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Senate Economics Committee

Inquiry into competition and pricing in the Australian dairy industry

Submission
by

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PROMOTING A VIABLE AND COMPETITIVE AUSTRALIAN DAIRY INDUSTRY:
PROPOSALS FOR PROMOTING EFFECTIVE INDUSTRY DISPUTE RESOLUTION PROCESSES; PREVENTING THE CONCENTRATION OF MARKETS; AND PROMOTING ETHICAL CONDUCT THROUGH THE *TRADE PRACTICES ACT*

This Submission is concerned with promoting a viable and competitive Australian Dairy Industry. The purpose of this submission is to ensure that the key gaps in the Australian competition and fair trading regulatory framework are identified and closed for the benefit of the Australian Dairy Industry. All recommendations are carefully targeted to deal with specific gaps in the regulatory framework and are designed to be a minimum necessary response to close such gaps. In particular, the Submission is focused on:

(i) Promoting effective dairy industry dispute resolution processes;
(ii) Preventing the concentration of markets; and
(iii) Promoting ethical business conduct through the *Trade Practices Act*

The proposals are designed to deal with both structural and behavioural issues within the Australian Diary Industry. Each of the proposals addresses Paragraph (e) of the Inquiry's Terms of Reference as to whether aspects of the *Trade Practices Act* are in need of review having regard to market conditions and industry sector concentration in this industry.

In short, the Submission will reveal that there are numerous aspects of the *Trade Practices Act* which are in urgent need of repair having regard to the market conditions and the high levels of concentration in the Australian dairy industry.

Outline of submission

The submission is divided into the following Parts:

- **List of Recommendations**
- **Part One: Promoting effective dairy industry dispute resolution processes**
- **Part Two: Preventing the concentration of markets**
- **Part Three: Promoting ethical business conduct**

List of Recommendations

(1) **Establishing an Office of the Australian Dairy Industry Ombudsman with specific responsibility for (i) researching and identifying existing and emerging areas of disputation in the Australian dairy industry with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes;**

(2) **Enact the *Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009*;**

(3) **Amend the *Trade Practices Act* to effectively prohibit anti-competitive price discrimination;**

(4) **Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers;**

(5) **Inserting a statutory definition of the term "unconscionable" into s 51AC of the *Trade Practices Act*;**

(6) **Enacting a statutory duty of good faith;**

(7) **That business to business contracts involving small businesses be reinstated in the unfair contracts proposals contained in the Australian Consumer Law Bill in accordance with the previous Minister's and Federal Cabinet's endorsement of the need to include small businesses in the unfair contract terms proposals;**

(8) **Prohibiting bullying, intimidation, physical force, coercion or undue harassment within dairy industry relationships.**

Part One: Promoting effective dairy industry dispute resolution processes

The establishment of a new Government agency to be called the Australian Dairy Industry Ombudsman would ensure that there was a suitable qualified and independent person with specific responsibility for (i) researching and identifying existing and emerging areas of disputation with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes.

In effect the Australian Dairy Industry Ombudsman would be a "trouble shooter" who would systematically investigate new and emerging areas of disputation in the Australian dairy industry with a view to seeking to identify strategies, mechanisms or legal options for efficiently and effectively resolving such disputes.

The Australian Dairy Industry Ombudsman would have dairy industry experience and would be available to assist industry participants to reach a business solution to disputes that arise within the dairy industry. The Australian Dairy Industry Ombudsman would play a distinct and valuable role which is unable to be performed by the Australian Competition and Consumer Commission. While the ACCC should be concerned with identifying and prosecuting breaches of the *Trade Practices Act*, there will clearly be instances where the viability of industry participants is the central issue and resolution of that issue needs a business assessment by an independent party such as the proposed Ombudsman rather than a legal assessment by the ACCC.

RECOMMENDATION

Establishing an Office of the Australian Dairy Industry Ombudsman with specific responsibility for (i) researching and identifying existing and emerging areas of disputation in the Australian dairy industry with a view to identifying strategies, mechanisms or legal options for minimising such disputes; and (ii) assisting industry participants to resolve disputes.

Part Two: Preventing the concentration of markets

There is no doubt that the greater the levels of market concentration, the greater the likelihood that consumers will be price gouged. The reason for this is quite simple. As markets become more concentrated, the opportunities for either collusion or parallel conduct with respect to pricing and related matters grow considerably. Within this context, mergers across the economy present a real and very serious risk to competition and consumers.

