TREASURY SUBMISSION TO THE SENATE ECONOMICS COMMITTEE INQUIRY INTO THE IMPACTS OF SUPERMARKET PRICE DECISIONS ON THE DAIRY INDUSTRY

Contents

KEY POINTS

Competition is best characterised as a process of rivalry between competing sellers and purchasers of goods and services. In general, competitive markets promote the efficient allocation of resources and are an important driver of economic growth, ultimately beneficial to all Australians.

- Policy reforms that introduce or increase competitive pressure in previously uncompetitive industries will invariably create winners and losers – especially in industries that are (or were) operating inefficiently. Through reform, successful businesses become more productive, generating substantial flow on benefits to consumers and the wider economy.

Many industries were opened up to greater competition through the National Competition Policy (NCP) process commenced in the 1990s, including dairy. The broader NCP reforms brought substantial benefits to the Australian community and increased the economy's resilience to economic shocks. They were responsible for directly reducing the prices of goods and services such as electricity and milk, and stimulated business innovation, customer responsiveness and choice.

- A review of NCP reforms by the Productivity Commission estimated that the productivity and price changes in key infrastructure sectors (electricity, gas, urban water, telecommunications, urban transport, ports and rail freight) in the 1990's to which NCP and related reforms have directly contributed, have served to permanently increase Australia's GDP by 2.5 per cent, or $20 billion per annum.

- They contributed to a productivity surge (i.e. the highest productivity growth rates in 40 years) that underpinned 13 years of continuous economic growth, and associated strong growth in household incomes, boosting the average Australian household's annual income by $7000.

Dairy producers and other primary producers are currently concerned with the pricing strategies being employed by the major supermarket chains (MSCs)[1]. It is unclear at this time, however, the extent to which this conduct will continue or what its effects may be in terms of future farm gate prices for producers.

- There is strong interdependence between businesses operating at each stage of the supply chain. Buyers in a market who may occupy a relatively strong bargaining position can be expected to be aware of the pressure placed on their trading partners by particular trading terms and conditions.

- At this time, there is no clear evidence available to suggest that the industry is not capable of maintaining prices sufficient to sustain the industry in the long-term, notwithstanding any short term fluctuations in outcomes at any particular point of the supply chain.

Australia's competition law framework generally applies equally to businesses across the economy. The anti-competitive conduct provisions of the Part IV of the *Competition and Consumer Act 2010* (CCA) (formerly the *Trade Practices Act 1974*) are designed to protect against particular types of conduct which would in all cases be anti-competitive. The CCA also provides immunity mechanisms to allow anti-competitive conduct which provides net public benefits to proceed.

[1] MSCs refers to Coles and Woolworths.

- The Part IV provisions are principally concerned with protecting the competitive process, not individual competitors. They are not designed to protect competitors from rigorous competitive behaviour, nor to force businesses to compete.

- Concerns that the current conduct of supermarkets amounts to anti-competitive conduct would, if proven, appear capable of being dealt with under the existing prohibitions of the CCA, particularly section 46, which deals with the misuse of market power.

Competition policy recognises that competition is a means, not an end. While competitive markets are an important driver of economic efficiency, markets are not always competitive and can require intervention to correct for market failures. Governments also concern themselves with the attainment of other policy objectives, including consumer welfare and income distribution.

- Competition policy, as applied in Australia and worldwide, recognises and provides for situations in which the promotion of competitive markets is an objective secondary to other policy objectives.

- However, given the well recognised and significant benefits which accrue from competitive markets, there is a rebuttable presumption in favour of competition unless proponents of alternative policies can demonstrate that they lead to greater net public benefits.

- Where policies are being proposed which contemplate government intervention in markets in response to an identified market failure, consideration must be given to Clause 5 of the *Competition Principles Agreement 1995*. Relevantly, it provides that, when intervening in markets, competition should not be restricted unless it can be demonstrated that:

  - the benefits of the restriction to the community as a whole outweigh the costs, and

  - the objectives of the legislation can only be achieved by restricting competition.

- At the Commonwealth level, the Regulatory Impact Analysis process administered by the Office of Best Practice Regulation requires an analysis of the extent to which this principle has been met for regulations which restrict competition.

If a market failure is identified in a particular industry, industry-specific measures may need to be considered, and it is likely such measures would be preferable to amending the economy-wide competition laws.

- Any proposals to amend the provisions of the CCA which seek to correct market failures in one sector need to carefully weigh the full range of possible costs and benefits which would accrue across the economy.

PART 1: ECONOMIC CONTEXT TO THE CURRENT INQUIRY

The dairy industry is an important contributor to the Australian economy, as one of the largest rural sectors, with around 40,000 people employed on dairy farms, manufacturing plants or in activities related to the wider dairy industry.[2] Drinking milk, which is being examined by the Senate Committee, currently accounts for around 25 per cent of Australia's annual milk production, with about 45 per cent of Australia's total milk production being exported as primarily manufactured products.[3]

Reforms to the dairy industry over a number of years have led to changes in the shape and nature of the industry. The deregulation process (which is examined in more detail in Attachment A) is reported by Dairy Australia to have led to an increase in milk production per cow, a fall in the number of producers, and a fall in the amount of milk produced (although production is now rising) – as noted in the terms of reference for this inquiry.

The Senate Committee is examining recent pricing decisions of the MSCs and other supermarkets such as Franklins and ALDI in terms of generic brand fresh drinking milk. On 26 January 2011, Coles announced that it would be cutting the price of generic milk by as much as 33 per cent, to a regular low price of $2 for a two litre bottle of Coles Brand milk, as part of a broad strategy to reduce the price of essential groceries.[4] This move by Coles to cut generic milk prices was quickly adopted by Woolworths, Franklins and ALDI.

