesalers. They have built up complete vertical integration over the years, so that they source all of their own supplies, mostly direct from manufacturers, growers and importers. For their purposes, there really is no wholesale market at all. Given that they occupy 80% of the retail market, there are some difficulties in establishing the existence of a distinct wholesale market which only affects 20% of the overall sector. And this is the main issue which caused the ACCC to lose the case.

The ACCC fell over on every component of market definition. In relation to the product dimension, the ACCC defined wholesale packaged groceries as excluding fresh items such as fresh fruit and deli items. The judge couldn't find any basis for the distinction, and found that the market includes all grocery items.

Much of the judgment is dedicated to analysing the question of whether the relevant market can be restricted to wholesale. A large part of this was looking at whether Metcash, as a wholesaler, is constrained in its activities by the major chains. The ACCC said that Franklins operates as a close competitive constraint on Metcash, but the majors do not. It pointed to evidence from

Metcash's internal documents, particularly the activities of its executive management committee, as demonstrating that Metcash has been very focused on Franklins' moves. The judge read the same material and reached the opposite conclusion.

The judge applied a real world analysis to the debate. He noted how hyper-competitive the grocery industry is, and that the independent retailers have no choice but to match or stay close to the majors on price if they are to survive. If they increase their prices, they lose business to the majors. If that happens, their wholesaler loses business too. At the same time, the majors have massively greater bargaining power with manufacturers and producers than does Metcash. So, Metcash gets squeezed at both ends: it has to pay more for the products, and it is constrained in the wholesale prices it can charge because its retailers are under intense price pressure at store level. Further, the ever-present threat that independent retailers might give up and sell out their stores to one of the major chains acts as an additional constraint on Metcash's wholesale pricing decisions.

From all this, Emmett J concluded as follows:

The separation of wholesaling and retailing functions tends to confuse the analysis in the present case. The true competitive constraints on the activities of Metcash come, to a great extent, from the major supermarket chains. While those constraints are, at least in part, indirect, they are powerful, and are much closer and more effective than the constraints imposed by Franklins. Thus, it is not possible to determine the competitive consequences of the acquisition of Franklins by Metcash without taking into account the constraints from the major supermarket chains.

His Honour also found that it is simplistic and artificial to treat Metcash itself as just a wholesaler. It owns and controls the IGA brand, and therefore operates in the retail market as well. Separating its wholesale and retail activities makes no sense.

At a broader level, Emmett J noted that the grocery industry is already highly vertically integrated. Over 80% of the industry is fully vertically integrated. The effect of this is that the constraints on both wholesalers and retailers cut both ways and it isn't possible to separate them out from each other.

Whether the market is as broad as Metcash contended (it argued that there is a national market for the sale of grocery products to consumers, incorporating all retailers and wholesalers), the judge did not have to decide. He found that the ACCC's pleaded market definition was not made out, and the case failed on that basis.

His Honour went on however to consider the other aspects of the case, being the counterfactual and the effect on competition.

There was a controversy over the correct test to apply when considering the likely effect of the acquisition, which Emmett J resolved as a two-part test:

- the Court must be satisfied that it is more probable than not that one of the ACCC's counterfactuals (ie what will happen) will come to pass if the acquisition does not proceed; and
- the Court must then be satisfied that there is a real chance that, if the proposed acquisition does proceed, that would result in a substantial lessening of competition compared to the scenario in which one of those counterfactuals comes to pass.

So, first the ACCC has to prove its counterfactual on the balance of probabilities. The ACCC's favoured counterfactual is that, if Metcash does not acquire Franklins, a consortium of small players in the grocery retail industry (who it has identified) will get together and purchase all or most of the Franklins stores, and then establish a viable wholesale business to support them. This scenario, the ACCC says, will preserve a level of competition at the wholesale level which will completely cease to exist if Franklins is absorbed by Metcash.

The judge went to great lengths to point out why this is really pure speculation (he actually says that). There is no credible evidence, he found, that the consortium is ever going to bid for all the stores or raise the finance necessary to buy them, nor is it likely that Pick n Pay will sell to them. If the Metcash acquisition does not proceed, he found that the likelihood is that the Franklins stores will be sold in groups or individually to various purchasers including Woolworths and Coles (who have offered to buy 22 and 8 of them respectively).

Having knocked over the ACCC on both market definition and the counterfactual, the judge decided to finish them off completely by finding that, even if he was wrong on all that, the transaction still will not cause a substantial lessening of competition. His conclusion was that it is quite likely that the acquisition will strengthen the capacity of the IGA retailers to compete with the major chains.

He never said as much, but the judge seems to have thought the ACCC remarkably naive in its analysis. He issued a number of cautions during the judgment against the application of economic theory in the abstract, without considering the real world context. I think that was directed at the ACCC.

Interestingly, another thing the judge did was to reject all of the expert evidence from both parties' economic experts on the application of economic principle to the circumstances of the case. He admitted the opinions as submissions only.

Competition & Consumer Law News

The ACCC has appealed this decision, not surprisingly. It's a pretty embarrassing outcome, not so much losing the case but losing on every single issue and doing so really badly. Basically, the judge found that the ACCC's case had absolutely no merit at all. That's not a good look for the regulator.



Michael Bradley,
Managing Partner
MARQUE LAWYERS