Risks to competition and consumers arise because mergers and acquisitions lead to a reduction in competitors and, in turn, lead to less competitive behaviour amongst the remaining players or to less incentive to do so or to innovate. This reduction in the intensity of competition is detrimental to consumers as any "efficiencies" or reduced costs achieved by a merger are much less likely to be passed onto consumers and much more likely to be pocketed by the merged firm. Yes, mergers are typically justified on the basis of allowing efficiencies or a reduction in costs to be achieved, but such efficiencies, if any, will only be beneficial to consumers if they are passed onto them. Indeed, the danger of mergers is that any efficiencies or reduction in costs that may be realised through a merger will not be passed onto consumers for the simple reason that as mergers remove competitors from the market, there will be fewer competitors left to take an independent stance to drive down prices to consumers, especially over time.

More dangerously for competition and consumers, as the few remaining firms become even larger through further mergers or, in particular, through creeping acquisitions the market share of the remaining firms itself becomes a considerable, if not insurmountable, barrier to entry. Thus, the mere fact that the market is "locked up" by a few large and powerful firms itself becomes a powerful disincentive or barrier to any potential new entrant.

In short, as the number of firms in a market diminishes, so too does the incentive for potential new entrants or for the remaining firms to aggressively attack one another on price or other terms and conditions. It is far easier for the remaining firms to act as a cosy club for their self interested advantage rather than to aggressively attack one another on price or other terms and conditions. Indeed, why enter into a price war when that would only cut profit margins for the "club members," namely the few remaining firms in a concentrated market? Why should club members sustain cuts in profit margins, when it is much easier for them to build profit margins by simply shadowing one another on price and other terms and conditions?

Of course, the club members will protest loudly that they "compete" with one another, but any such "competition" is conducted in a manner that is beneficial to the club members rather than in manner that produces the maximum benefit to consumers. In a less concentrated market, it would only take one independently minded player to lower prices for the others to be compelled to follow. In a more concentrated market the players are less likely, if at all, to be

"independently minded" as such a mindset only serves to undermine the ability of the few remaining firms to maintain or grow profit margins.

In view of the importance of preventing markets from becoming highly concentrated, this submission recommends the enactment of the *Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009*, a Bill drafted by the author, on the basis that it has been designed with the specific aim of promoting consumer welfare by protecting and facilitating vigorous competition across all sectors of the Australian economy.

The background and rationale behind the Richmond Amendment

This part of the Submission will consider:

- The need to amend s 50 of the *Trade Practices Act* to prohibit any merger or acquisition that "materially" lessens competition;
- Dealing with creeping acquisitions: The importance of preventing the destruction of competition by stealth.

In doing so, this part of the Submission will outline the clear need to amend s 50 of the *Trade Practices Act* so as to ensure that Australia has the most effective anti-merger laws possible for the promotion of competition and consumer welfare.

Need to amend s 50 of the *Trade Practices Act* to prohibit any merger or acquisition that "materially" lessens competition

Currently, s 50 of the *Trade Practices Act* only prohibits a merger or acquisition if it substantially lessens competition:

> (1) A corporation must not directly or indirectly:
>
> (a) acquire shares in the capital of a body corporate; or
>
> (b) acquire any assets of a person;
>
> if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

Unfortunately for consumers and competition, the "substantial lessening of competition" test is far too high a threshold to meet and, accordingly, explains why the ACCC approves around 97% of mergers or acquisitions that it considers. The "substantial lessening of competition" test requires that in order for the merger or acquisition to be considered in breach of the test, the merged entity must have the ability to raise prices without losing business to rivals. In this way, the "substantial lessening of competition" test has come to be equated with the "substantial market power" test which also requires that it

be established that the company have the ability to raise prices without losing business to rivals.

With the near perfect record of mergers being approved or escaping scrutiny under the current s 50(1) it is not surprising that Australia has some of the most highly concentrated markets in the world. Such near perfect approval rate provides compelling evidence of the failure of s 50(1), as currently drafted, to protect competition and consumers from the adverse effects of mergers or acquisitions This is particularly so as with a reduction in genuine competition between the fewer companies remaining post merger there is a much greater likelihood that the remaining companies will act as a cosy club to the detriment of consumers.