Dairy producers have expressed concerns that the cost of lower retail milk prices will inevitably be passed on to dairy farmers, in the form of lower farm gate prices, imposing further cost pressures on many farmers who are already impacted by recent natural disasters and rising input costs. Others such as Woolworths have suggested that the price reductions are unsustainable and that prices will inevitably rise again[5]. Coles has publicly stated in a variety of forums its position with respect to this price change, including publicly committing to fully absorbing the costs of the price discounting which have been estimated by retail analysts to be approximately $50 million a year.[6]

- Coles publicly stated that it intended to increase the price paid to a milk processor, Fonterra's Brownes Dairy, by five cents per litre, with the intention that this be passed on directly to dairy farmers in Western Australia.[7] Recent media reports have claimed that Fonterra may not pass on the money, as farm gate prices have been already set.[8]

It is unclear at this time, however, the extent to which discounting of generic brand fresh drinking milk will continue or what its effects may be in terms of future farm gate prices for producers.

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[2] Dairy Australia, 2011, *The Australian Dairy Industry: Deregulation*, http://www.dairyaustralia.com.au/Our-Dairy-Industry/The-Australian-Dairy-Industry.aspx.

[3] *Ibid*

[4] Coles media release, http://www.coles.com.au/LinkClick.aspx?fileticket=sinYOlrPfLk%3d&tabid=101.

[5] AM radio interview with Woolworths Spokesman, Simon Berger, 28 February 2011.

[6] Coles media release, http://www.coles.com.au/LinkClick.aspx?fileticket=686uh4%2bfxl8%3d&tabid=101.

[7] ABC media report, http://www.abc.net.au/rural/news/content/201102/s3146748.htm.

[8] ABC media report, http://www.abc.net.au/rural/news/content/201102/s3147884.htm.

There is strong mutual interdependence between businesses operating at each stage of the fresh drinking milk supply chain. The impacts of the current conduct will depend on the nature of the contracts and the relationships between the MSCs, the processors and the dairy farmers.

Buyers in a market who may occupy a relatively strong bargaining position can be expected to be aware of the pressure placed on their trading partners by particular trading terms and conditions. MSCs and processors are unlikely to risk continuity and stability of supply for a staple such as fresh drinking milk, given its importance to their overall grocery strategy as a key consumer value item.

At this time, there is no clear evidence available to suggest that the industry is not capable of maintaining prices sufficient to sustain the industry in the long-term, notwithstanding any short term fluctuations in outcomes at any particular point of the supply chain.

To the extent that the current conduct of the MSCs and other supermarkets with respect to the pricing of fresh drinking milk amounts to anti-competitive conduct, the CCA provides the current framework for safeguarding against the effects of anti-competitive conduct across all sectors of the economy. The operation of the CCA is outlined in Part 2.

In this context, the recent price reductions for drinking milk may be generally viewed as a short term net positive outcome for consumers. It is less clear whether any long term negative consequences may arise, and if they do, whether those negative consequences would outweigh the net community benefits.

PART 2: COMPETITION LAW

2.1 Role of competition law

Competition laws are intended to protect the competitive process in our markets, which will generally deliver greater efficiency and productivity, and better outcomes for consumers. These laws are designed to safeguard against particular types of conduct which would in all cases be anti-competitive (although containing provisions to allow authorisation where conduct may nonetheless produce a net public benefit).

Competition is a process of rivalry in all dimensions of the price-product package offered to consumers. In examining a market to determine its competitiveness, there are various factors which can indicate how competitive a market is, including: barriers to entry to the market; level of concentration in a market; degree of countervailing power in a market; availability of substitutes; dynamic characteristics of the market including growth, innovation and product differentiation; and the nature and extent of vertical integration in a market.[9] While none of them by themselves unambiguously suggest a lack of competition, the presence of one or more can be grounds for closer investigation.

Competition laws are principally concerned with protecting the competitive process, not individual competitors. They are not designed to protect competitors from rigorous competitive behaviour, nor to force businesses to compete.

While noting that this is an inquiry into specific circumstances facing one particular market, it must be remembered that Australia's competition laws apply to business transactions throughout the economy. It may be the case that individual markets are not working effectively for consumers or business (i.e. there is an identifiable market failure). In these circumstances, the question becomes what remedy can be applied to improve outcomes, if any at all. If a market failure is identified in a particular industry, industry-specific measures may need to be considered, and would be likely to be preferable to amending the economy-wide competition laws.

It is in this context that the Committee has been tasked with, in part, examining the effectiveness of the provisions of the CCA. This Part of Treasury's Submission sets out the purpose and current state of the relevant provisions for the Committee's consideration.

- Competition law, as applied in Australia and embodied in Part IV of the CCA, principally concerns itself with safeguarding against the effects of anti-competitive conduct across all sectors of the economy.
  - Part IV of the CCA contains the substantive competition provisions of the CCA, which is intended to prevent anti-competitive conduct and foster competition through a host of targeted prohibitions.
  - Part VII of the CCA enables the Australian Competition and Consumer Commission (ACCC) to grant immunity from legal proceedings for conduct that may breach the competition prohibitions in Part IV (including, for example, collective bargaining), but which results in a net public benefit.

[9] These factors are largely reflected in section 50(3) of the CCA, which provides a non-exhaustive list of matters that may be taken into account in considering whether a proposed merger substantially lessens competition.

