

# Chapter Fifteen

## Summary of Conclusions and Recommendations

### 15.1 Net Invoice Price

The Prohibition in Article 11 of the 1987 Groceries Order does not operate as a ban on below cost selling. It is more correctly referred to as a prohibition on selling below net invoice price.

The term “net invoice price” was introduced into the Groceries Order in 1978 solely as an administrative convenience, almost certainly with the agreement and encouragement of the trade, in order to make it easier to enforce a ban on below-cost advertising.

The definition of the term, which was later added in the 1981 Order, was based on the High Court’s interpretation of the meaning to be ascribed to the words “net-invoice price.”

Thus, the term has no economic rationale whatsoever.

The term was retained in Article 11 of the 1987 Order on the assumption that all discounts, rebates, allowances and other supplier payments would be included on the invoice.

In 1991, the Restrictive Practices Commission expressed concern at the fact that this assumption had not been realised and identified the use of off-invoice discounts as a potential abuse of the legislation.

The Majority recommendation of the Restrictive Practices Commission that the Order be repealed was not acted on immediately in order to allow a settling in period for the new Competition Act, 1991.

The Minority view that the term Net Invoice Price should not be allowed to continue was not reflected in an amendment to the 1987 Order as no point was seen in amending an Order that was destined to be ultimately revoked.

The Order has been under virtual ongoing review since 1991.

### 15.2 Off-Invoice Discounting

The provisions of Article 13 of the Order regarding terms and conditions of supply remain unchanged since the 1978 Order despite a view expressed by the Restrictive Practices Commission in 1987 that there was only token compliance with them.

The provisions of Article 13 facilitate and encourage the use of off-invoice discounting.

Article 13 allows the use of supplementary terms and conditions and these are operated generally in a secretive, arbitrary and discriminatory manner.

The Order does not protect suppliers from the buying power of larger retailers, although such power is likely to be reflected in demands for higher discounts rather than lower invoice prices.

We have not been provided with sufficient information as part of this review to determine the extent of off-invoice discounts paid to grocery retailers.

Off invoice discount income earned by retailers is a significant element of the trade and cannot be passed on to consumers in the form of reductions, to a price below the invoice price, of goods covered by the Order.

This means that any such income can only be passed on in a way that distorts competition in the trade and which may impact negatively on the Consumer Price Index.

This is a serious restriction on competition and a serious interference with the freedom to trade that could only be justified if clearly identifiable benefits accrue to all parties as a result of its imposition.

We are unable to conclude that such benefits exist.

We conclude that it is not realistic, may not be legally enforceable, nor should it be necessary, for the Director of Consumer Affairs to exercise the powers available to her under the Groceries Order in order to seek to establish the level of off-invoice discount income earned by Irish grocery retailers.

We further conclude that such information is unlikely to alter the conclusions and recommendations of this Report.

Additionally, to undertake this exercise as a pre-condition to deciding the future of the Order would delay a decision unnecessarily and such a delay would not be in the public interest.

The Director of Corporate Enforcement has submitted that *“...it does seem desirable to us that if the Order is being retained, it should be amended to remove any direct or indirect inducements therein which may lead companies to cause their primary books and records (including invoices) to be kept on any form of artificial basis.”*

### **15.3 Resale Price Maintenance**

The combined impact of the ban on selling below invoice price and the practice of off-invoice discounting is to put a floor under the retail price of

goods covered by the Order. This floor, which acts as a minimum price below which the goods cannot be sold, is determined, not by normal competitive forces as might be the case in other traded sectors of the economy, but by the supplier acting either unilaterally or in agreement with his retail customer.

Consequently, the effect of the Order is that a form of resale price maintenance operates in the retail grocery trade in Ireland, despite the fact that such practice is declared to be illegal and can attract criminal sanctions under the provisions of the Competition Act 2002.

Furthermore, we believe there is a startling contradiction between on the one hand Article 3 of the 1987 Groceries Order and Article 4 of the 2002 Competition Act both of which prohibit resale price maintenance, and, on the other hand, Articles 11 and 13 of the 1987 Groceries Order which facilitate the practice.

We consider that this contradiction has the potential to bring the Irish statute book into disrepute.

#### **15.4 Impact of Removing the Order**

The impact of revoking the Groceries Order would be to remove this price floor and eliminate the upward pressure on prices that it creates. It would also remove one of the principal incentives for off-invoice discounting and result in substantially greater price transparency by ensuring that the invoice price more accurately reflects the true purchase price of goods to the retailer.

We would expect that the impact of the resulting competition in the market would be to bring about decreases in the retail prices of goods covered by the Order.

However, we don't believe that it is possible to predict in any meaningful way the precise extent of such price reductions. Ultimately, that will be a function of a variety of factors including the amount of off-invoice discounts that are available for transfer back to the invoice, the actual level of net margin obtaining in the retail trade currently, and the extent to which resulting competitive forces will drive efficiencies at all levels of the production and distribution chain.