This failure of the current s 50(1) to prevent mergers and acquisitions having a detrimental effect on consumers and competition can be directly attributed to the view that the present "substantial lessening of competition" test is simply too high a test to act as an appropriate filter to protect competition. In short, because the "substantial lessening of competition" test is set too high, s 50(1) as currently drafted is failing to prevent anti-competitive mergers and acquisitions.

Proposed amendment to s 50(1) of the *Trade Practices Act*

Within this context, it would be submitted that the "substantial lessening of competition" test under the current s 50(1) is in urgent need of change to a more balanced test of a "material lessening of competition." A "material lessening of competition" test as included in the Richmond Amendment would operate to lower the threshold for determining whether a merger or acquisition is anti-competitive in a manner that would allow the merger or acquisition to be tested by reference to whether it has a pronounced or noticeably adverse affect on competition and consumers rather than on whether the merged entity would, post merger, be able to exercise substantial market power as is currently the case.

Dealing with creeping acquisitions: The importance of preventing the destruction of competition by stealth

Dealing effectively with the issue of creeping acquisitions is essential to having a world's best competition law framework. Failure to deal effectively with creeping acquisitions undermines competition to the clear and longstanding detriment of consumers. Unless the *Trade Practices Act* effectively prevents creeping acquisitions there will be a considerable gap in the Act allowing large businesses to acquire competitors in a piecemeal manner that gets around the existing prohibition against mergers found in s 50(1) of the *Trade Practices Act*.

The issue of creeping acquisitions arises because of the current drafting of s 50 of the *Trade Practices Act*. First, as discussed above, s 50(1) is far too permissive in allowing around 97% of mergers to be approved by the ACCC. Second, s 50(1), as currently drafted, refers to an "acquisition" in the singular

making it clear that it is each individual acquisition that needs to be assessed under s 50. Unless the particular acquisition, in itself, substantially lessens competition, it will not be in breach of s 50. As a result, the individual acquisition will be allowed under s 50(1) as currently drafted as the "substantial lessening of competition" test is too high a threshold to deal with mergers or acquisitions.

It is clear that s 50 can be easily circumvented by undertaking piecemeal or small scale acquisitions which individually don't substantially lessen competition, but which over time lead to the increased dominance of the merged entities. As noted above, this is clearly evident in the Australian banking sector where the series of acquisitions by the Commonwealth Bank and Westpac in recent years has led to the increased dominance of these 2 major banks in circumstances where s 50(1) as currently drafted has hitherto failed to prevent those piecemeal acquisitions.

Thus, while over time individual piecemeal acquisitions may, when taken together with previous acquisitions by the same entity, have the effect of collectively destroying competition, the current s 50(1) is powerless to stop the piecemeal acquisitions as can be so clearly seen in the Australian banking sector.

So under s 50(1), as currently drafted, the creeping acquisitions of individual competitors will not be prevented because their small scale will not be considered to substantially lessen competition and accordingly not breach s 50(1) of the *Trade Practices Act*. In this way creeping acquisitions lead to the destruction of competition over time in a manner that is not prevented by the current s 50(1) of the *Trade Practices Act*.

While, of course, those engaging in creeping acquisitions will justify the creeping acquisitions on efficiency grounds as possibly leading to greater economies of scale, it is essential to note that the removal of individual efficient competitors over time means that there is a reduction in the very competition required to ensure that any savings from any economies of scale gained from acquisitions are passed onto consumers.

Thus, unless there is sufficient competition to force the merged entities to pass efficiency savings onto consumers, the benefits of any economies from mergers or acquisitions will simply be a windfall for the merged entity and not be passed onto consumers. More dangerously for consumer, the weakening of competition through merger activity, along with the increased dominance of the merged entities, allows the merged entities to raise prices and/or product choices to detriment of consumers.

Recommendation

Enact the *Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009*

Prohibiting anti-competitive price discrimination

While anti-competitive price discrimination is a form of anti-competitive conduct intended to be covered by s 46 of the *Trade Practices Act*, it remains a problem area given the current ineffectiveness of s 46. Indeed, the repeal of s 49 of the *Trade Practices Act* in 1995 was premised on s 46 being adequate to deal with anti-competitive price discrimination. Unfortunately, s 46 has completely failed to live up to expectations in this regard, and consequently, Australia presently does not have an effective prohibition against anti-competitive price discrimination. This current lack of an effective prohibition against anti-competitive price discrimination is detrimental to competition and consumers.