2.2 Part IV of the CCA – competition law prohibitions

Effective competition can be reduced by firms behaving, either independently or with other firms, in ways that reduce rivalry in the market, or prevent or deter the entry of new firms. Recognition of these problems gives rise to the core purpose of the competition provisions in Part IV of the CCA which seek to restrain conduct that substantially lessens competition, but to otherwise leave firms free to act as they see fit.

The classes of anti-competitive conduct that are prohibited under Part IV of the CCA are outlined in Box 1.

BOX 1: SUMMARY OF TYPES OF CONDUCT PROHIBITED UNDER PART IV

Cartel conduct (sections 44ZZRF, 44ZZRG, 44ZZRJ and 44ZZRK)

- The cartel provisions prohibit a contract, arrangement or understanding which has the effect of creating a cartel between parties who would otherwise be competing against each other. A cartel is a formal (explicit) agreement among competing firms to coordinate conduct.
- The CCA definition of 'cartel provision' provides for four varieties of cartel conduct: price fixing; output restrictions; allocating customers, suppliers or territories; and bid rigging.
- There are both criminal and civil penalties available for cartel conduct.

Horizontal restraints (section 45)

- Section 45 prohibits contracts, arrangements or understandings that restrict dealings or substantially lessen competition. By colluding with one another, competitors who do not individually have market power are able to distort the competitive process. For example, competitors reaching agreement about the price to be charged for goods and services or who will supply particular segments of the market.

Misuse of market power (section 46)

- Section 46 prevents corporations with a substantial degree of market power from taking advantage of that power for the purposes of eliminating or substantially damaging a competitor, preventing the entry of a person into that or any other market or deterring or preventing a person from engaging in competitive conduct in that or any other market.
  - A business has substantial market power when its activities are not significantly constrained by competitors, suppliers or customers. Subsection 36(3C) specifies that a business may have market power even though it does not have substantial control of the market and does not have absolute freedom from constraint by the conduct of competitors, suppliers or customers.

Predatory pricing (subsection 46(1AA))

- Subsection 46(1AA) prohibits businesses with a substantial market share (having regard to the number and size of its competitors in the market) from selling goods or services for a sustained period at a price below their relevant cost of supply, for an anti-competitive purpose.

BOX 1: CONTINUED

Exclusive dealing (section 47)

- Section 47 prohibits vertical restraints referred to as 'exclusive dealing'. Vertical restraints involve dealings between firms operating at different stages of the production process. Vertical restraints can be entered into for a variety of purposes, many of which will not be anti-competitive but are in fact designed to promote the competitiveness of the firm.

- The CCA prohibits per se third line forcing, which is a specific form of exclusive dealing that involves the supply of goods or services on condition that the purchaser buys goods or services from a particular third party, or a refusal to supply because the purchaser will not agree to that condition.

- All other forms of exclusive dealing conduct are prohibited if the conduct has the purpose, effect, or likely effect of substantially lessening competition.

Resale price maintenance (section 48)

- Section 48 of the CCA prohibits resale price maintenance, which is conduct by a supplier which is designed to dictate the minimum price for the resale of its goods or services by any party which acquires those goods or services. It is also illegal for a supplier to cut off, or threaten to cut off, supply to a reseller (wholesale or retail) because they have been discounting goods or advertising discounts below prices set by the supplier. It is not a contravention to state a recommended resale price so long as it is just that—recommended.

- Resale price maintenance is prohibited on a per se basis, as the prohibition refers exclusively to the conduct of the supplier of goods. The purpose or effect of that conduct are irrelevant in determining whether section 48 has been breached, as is the degree of market power held by the supplier.

Mergers and acquisitions (section 50)

- Section 50 prohibits mergers or acquisitions that would result in a substantial lessening of competition.

  - The ACCC has primary responsibility of review in regard to mergers in the Australian market. When undertaking a review the ACCC assesses each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case.

- Parties can proceed with a merger without seeking any regulatory consideration from the ACCC, however, this may put merger parties at risk of the ACCC or other interested parties taking legal action under section 50. To avoid this, there are three avenues available for firms to have their proposed acquisition or merger considered.

  - Formal Clearance: enables an acquirer to apply to the ACCC for clearance of a proposed acquisition which, if granted, provides protection to the acquirer from legal action under section 50. It is rarely used in practice.

  - Informal Clearance: parties may wish to seek the ACCC's informal advice on the effects of the proposed merger and, by implication, whether the ACCC is likely to challenge the merger should it proceed. It does not provide protection from legal action under section 50. In practice, informal clearance is the primary method used by firms.

BOX 1: CONTINUED

Mergers and acquisitions (section 50) (continued)

- Australian Competition Tribunal authorisation: a firm can also make an application to the Tribunal under section 95AT of the CCA. If authorisation is granted, neither the ACCC nor any other party may take action under section 50 in respect of the acquisition. It is rarely used in practice.

The 2010 Senate Economics References Committee report, *Milking it for all its worth – competition and pricing in the Australian dairy industry* raised concerns regarding the operation of specific Part IV prohibitions, including misuse of market power (section 46) and price discrimination (the former section 49). As these issues may be of particular interest to the Committee, they are outlined in more detail below.

2.3 Misuse of market power (section 46)

What is the purpose of the prohibition?

Section 46 regulates unilateral anti-competitive conduct. The role of section 46 is to distinguish between vigorous competitive activity (which is desirable) and economically inefficient, monopolistic practices that may enable a firm to entrench its market position to the detriment of the competitive process (and hence, which are undesirable).