Other extraneous factors, including input costs and consumer demand, also impact on retail prices and make it difficult to isolate the impact of any one factor such as the ban on selling below net invoice price.

#### **15.5 Impact of Only Preventing Off-Invoice Discounts**

If off-invoice discounts were prohibited – as a stand-alone measure – it would be desirable that there would be corresponding reductions in invoice prices to reflect and match the retailers lost income.

If there were not such corresponding reductions in invoice prices – and there is no law that we can conceive of that would require it – then an inevitable effect of such a measure would be an increase in the retail price of groceries to consumers in order to compensate retailers for the lost income.

## **15.6 Structure of the Grocery Trade**

The Irish grocery market shows a high degree of concentration.

Market concentration has increased in the period since the Groceries Order was introduced. Much of this increased concentration has taken place below the level of the multiples and, particularly in the period since 1994, would seem to have been driven by consolidation in the symbol/independent segment.

The Irish market demonstrates similar structures and levels of concentration to the UK market, where, of course, no ban on below cost selling exists. If anything, we believe that the Irish market is marginally more concentrated.

We believe that within the main urban areas, a dualistic structure exists with multiples catering for the “one-stop” shopper and the smaller symbols/independents catering for the convenience “niche” market.

A similar dualistic structure is unlikely to operate in more rural locations due to the fact that many multiples are not attracted to areas of low population density. Thus the symbols/independents are servicing both the “one-stop” and the convenience markets in these locations.

In the UK, the convenience sector is the fastest growing sector of the grocery market as is evidenced by the recent entry into the market by many multiples and by Irish symbol group operator, Musgraves. Turnover in the convenience sector is expected to grow by 25% over the next four years.

Consequently, and given the similar market structures that operate, there is no reason to believe that the convenience market in Ireland would suffer as a result of the removal of the ban on selling below net invoice price.

## **15.7 Predatory Pricing**

Predatory pricing is anti-competitive and operates against the interests of consumers. However, the practice, as defined by the accepted principles of anti-trust law, is already prohibited by the Competition Act, 2002.

Loss-leading is a legitimate business practice which operates in many business sectors and can be a logical outcome of the competitive process. It is a practice that can operate without distorting the market and without producing any consumer detriment.

The practice of persistent below cost selling of grocery products, when operated in a manner that does not meet the definition of predatory pricing, is not prohibited by the Act. It is possible to conceive of instances in which the practice might act against the public interest if its effect is, or is likely to be, an alteration in market structure resulting in less choice for consumers.

We consider the provisions of the 1987 Order to be a disproportionate response to the threat of both predatory pricing and the threat of persistent below cost selling for reasons which include the following:

- Article 11 acts against the interests of consumers by taking no account of legitimate, pro-competitive reasons for selling below cost;
- There is no test to determine whether or not the practice of below cost selling is likely to distort the market or be harmful to the public interest in any given circumstance;
- It does not provide any valid measure of cost and is incapable of distinguishing between genuine acts of predation and legitimate and vigorous pro-competitive pricing from which consumers should be allowed to benefit;
- No account is taken of discounts, rebates or other allowances, paid by suppliers to retailers;
- The Articles limit the freedom of retailers to decide whether and how such discounts should be passed on to the consumer;
- The Order has the effect of stifling price competition from the market and that, in turn, is driving market concentration. That is unlikely to be advantageous to consumers.
- Article 11 limits the ability of smaller retailers to compete with legitimate lower cost selling by larger competitors.
- Article 11 also limits the ability of even the largest retailer to compete in certain circumstances. For example, if supermarkets in Northern Ireland engage in below cost selling during the Christmas period, all retailers in this jurisdiction are placed at a competitive disadvantage.
- The combined effect of the Articles is to limit competition and thus the incentive to find efficiencies in the distribution chain from which consumers might benefit in the form of lower prices.

## **15.8 H. Williams**

Available testimony of the time suggested that the demise of the H. Williams Group was as much a consequence of the company's vulnerable financial

position as it was it was of predatory pricing tactics employed by their competitors.

## 15.9 Impact on Prices and Inflation

We consider that there are very many factors that impact on the rate of inflation and absolute price levels. It is very difficult in our view to isolate out any one factor such as the Groceries Order and say that it is the principal driver of either high inflation or low inflation, high prices or low prices.

However, there are certain anomalies shown up by our analysis of inflation trends which are not readily explained and which are highly suggestive of the retail food sector being protected from competition. In particular, it would be unsafe to draw a conclusion that there is *no* connection between these anomalies and the Order.

Consequently, while we are reluctant to draw firm conclusions in regard to the impact of the Order on inflation and price levels, we consider that our analysis of inflation trends would support the case for repeal of the Order.