Price discrimination in the dairy industry can have an anti-competitive impact where lower prices that milk processors charge Coles and Woolworths for generic milk lead to the milk processor charging higher prices for branded milk, especially to smaller retailers. Clearly, there is a level of return that a milk processor requires and, therefore, the lower the prices paid by Coles and Woolworths for generic milk, the higher the prices that milk processor will charge smaller retailers for branded milk to make up for the lower returns or shortfall from Coles and Woolworths. Inevitably there is a cross-subsidy being paid by smaller retailers for branded milk to fund the lower prices at which milk processors sell generic milk to Coles and Woolworths.

With smaller retailers at a substantial competitive disadvantage because of the higher prices they pay for branded milk, Coles and Woolworths need not compete as aggressively on price as they would have to if the smaller retailers were able to provide a stronger competitive constraint on Coles and Woolworths. With Coles and Woolworths growing their profit margins, the lower prices for generic milk they obtain from milk processors may be pocketed by Coles and Woolworths rather than being fully passed onto consumers.

Clearly, there is a very real danger that price discrimination in the market for milk is deterring or preventing competitive conduct within that market in a way that is substantially detrimental to consumers. In short, price discrimination can be anti-competitive in that a smaller retailer is simply unable to compete as aggressively as possible in the market because of the price discrimination it faces. Consequently, consumers are denied the benefits of vigorous competition between large and small retailers. Needless to say, if smaller retailers are unable to be competitive because of higher milk prices they pay in comparison to Coles and Woolworths, there is a further and very real danger that the smaller retailers will go out of business, thereby further reducing competition.

Where anti-competitive price discrimination is present, it should be dealt with under the *Trade Practices Act*. Given the continued ineffectiveness of s 46 it is appropriate to amend the *Trade Practices Act* to deal specifically with anti-competitive price discrimination. A number of international precedents are

available including the United States *Robinson-Patman Act of 1936* and s 18 of the United Kingdom *Competition Act 1998*:

> **18.** - (1) Subject to section 19, any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in-
>
> (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;…
>
> …
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; …

Recommendation

Amend the *Trade Practices Act* to effectively prohibit anti-competitive price discrimination

Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.

Unlike the United Kingdom or the United States, Australia does not provide for a general divestiture power to deal with highly concentrated markets having characteristics that prevent, restrict or distort competition in those markets. In the United Kingdom a very sophisticated framework has been enacted to allow for highly concentrated markets to be reviewed with the purpose of assessing the level of competition in a market and for taking steps to remedy market distortions having a detrimental impact on competition and consumers.

RECOMMENDATION

Amend the *Trade Practices Act* to provide for a general divestiture power whereby a Court can, on the application of the ACCC, order the break up of companies (i) having substantial market share; and (ii) where either the characteristics of the market prevent, restrict or distort competition; or the companies have engaged in patterns of conduct that are detrimental to competition and consumers.

Part Three: Promoting ethical business conduct – Closing the gaps in the unconscionable conduct sections of the *Trade Practices Act* and clearly identifying standards of ethical conduct

The recommendations made in this part of the submission are intended to address a number of problem areas in relation to s 51AC of the *Trade Practices Act* as well as offering various statutory alternatives to promoting ethical business conduct. Once again, these recommendations are concerned to ensure that contractual power is not abused in a manner that denies the small business or farmer the benefits of the transaction. In particular, the recommendations are aimed at clarifying key concepts such as unconscionable conduct in a manner that is in keeping with their parliamentary intention. Such statutory clarification is needed in view of the very narrow approach taken by the Courts towards such concepts.

Once again, the focus of the recommendations is to promote the most efficient outcome for dairy industry participants. The recommendations are not about picking winners or protecting the inefficient, but rather are concerned to ensure that larger business behave in an ethical manner towards small business and farmers. Currently, there are allegations of unethical conduct that are not being tested in the Courts simply because the Courts are giving such narrow interpretation of the concept of unconscionable conduct that victims of unethical conduct are being advised that the chances of success in court are virtually non-existent.

In these circumstances, for vested interest groups to suggest that there is no need to insert a statutory definition of unconscionable conduct is to again take a "head in the sand" approach to what is a serious issue. Once again, such a dismissive approach is not only self serving and protective of the vested interests of large and powerful companies, but more importantly it fails the Australian dairy industry as a whole. Unethical conduct leads to higher levels of disputation. If we are aspiring to have a viable and competitive Australian dairy industry, the industry must not be characterised by unethical conduct. Currently, such unethical conduct continues to exist because such conduct goes unchallenged as a result of the very narrow judicial interpretation of the concept of unconscionable conduct.