The object of subsection 46(1) in distinguishing between a misuse of market power and aggressive competitive behaviour was described by the High Court in an oft cited passage:

> 'The object of s 46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. 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 the inevitable consequence of the competition section 46 is designed to foster.'[10]

How does the current law operate?

There are three elements that must be proven in order to establish a breach of the misuse of market power prohibition in subsection 46(1):

1. the respondent has a substantial degree of power in a market (which has essentially been interpreted as a freedom from competitive constraint);

2. the respondent took advantage of that power (acted in a manner that it would not have acted were it subject to competitive pressures); and

3. the conduct had the purpose of:

    : eliminating or substantially damaging a competitor;

    : preventing entry to a market; or

    : preventing or deterring a person from engaging in competitive conduct in any that or any other market.

Predatory pricing

Section 46 was amended in 2007 and 2008 to specifically proscribe predatory pricing. The 2007 amendment (known as the 'Birdsville amendment') created a new prohibition in subsection 46(1AA), which exists in tandem with the existing subsection 46(1). The rationale behind the Birdsville Amendment was to provide protection for small business against predatory pricing on the assertion that section 46 was too difficult to prove.[11] The new subsection 46(1AA) prohibits a corporation

[10] *Queensland Wire Industries Pty. Ltd. v The Broken Hill Proprietary Company Limited & Anor* (1989) Australian Trade Practices Reports 40-925, at 50,010.

[11] Senator Barnaby Joyce, Hansard, Tuesday, 11 September 2007.

with a substantial 'share of a market' (as opposed to 'degree of market power') from engaging in sustained below-cost pricing conduct for one of the proscribed anti-competitive purposes.

'Market power'

Only firms with a 'substantial degree of market power' are prohibited from taking advantage of that power for a proscribed anti-competitive purpose. This is because firms that lack substantial market power are rarely, if ever, able to unilaterally harm competition in an enduring way. The prohibition therefore applies only to firms that meet the threshold requirement of possessing substantial market power.

'Market power' has been interpreted by the courts as:

- the ability to behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm; or, alternatively
- the ability of a firm to raise prices above the supply cost without rivals taking away customers in due time, the supply cost being the minimum costs an efficient firm would incur in producing the product or service.[12]

Market power is a distinct economic concept to market share. Market share is not determinative of market power. A firm can have a substantial degree of power in a market even though its market share in that market is quite low, and despite there being a number of other significant competitors in that market. For example, the Federal Court has previously imposed penalties for misuse of market power where a corporation had only around 16-20 per cent of the share in the relevant market.[13]

Subsection 46(3C) clarifies that a corporation may have market power even if it does not have substantial control of the market and does not have absolute freedom from constraint by the conduct of competitors, suppliers or customers.

The CCA also enables the aggregation of the market power of related companies for the purposes of assessing market power (subsection 46(2)) and enables the Court to have regard to any market power the corporation has that results from contracts, arrangements or understandings with others, or results from covenants that the corporation is entitled to the benefit of (subsection 46(3A)).

'Take advantage'

In order to establish a misuse of market power, it must be established that the market power was taken advantage of for the relevant anti-competitive purposes. The *Trade Practices Legislation Amendment Act 2008* clarified the meaning of the term `take advantage' for the purposes of section 46.

During the Senate Economic References Committee's inquiry into the *Effectiveness of the Trade Practices Act 1974 in protecting small business,* concerns were expressed that the interpretation

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[12] *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co Ltd* (1989) 167 CLR 177.

[13] *Australian Competition and Consumer Commission v Australian Safeway Stores Pty Limited* (No 4) [2006] FCA 21 (31 January 2006).

given to `take advantage' by the High Court in *Rural Press* may prevent section 46 from adequately addressing anti-competitive unilateral conduct.

In Rural Press the High Court endorsed a `take advantage' test which inquires whether a corporation could have undertaken the conduct in question without possessing a substantial degree of market power. The Senate Inquiry considered that this test focuses on a corporation's physical or business capacity to engage in conduct rather than its rationale or intent for doing so. The Inquiry found that the test appeared to result in a situation where corporations may use their market power to engage in proscribed conduct with impunity, so long as they could also engage in that conduct in the absence of market power.

The Senate Inquiry recommended that the CCA be amended to address this situation so as to make it clearer and reduce uncertainty with regard to the meaning of `take advantage'.

Consistent with the Senate Inquiry's recommendation, the CCA was amended to provide that for the purposes of section 46 in determining whether, by engaging in conduct, a corporation has taken advantage of its substantial degree of power in a market, the court may have regard to any or all of the following:

- whether the conduct was materially facilitated by the corporation's substantial degree of power in the market;
- whether the corporation engaged in the conduct in reliance on its substantial degree of power in the market;
- whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of power in the market; and/or
- whether the conduct is otherwise related to the corporation's substantial degree of power in the market.

These factors clarify the meaning of `take advantage' for the purposes of subsections 46(1) and 46(1AA). They also address the Senate Inquiry's concerns deriving from the Rural Press case by ensuring that a court may consider whether a corporation would have had an incentive to engage in the relevant conduct if it lacked substantial market power.

These amendments are largely untested in the courts at this time.

Anti-competitive purpose

Section 46 focuses on the purpose of the firm's conduct because this is considered to be the best way of distinguishing between pro-competitive and anti-competitive behaviour.

Purpose may be inferred from a firm's behaviour or from relevant circumstances (subsection 46(7)). A firm's purpose must be substantial but it need not be the sole or dominant purpose for engaging in the conduct.[14]

[14] *Re Mark Lyons Pty Limited v Bursill Sportsgear Pty Limited [1987] FCA 282 (25 August 1987) at 44.*

Section 46 does not look to the effect of the firm's behaviour. If it did, there is the potential for pro-competitive conduct by firms with substantial market power to be deterred, with consequentially reduced gains in efficiency and productivity and hence economic welfare.