## 15.10 Regulations in Other Jurisdictions

- Of the EU 15, seven countries other than Ireland have a prohibition on below cost selling. These countries are Belgium, France, Greece, Italy, Luxembourg, Portugal, and Spain.
- The relevant legislation in six of these seven countries (Belgium, France, Italy, Luxembourg, Portugal and Spain) provides for a wider range of exceptions than is provided for in the Groceries Order.
- In particular, Belgium, Portugal and Luxembourg, and France all allow promotional below cost selling and below cost selling for the purpose of matching competitors' prices. In addition, Spain allows below cost selling for the purpose of matching competitors' prices. Italy allows up to three below cost sales of up to 10 days duration each year in addition to other exceptions. The French Law has been significantly changed in 2005.
- The remaining seven countries only prohibit the practice below cost selling when it constitutes unfair competition or an abuse of a dominant position.
- No conclusions can be drawn as to their appropriateness to Ireland of provisions applying in other Member States – particularly in the absence of a detailed study of market conditions and trading practices.

## 15.11 Ghost Town Britain

We conclude that figures suggesting that 7 out of 10 towns and villages in the UK have no shop are hopelessly wrong and have no basis in fact. The statistic is a serious and manifest misrepresentation of the facts.

The repeated use of the statistic in submissions received is suggestive of a concerted campaign to place the figure of 70% in the public mind with a view to generating unwarranted concerns in regard to the possible impact of the removal of the Groceries Order.

Almost 87% of rural households in England live within 4km of a petrol station – most of which have a convenience store attached.

Meanwhile, 79% of rural households in England live within 4km of a supermarket.

The Ghost Town Britain II Report published in 2003 actually argues that prices of fresh meat and vegetables in edge-of-town supermarkets are often *higher* than in local independently owned retail outlets.

## 15.12 Impact on Society

We believe the fears of Agencies representing less well off sections of society that removal of the Groceries Order will result in restricted access to groceries for those on low incomes are unfounded.

We believe that this view is borne out by research conducted in the UK – where no ban on below cost selling exists.

In our view, the Groceries Order is a highly inappropriate and disproportionate mechanism by which to seek to control alcohol consumption

## 15.13 Legal Status of the Order

The order can only be repealed by primary legislation.

An amendment to the Order requires the introduction of primary legislation which would provide comprehensive enabling powers to the Minister.

We have identified a number of anomalies in the drafting of the 1987 Order as well as difficult issues of interpretation.

These could give rise in the future to difficulties for the Director of the Consumer Affairs in seeking to enforce specific terms of the Order. They also raise issues relating to the even-handed application of the terms of the Order to all elements in the grocery trade.

On this basis alone, there seems to be a substantial reason for concern about the capability of the Order to do the things it was designed to do.

#### **15.14 Prevention of Below Cost Selling**

We do not believe that that case is proven that instances of persistent below cost selling are likely to emerge to such an extent and in a way so harmful to the public interest as to justify the introduction of regulatory measures beyond the prohibition on abuse of dominance already contained in Section 5 of the 2002 Competition Act.

The fear that the removal of the Groceries Order will herald the emergence of large scale hypermarkets at the expense of the small independent retailer is, we consider, unfounded and suggests a misplaced faith in both the intention and scope of the Order. The prohibition of selling below net invoice price does not prevent multiple supermarket chains from opening large-scale stores. It simply prevents them from selling product below a specified minimum price.

Limiting the size of individual retail outlets is a function of the planning process.

#### **15.15 Recommendations**

We recommend that the 1987 Groceries Order be repealed in its entirety by means of an amendment to the Competition Act 2002

No alternative prohibition on below cost selling should be introduced.

The Competition Authority, in cooperation with the Director of Consumer Affairs, should be asked to review and monitor the structure and operation of the grocery trade on an ongoing basis over the next number of years to assess the impact of the new regulatory environment. The scope and extent of such a programme can be agreed between the Authority and representatives of the trade at a later stage.

The Authority in reviewing the structure and operation of the grocery trade should be asked to comment and make recommendations on guaranteeing access for all sections of society to as wide a range of grocery products as possible.



We recommend that the Retail Planning Guidelines continue to operate in a pro-competitive way.

We recommend that the guidelines and the planning process generally be operated in such a way as to ensure the existence of an appropriate mix of small and large retail development throughout the country so as to stimulate consumer choice of their preferred shopping environment.

Objections to new retail development should be based on sound planning principles. Vested interests should not be allowed to use the process to prevent the emergence of competition and so damage the interests of consumers.

We consider that the Competition Act, 2002 captures the bulk of the anti-competitive practices which the Groceries Order was originally designed to prevent.

However, we consider it desirable to significantly strengthen the Act in some respects and particularly to specifically prohibit resale price maintenance, unfair discrimination and “hello money”.

Such provisions will, henceforth, be enforced by the Competition Authority.