The following recommendations are made in this part of the submission:

- **Inserting a statutory definition of the term "unconscionable" into s 51AC of the *Trade Practices Act*;**

- **Enacting a statutory duty of good faith;**

- **That business to business contracts involving small businesses be reinstated in the unfair contracts proposals contained in the Australian Consumer Law Bill in accordance with the previous**

Minister's and Federal Cabinet's endorsement of the need to include small businesses in the unfair contract terms proposals;

- **Prohibiting bullying, intimidation, physical force, coercion or undue harassment within dairy industry relationships;**

Inserting a statutory definition of the term "unconscionable" under s 51AC of the *Trade Practices Act*

The insertion of a definition of "unconscionable" in s 51AC of the *Trade Practices Act* would be an obvious way to provide clear statutory guidance as to what is meant by the term as is used in s 51AC.[1] Importantly, the insertion of a statutory definition in s 51AC would send a clear parliamentary signal to the Courts that the concept is not only broader than the equitable concept, but that s 51AC is intended to promote ethical business conduct. Such a definition would set out a non-exhaustive benchmark for assessing conduct to determine whether or not it goes beyond what is reasonably necessary to protect the legitimate interests of the parties involved. This would not in any way interfere with the driving of a "hard" bargain, but rather would provide clear statutory guidance as to what is considered unethical. Currently, in the absence of a statutory definition in 51AC of the term "unconscionable" the Courts are being left to define the term and, in doing so, are taking such an onerous view of what constitutes "unconscionable" that there is a growing danger that s 51AC will fall into disuse.

Growing acknowledgement of the presence of unfair terms in contracts involving small business

The difficulty of bringing action under s 51AC of the *Trade Practices Act* has been recently acknowledged in a number of State Government reports and discussion papers. In each case, the consensus is that s 51AC or equivalent State and Territory provisions is being too onerously interpreted by the Courts and, as a result, there is a need to either reform those provisions or adopt a new approach to unfairness in business to business contracts involving small businesses.

One example of the growing acknowledgement that s 51AC has not been interpreted in keeping with its original parliamentary intention is found in a recent report by the South Australian Parliament into the franchising sector. In its report titled – *Franchises* – the Economic and Finance Committee of the South Australian House of Assembly made the following observations:[2]

> "Section 51AC of the *TPA* was introduced in 1998 to address the problem of small businesses facing power imbalances while dealing with larger commercial entities.[3] It prescribes unconscionable conduct in a specific way and refers to a list of factors that a court may consider in determining whether the conduct in question is unconscionable. This non-exhaustive list of statutory indicators of unconscionable conduct is intended to guide the courts in their application of the provision. The presence of a single factor, such as unequal bargaining power, does not

[1] See Zumbo F., "Commercial Unconscionability and Retail Tenancies: A State and Territory perspective," (2006) *Trade Practices Law Journal*, Vol. 14, p 165 at p. 171 – 172.
[2] The Economic and Finance Committee of the South Australian House of Assembly Report, *Franchises*, May 2008, 42-43.
[3] Philip Tucker, "Unconscionability: The hegemony of the narrow doctrine under the Trade Practices Act" (2003) 11 *Trade Practices Law Journal* 78.

> define the conduct as unconscionable in the absence of some other factor. In the absence of a definition of unconscionable conduct the courts have the power to determine on a case by case basis whether particular action amounts to a breach of the provision.
>
> A narrow doctrine of unconscionability, developed in common law, has been traditionally guided by the assertion that "equity does not expect commercial people to be each others' keepers".[4] It is evident, however, that the meaning of unconscionability under section 51AC is wider than this older, restrictive model. The intention of creating a level playing field for commercial parties of different sizes and bargaining strengths is the underlying theme of the provision. The inclusion of a list of factors in the text of the provision has been interpreted as an indication that unconscionability should be given a broader meaning.[5]
>
> The problem with section 51AC, as put to the Committee, is that the section has not been effective despite its broader remit. The Committee was told that despite the inducements in the provision to consider a wider definition, judicial interpretation of statutory unconscionability has tended to rely on so-called "procedural" aspects of unconscionability, restricting its scope to cases of serious misconduct during the formation and performance of the contract. [6] That approach seems to exclude instances where harsh contractual terms have been inserted in otherwise procedurally valid contracts.[7]
>
> Controversy surrounding the application of the section is provoked by the cautious approach adopted by Australian judges to interpreting it.[8]"