The Dawson Review noted that 'it is the behaviour which gives rise to the prohibition rather than its effect—although, of course, the ultimate object of the section is to protect and advance a competitive environment and the competitive process rather than to protect individual competitors.'[15]

Recent reviews of the operation of section 46

The CCA prohibitions were examined by the OECD in 2009 as part of the *OECD Review of Regulatory Reform- Australia*. In its assessment of the section 46 prohibition, the OECD concluded:

> 'It is questionable whether there is sufficient evidence to support a view that the general prohibition under Section 46 does not cater adequately for predatory pricing cases. In its current form, the new dedicated prohibition risks causing undue and unproductive uncertainty in the business sector about pricing decisions and may even have a chilling effect on competitive behaviour; in particular in light of the replacement of the 'power' element with a 'share' element in the predatory pricing prohibition. The current government has been thwarted in the Parliament in its attempts to address these concerns. In light of this, the government should monitor this area and take advantage of future opportunities to remove at least the market share aspect of the Birdsville amendment when they arise.'[16]

[15] *Review of the Competition provisions of the Trade Practices Act*, January 2003.

[16] OECD Reviews of Regulatory Reform 2010, http://www.oecd.org/dataoecd/63/61/44529918.pdf.

2.4 Price Discrimination (former section 49)[17]

From its enactment in 1974 until 1995, Part IV of the CCA contained a prohibition in Section 49 which specifically prevented some forms of anti-competitive price discrimination (the text of the former section 49 is reproduced below).

What did the former section 49 look like prior to its repeal?

49. (1) A corporation shall not, in trade or commerce, discriminate between purchasers of goods of like grade and quality in relation to:

(a) the prices charged for the goods;

(b) any discounts, allowances, rebates or credits given or allowed in relation to the supply of the goods;

(c) the provision of services in respect of the goods; or

(d) the making of payments for services provided in respect of the goods;

if the discrimination is of such magnitude or is of such a recurring or systematic character that it has or is likely to have the effect of substantially lessening competition in a market for goods, being a market in which the corporation supplies, or those persons supply, goods.

(2) Subsection (1) does not apply in relation to a discrimination if:

(a) the discrimination makes only reasonable allowance for differences in the cost or likely cost of manufacture, distribution, sale or delivery resulting from the differing places to which, methods by which or quantities in which the goods are supplied to the purchasers; or

(b) the discrimination is constituted by the doing of an act in good faith to meet a price or benefit offered by a competitor of the supplier.

(3) In any proceeding for a contravention of subsection (1), the onus of establishing that that subsection does not apply in relation to a discrimination by reason of subsection (2) is on the party asserting that subsection (1) does not so apply.

(4) A person shall not, in trade or commerce:

(a) knowingly induce or attempt to induce a corporation to discriminate in a manner prohibited by subsection (1); or

(b) enter into any transaction that to his knowledge would result in his receiving the benefit of a discrimination that is prohibited by that subsection.

(5) In any proceeding against a person for a contravention of subsection (4), it is a defence if that person establishes that he reasonably believed that, by reason of subsection (2), the discrimination concerned was not prohibited by subsection (1).

[17] There is now an unrelated section 49 in the CCA relating to Dual Listed Companies.

Application of section 49

Only a handful of cases were brought before the courts on the reliance on the provision. In the one instance where price discrimination was proven, the conduct also amounted to contravention of the prohibition on exclusive dealing (section 47), which remains in effect. [18]

Reviews pre-repeal

Since the enactment of the CCA in 1974, there have been three major independent reviews looking at the operation of the Act. All three reviews examined section 49 and ultimately recommended the repeal of section 49 for a variety of reasons.

Swanson

The *Trade Practices Act Review Committee* (Swanson Committee) in 1976 considered that section 49 reduced price flexibility.

> 'The Committee considers that in the Australian context the conduct of a large buyer who is endeavouring to secure price cutting in his favour, whether it be discriminatory or not, may be more pro-competitive than anti-competitive. Indeed such price cuts as a large buyer is able to obtain can trigger off competition from rival suppliers or can trigger off competition in a market where other forces are unlikely to produce active competition.'[19]

> 'The prohibition on price discrimination in section 49 has, in our view, operated substantially to limit price flexibility. The Committee believes that in the Australian context, section 49 has produced such price inflexibility that the detriment to the economy as a whole from the operation of the section outweighs assistance which small business may have derived from it. It is price flexibility which is at the very heart of competitive behaviour. The Committee thus recommends that section 49 should be repealed.'

Blunt

The *Trade Practices Consultative Committee* (Blunt review) of the CCA in 1979 noted the infrequent use of section 49 and recommended a strengthening of the section 46 prohibition on misuse of market power to ensure anti-competitive behaviour would be captured. The Blunt review regarded section 49 as detrimental to price flexibility, to consumers, big and small business. It also noted it brought about undesirable inflationary effects.

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[18] In *Re Cool and Sons Pty Ltd Trading As Wagga Windscreen Service v O'Brien Glass Industries Limited [1981] FCA 95* (13 July 1981), based upon the breach on section 49, Keely J observed; 'There is some overlapping between the different sub-sections of the Trade Practices Act. In particular, in the present case, it is alleged that the same conduct of the respondent constitutes both exclusive dealing contrary to Section 47 of the Act and price discrimination contrary to Section 49 of the Act. In other words, the giving of a substantial discount on certain conditions can be price discrimination and also, constitute exclusive dealing contrary to Section 47. Indeed, in the applicant's submission, it is the combination of the large systematic discounts and the exclusive dealing condition which greatly increases the adverse anti-competitive effects in the present case …'

Further, in *Re O'Brien Glass Industries Limited v Cool & Sons Pty Limited Trading As Wagga Windscreen Service* [1983] FCA 191; 77 FLR 441 (18 August 1983), Fox, Franki and Sheppard JJ commented 'It is also to be noted that the purpose of the discrimination in s. 49(1) is irrelevant and this may be compared with the provisions of s. 47(10).'

Small business representatives considered the retention of section 49 as desirable and that the prohibition should be strengthened. The Blunt Review noted that the majority of small businesses regarded section 49 as having been of no real assistance to them, noting that those seeking relief from price discrimination were generally seeking relief from predatory pricing by powerful firms.

The Committee recommended the repeal of section 49 and amendments to the misuse of market power provision (section 46) to enable it to capture conduct by firms with a substantial degree of market power rather than only firms who could substantially control the market. The government subsequently amended section 46, consistent with these recommendations.

Hilmer

The *National Competition Policy Review* (Hilmer Report) in 1993 also highlighted the existence of sections 45 and 46 to guard against anti-competitive price discrimination and concluded that where small business required specific protection that this should be delivered through open direct assistance.

> 'The Committee considers that price discrimination generally enhances economic efficiency, except in cases which may be dealt with by section 45 (anti-competitive agreements) or section 46 (misuse of market power).'
>
> 'To the extent that section 49 has had any effect it seems to have been to diminish price competition.'
>
> 'The Committee does not consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is potentially to the detriment of the welfare of the community as a whole. Sectoral assistance policy of this sort is generally most efficiently implemented by more open and direct assistance, including budgetary and taxation measures of various kinds. In any event, it seems clear that small businesses have not achieved any significant benefit from the presence of section 49.'[20]

Section 49 was subsequently repealed in 1995 through the *Competition Policy Reform Act 1995*. The second reading speech for the amending legislation, 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.'[21]

Post-repeal reviews

Since the repeal of section 49, there has been one prominent review of the CCA. The Dawson Review in 2003 looked at the current competition provisions and their ability to address anti-competitive price discrimination.

[20] Hilmer Report page 79.

[21] Assistant Treasurer, Hansard, Friday, 30 June 1995.

The review concluded that section 46 provides an appropriate means to tackle anti-competitive price discrimination. The review considered and rejected a proposal to introduce an effects test to section 46 to address concerns regarding price discrimination.

> '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. And effects test could, in the view of the Committee, discourage legitimate competitive practices by small business having the effect of injuring a competitor or discouraging a potential competitor, in the same way as with large businesses.'

The review further noted that section 46's terms are apt to enable prosecution for anti-competitive price discrimination.

> 'Other section 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.' [22]

The review also made comments on the role of competition law.

> '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.'

In 1997, a report by the House of Representatives Standing Committee on Industry, Science and Technology tabled a report titled *Finding a Balance: Towards fair trading in Australia*. The report explores price discrimination as a part of "Misuse of Market Power" and concluded:

> 'The Committee considers the repeal of section 49 resulted in a marginal weakening of protection for small business against price discrimination. The onus is now on businesses facing price discrimination to prove that the conduct has an anticompetitive purpose, not just an anticompetitive effect. However, the Committee also notes section 49 is not considered to have proven a particularly effective protection against price discrimination anyhow.'
>
> 'The Committee does not believe it would be appropriate to re-introduce the price discrimination provision. The Committee considers price discrimination against small business can best be dealt with under the 'unfair conduct' amendments to Part IVA of the Trade Practices Act proposed in chapter 6 of this report.'

[22] Dawson Review page 93.

2.5 Authorisation and notification (Part VII)

Under the authorisation and notification provisions contained in Part VII of the CCA, the ACCC has the power to grant immunity from legal proceedings for and conduct that might otherwise breach the competition prohibitions (Part IV). Authorisation is not available for misuse of market power (section 46).

The ACCC can grant immunity for these types of conduct when any anti-competitive detriment involved is outweighed by the public benefit resulting from the arrangement or conduct. In considering applications for authorisation, the test applied by the ACCC depends on the conduct in question.

For agreements that may substantially lessen competition, an applicant must satisfy the ACCC that the agreement results in a benefit to the public that outweighs any anti-competitive effect.

The 2010 Senate Economics References Committee report, *Milking it for all its worth – competition and pricing in the Australian dairy industry* recommended reviewing the collective bargaining authorisation and notification arrangements under the CCA.

Given that collective bargaining may be of particular interest to the Committee, the arrangements are outlined in more detail below.

Collective bargaining

What is the purpose of the collective bargaining arrangements?

Collective bargaining under the CCA refers to an arrangement under which two or more competitors in an industry come together to negotiate terms and conditions (which can include price) with a customer or supplier. It is distinct from the bargaining process which takes place between an employer and employee to negotiate terms and conditions of employment, which is principally mandated by the *Fair Work Act 2009*.

Collective bargaining attempts to redress the imbalance in bargaining power between small business and big business by enabling small businesses to engage in negotiations with big businesses on a more equal footing. It can increase productivity and efficiencies for the businesses involved in the arrangement. The arrangements can result in benefits to Australian businesses, consumers and the economy generally.