The Report especially identified the omission of a definition of the concept of "unconscionable conduct" as representing a considerable challenge in taking action under s 51AC of the *Trade Practices Act*:

> "The fact the *TPA* does not provide a definition of the term "unconscionable conduct" appears to represent a challenge for the ACCC, the agency responsible for enforcement of the prohibition. While the ACCC is responsible for developing and testing the law in this area, the understanding of the provision remains very limited ten years after its introduction. However, as some witnesses pointed out, the reason for that lack of success may be the original construction of the provision and a lack of guidelines pointing to the intended meaning of the term

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[4] Ibid 83.
[5] Joachim Dietrich, "The Meaning of Unconscionable Conduct Under the Trade Practices Act 1974" (2001) 9 *Trade Practices Law Journal* 141.
[6] Frank Zumbo, "Promoting Fairer franchise agreements: A way forward?" (2006) 14 *Competition and Consumer Law Journal* 127.
[7] *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999) 21 ATPR 41-703.
[8] Liam Brown, "The impact of section 51AC of the Trade Practices Act 1974 (Cth) on commercial certainty" [2004] 20 *Melbourne University Law Review* at <http://www.austlii.edu.au/cgi-bin/sinodisp/au/journals/MULR/2004/20.html?query=impact%20of%20section> at 15 August 2008).

> "unconscionability". Many of those who contributed to the inquiry also stressed that the uncertainty surrounding the meaning of unconscionability makes litigators and lawyers very reluctant to rely on section 51AC as a chosen cause of action. The inability to resort to any other similar provision creates a situation where businesses are denied legal remedies in disputes that often severely impact their interests. In the course of the inquiry perhaps the most high profile example of a franchisee feeling unable to rely on the section was provided by Competitive Foods Australia Pty Ltd (Competitive Foods), whose dispute with Yum! Restaurants International in Western Australia was the subject of discussion and investigation in that State, but it was not an isolated example across the sector."[9]

In view of these concerns and of the considerable evidence put before the Committee, the Report took the position that legislative reform of s 51AC of the *Trade Practices Act* was required:[10]

> "The Committee is of the opinion that section 51AC of the *TPA*, as it currently stands, is not being effectively utilised because of a combination of drafting imprecision and judicial caution. The section has the potential to provide a clear course for redress for franchise disputes and those factors currently obstructing its use should be identified and resolved, even if this requires revisiting the Act. Any such examination of the Act should be done in consultation with the franchising industry, with the needs of franchisees given equal weight with those of franchisor advocates."

> **The Committee recommends section 51AC of the *Trade Practices Act 1974 (Cth)* be amended by the inclusion of a statutory definition of unconscionability or alternatively by the insertion in the Act of a prescribed list of examples of the types of conduct that would ordinarily be considered to be unconscionable.**

In short, the Report provides further recognition of the limitations of s 51AC of the *Trade Practices Act* and, in particular, of how the provision has been narrowly interpreted by the Courts.

A further example of the growing acknowledgement that s 51AC or equivalent provisions are too narrowly interpreted by the Courts or Tribunals is found in a recent discussion paper issued in New South Wales in relation to the retail leasing industry in that State. Indeed, the discussion paper titled - *Issues affecting the retail leasing industry in NSW: Discussion paper – February 2008* – specifically acknowledged the onerous interpretation being given to the New South Wales equivalent to s 51AC. That provision, which is found in s 62B of the *Retail Leases Act 1994*, was described in the following terms in the discussion paper:

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[9] Ibid 44-45.
[10] Ibid 46.

> "Section 62B sets out a non-exhaustive list of matters to which the Administrative Decisions Tribunal may have regard in assessing whether particular conduct is unconscionable:
> …
> Since 2002, the Administrative Decisions Tribunal has heard 29 cases alleging unconscionable conduct. These authorities indicate that a finding of unconscionable conduct under s 62B can only be made if the conduct can be described as 'highly unethical' and involves 'a high degree of moral obloquy'— s 62B unconscionable conduct will not be found simply because conduct is 'unfair' or 'unjust'.[11] The outcomes of the 29 cases were as follows:
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> - Unconscionable conduct was found in five cases (however two of these were overturned on appeal on grounds unrelated to the unconscionable conduct claims);
> - One matter was transferred to the Supreme Court;
> - The unconscionable conduct claims were withdrawn in five cases;
> - Unconscionable conduct was held not to be made out in 13 cases;
> - It was held unnecessary to consider the question of unconscionable conduct in six cases.
>
> Analysis of the unconscionable conduct cases heard by the Administrative Decisions Tribunal to date indicates the test is onerous and the threshold for a finding of unconscionable conduct is very high. Because of the narrow interpretation of s 62B in accordance with equitable doctrine, the unconscionable conduct provisions have not operated as intended. There are many instances of unfair conduct on the part of landlords where tenants are unable to avail themselves of the remedy in s 62B due to the onerous test imposed."[12]