While collective bargaining can result in public benefits, it may also have an anti-competitive effect, for example, where it reduces competition as a result of collusion; impacts detrimentally upon competitors and competition outside of the bargaining group; reduces the likelihood of new entrants to the market; or increases potential for harmful collective activity that falls outside the conduct for which protection is sought from legal action under the anti-competitive conduct rules.

Recognising the harm to competition and consumers of anti-competitive agreements between businesses, collective bargaining is subject to the competition law prohibitions in Part IV of the CCA. The CCA's collective bargaining arrangements enable the parties to obtain protection from legal action where the public benefits likely to result from the circumstances of the individual case outweigh the harm from that activity.

There are two mechanisms in the CCA for obtaining legal protection for conduct that may breach the competition prohibitions in Part IV of the CCA – authorisation and notification.

Authorisation

Since 1974, the CCA has enabled parties to seek protection from legal action through the ACCC's authorisation process. The onus is on authorisation applicants to satisfy the ACCC that authorisation should be granted on the grounds that public benefits outweigh any anti-competitive detriment. The fee for authorisation is $7,500.

The authorisation process is open and transparent, involving public registers, consultation with interested parties and the publication of draft and final determinations. A six-month time limit generally applies to the ACCC's consideration of applications for authorisation.

The ACCC also offers a simpler and more streamlined process for parties seeking authorisation of collective bargaining arrangements for small businesses, with final determinations able to be made within three months.

In comparison with notification (outlined below), authorisation may be more appropriate where a collective bargaining group needs:

- more flexibility;
- to negotiate with no transaction limit or to negotiate with a number of targets or for arrangements covering several bargaining groups; or
- to negotiate for more than three years.

Notification

The notification regime is a process under which small businesses proposing to engage in collective bargaining conduct may obtain immunity from legal action under the CCA, if the conduct is in the public interest. The collective bargaining notification arrangements were added to the CCA in 2007 to provide a cheaper, faster and simpler method than the authorisation process to assist small businesses to seek legal protection to bargain collectively.

To enable the ACCC to make a timely decision whether to object to a notified collective bargaining arrangement, any notification lodged with the ACCC must set out the full details of the collective bargaining arrangement. In particular:

- the name and address of each member of the collective bargaining group must be provided, along with proof of their consent to the notification being lodged;
- the business that the collective bargaining group proposed to negotiate with (known as the target) must be identified; and
- each member party to the collective bargaining group must 'reasonably expect' that they will enter into at least one contract with the target in a 12 month period, to which a transaction threshold of $3 million generally applies (higher thresholds can be set for specific industries, and have been for petrol retailers, retailers of new motor vehicles and farm machinery and primary producers).

Any party to a collective bargaining arrangement or their representative can lodge a notification with the ACCC.

Once a valid notification is lodged, legal protection commences after 14 days unless the ACCC issues an objection notice. The legal protection ceases to be in force three years after the day the corporation gave the collective bargaining notice.

The fee for a notification is $1,000. A concessional fee ($0) applies where there are reasonable grounds for the ACCC to believe the notification relates to conduct in the same market (or closely related markets) as another notification and is lodged within 14 days. However, a notification cannot be amended. If an applicant wishes to amend the description of the collective bargaining arrangements or amend the parties named in the notification, a new notification must be lodged. Unlike authorisation, the ACCC does not have the power to waive a notification fee.

Use of collective bargaining

The ACCC has approved collective bargaining arrangements covering a wide range of industries including, fruit and vegetable growing, dairy farmers, newsagents, doctors, removalists, anaesthetists, paint franchising, clubs and hotels, chicken growing, traffic management and security contractors, financial services franchising, waste and recyclables collection and processing, milk vendors, airlines, freelance journalists, oil producers, rail haulage services, elite swimmers, liquor retailing, earth moving contractors and telecommunications retailing.

Year	Notifications	Authorisations
2007/08	7 approved 1 revoked	29 authorised
2008/09	64 approved 0 revoked	35 authorised
2009/10	74 approved 0 revoked	37 authorised

ATTACHMENT A

IMPACT OF DEREGULATION ON THE DAIRY INDUSTRY

Prior to 2000, the Australian dairy industry was regulated by State Governments. State authorities set the farm gate price for fresh drinking milk to ensure the additional costs of year round supply were covered.

This dairy industry regulation was subject to examination under the National Competition Policy (NCP). The underlying principle behind NCP is that competitive markets will generally serve the interests of the wider community, and therefore arrangements that detract from competition should only be retained if they can be demonstrated to be in the public interest. All jurisdictions agreed to use this underlying principle to review, and where appropriate, reform legislative restrictions on competition (such as state regulation in the dairy industry).

In 1999, the industry's peak policy body, the Australian Dairy Industry Council, approached the Australian Government with a plan for a national approach to the deregulation of the drinking milk sector in conjunction with the end of manufacturing milk price support.

The impact of deregulation at the farm level varied across the different States of Australia – the impact was largely dependent on how important drinking milk (with its regulated higher farm gate price) was to the individual farm enterprise in relation to total milk production.

The Government provided significant support to assist industry adjust to the deregulated market through the Dairy Industry Adjustment Program (DIAP), announced in September 1999. The DIAP involved the imposition of a retail Dairy Adjustment Levy of 11 cents per litre on consumers of products marketed as dairy beverages. The levy funded quarterly DIAP payments (over eight years) to Australian dairy farmers to support them to make the necessary adjustments to a deregulated environment. The levy was removed on 23 February 2009 after the Senate passed the *Dairy Adjustment Levy Termination Act 2008*.

Literature on the impact on deregulation indicates that, in the decade following deregulation, a decline in the number of dairy farms was accompanied by a corresponding increase in the average size of dairy farmers and dairy farm herds.[23] The dairy industry has benefited from substantial productivity gains within the last decade, with annual milk yields in Australia growing by 20 per cent to 5,810 litres a cow.[24] Changes in the industry have also emerged in the form of growing opportunities to export to international markets such as China and Russia where import demand for dairy products is rapidly expanding.

The Productivity Commission, National Competition Council and Australian Competition and Consumer Commission (ACCC) within the Treasury portfolio have each independently examined the impacts of deregulation on the dairy industry at various points in time. In broad terms, these reviews have noted impacts such as a reduction in the number of producers and consolidation among dairy processors. However, these reviews have concluded that the benefits of deregulation in terms of productivity growth, and for consumers in the form of lower prices and increased choice, have resulted in a net public benefit to the Australian economy.

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[23] McKinnon, D., Oliver, M., and Ashton, D., *2010, Australian dairy industry: technology and management practices, 2008–09*, ABARE–BRS report 10.11, Canberra, November.

[24] Ibid.

Productivity Commission 2005 review

In 2005, the Productivity Commission (PC) concluded its inquiry, *Review the National Competition Policy Arrangements*, which reported on the impact of NCP and related reforms and assessed the impacts of these reforms on significant economic indicators such as growth and productivity and other policy goals.

In terms of the impact of the broad NCP reform agenda, the PC found that implementation of NCP has delivered substantial benefits to the Australian community which, overall, have greatly outweighed the costs. It has:

- contributed to the productivity surge that has underpinned 13 years of continuous economic growth, and associated strong growth in household incomes;
- directly reduced the prices of goods and services;
- stimulated business innovation, customer responsiveness and choice; and
- helped meet some environmental goals.

The inquiry report noted that benefits from NCP have flowed to both low and high income earners, and to country as well as city Australia.

The Productivity Commission also found that observed productivity and price changes in key infrastructure sectors in the 1990s — to which NCP and related reforms have directly contributed — have increased GDP by 2.5 per cent, or $20 billion.

Specifically in regard to the dairy industry, the PC concluded that:

- consumers had received benefits in the form of:
  - the average retail price of drinking milk had fallen by 5 per cent in real terms since full deregulation in 2000, despite the imposition of an 11 cents per litre levy to fund an assistance package for dairy farmers; and
  - the range of milk products available to consumers broadened with the introduction of new products to meet various dietary and health needs;
- there had been transitional costs – some regional communities had to deal with losses of income and reduced employment opportunities;
- dairy deregulation had substantially reduced returns to those farmers heavily dependent on supplying the previously protected market for drinking milk (though across Australia, dairy farm income appears to have risen since deregulation mainly as a result of higher revenues from milk used for manufactured products);
- a number of farmers had taken advantage of the exit payments offered under the DIAP to leave the industry; and
- the overall impact was a decrease in the number of farms, which continued the industry trend that had been apparent for over three decades, and an increase in the average size of farms.

National Competition Council 2004 review

A report of the National Competition Council Occasional Series, *Dairy – Now and Then: The Australian Dairy Industry Since Deregulation*, conducted by RidgePartners in 2004, noted benefits to consumers in the form of:

- retail milk prices declining on average, across all milk categories and across the different market segments, in particular, noting that deregulation allowed major retail chains to offer consumers cheaper dairy products through the promotion of private label brands; and

- increased choice of product and increased access to innovative products which are aimed at various dietary and convenience needs, noting that deregulation created strong incentives for dairy companies to expand their income base by engaging in greater innovation in product development and marketing.

ACCC 2001 and 2008 reviews

The ACCC in its 2001 report, *Impact of Farm Gate Deregulation in the Australian Milk Industry: Study of Prices, Costs and Profits*, noted that:

- deregulation has changed the competitive dynamics between processors and the retail sector, with market power shifting in favour of MSCs, who have expanded their investment in generic-labelled milk;

- Australian milk consumers have benefited from deregulation due to increased availability of low-priced generic milk in MSCs; and

- many milk processors have made considerable capital investments in state-based milk processing facilities. These investments would be lost should local farms cease to supply sufficient quantities of milk for processing. As consumers are prepared to pay a premium for fresh milk, processors require a reliable supply of market milk and will have to pay farmers a sufficient return to guarantee such supplies.

In 2008, the ACCC released the *Inquiry into the competitiveness of retail prices for standard groceries* (the Grocery Inquiry). The ACCC reported on the role of generics in the grocery market, including that:

- the introduction of generic brands among grocery products offers consumers additional choice and is pro-competitive, all other things being equal; and

- while retailers do have the incentive to promote their own labels in preference to other brands, it is necessary for retailers to deliver products that consumers value or risk seeing their customers shop at other stores.

On the broader issue of competition in the retail grocery market, the ACCC concluded that:

- grocery retailing is workably competitive, and that at most only one twentieth of recent food price increases was attributable to increases in margins of the major grocery retailers. However, the Inquiry also identified a number of factors that limited the level of price competition, including:

  - high barriers to entry and expansion, particularly in relation to difficulties in finding new sites for development;
  - limited incentives for Coles and Woolworths to compete aggressively on price; and
  - limited price competition from independent retailers; and
- ALDI has been a vigorous price competitor, which has brought about competitive responses from Coles and Woolworths.

Specifically in relation to the dairy industry, the ACCC noted that:

- within the dairy industry, there appears to be no evidence that processors and retailers are able to lower farm gate pricing in the face of rising world dairy prices.
- in relation to milk, the ACCC is satisfied that the number of dairy processors available in Australia result in a workably competitive market.