Significantly, the discussion paper raised similar concerns with s 51AA of the *Trade Practices Act*:

> "Similar criticisms have been levelled at s 51AA of the *Trade Practices Act 1974* (Cth), which contains specific provisions aimed at providing increased protection where there may be an imbalance of bargaining power between small businesses and their larger business suppliers or customers. This section was introduced in 1992 to extend the unconscionability provisions. The ACCC noted in its submission to the 2007 Productivity Commission inquiry that it had been anticipated these provisions would be of particular use to tenants and franchisees in unequal bargaining positions with their landlords or franchisors. It noted however that s 51AA had not lived up to its expectations in respect of retail leasing matters due to the court's limited interpretation of s 51AA in accordance with equitable doctrine. Despite making enforcement of s

[11] *Attorney General of New South Wales v World Best Holdings Ltd* (2005) 63 NSWLR 557, 583.
[12] *Issues affecting the retail leasing industry in NSW: Discussion paper – February 2008,* 17-18.

> 51AA a priority, the ACCC has been unable to build a single case that would succeed in relation to complaints from retail tenants in shopping centres."[13]

In short, the Courts are taking a narrow approach to the concept of unconscionable conduct and, consequently, it is appropriate that legislature define the term in the legislation to ensure that the concept is interpreted in a manner that promotes ethical business conduct.

A proposed definition of unconscionable conduct

The following is a draft of a proposed definition of "unconscionable conduct" that could be inserted under the *Trade Practices Act* and in relevant State and Territory legislation:

> "For the purposes of this section "unconscionable conduct" includes any action in relation to a contract or to the terms of a contract that is unfair, unreasonable, harsh or oppressive, or is contrary to the concepts of fair dealing, fair-trading, fair play, good faith and good conscience.

The proposed definition represents a non-exhaustive definition of unconscionable conduct. Importantly, the use of word "includes" makes it clear that the proposed definition is intended to allow the existing judicial interpretation to be built upon through a statutory mandate that makes it clear that the concept of unconscionable conduct for the purposes of s 51AC of the *Trade Practices Act* is meant to cover all forms of unethical conduct.

In short, the proposed definition is intended to overcome the restrictive view that the Courts are currently taking towards the notion of "unconscionable conduct" under s 51AC. Indeed, in applying the concept of "unconscionable conduct" under s 51AC the Courts are focusing increasingly on procedural unconscionability. In doing so, the Courts continue to be influenced by the narrow equitable doctrine of unconscionability. While perhaps not surprising given the concept of "unconscionable conduct" has been previously used under the equitable doctrine of unconscionability, this procedural unconscionability bias unfortunately raises considerably the threshold for succeeding under s 51AC. Thus, to ensure that the concept of "unconscionable conduct" is given a wider application than is currently the case it would be appropriate to include a legislative definition of the concept of "unconscionable conduct." Such a definition defines "unconscionable conduct" by reference to a variety of other known concepts that make it clear that the term "unconscionable" as used under the proposed provision is one concerned with dealing with unethical conduct within trade or commerce generally.

[13] Ibid 19.

Enacting a statutory duty of good faith

While any statutory definition of "unconscionable" could usefully rely on the concept of good faith as a means of ensuring the Courts take a broader approach to s 51AC of the *Trade Practices Act* than their presently onerous and very legalistic approach to the section, an alternative would be to enact a stand alone statutory duty of good faith. Either way, the concept of good faith offers considerable potential as a mechanism for promoting ethical business conduct. Indeed, this is readily apparent from the growing judicial attention and support given to an implied duty of good faith in commercial contracts, especially in New South Wales.[14]

Such a statutory duty of good faith should operate generally within the business to business relationships involving small businesses and farmers, including requiring the parties to resolve disputes in good faith. A precedent for requiring the parties to mediate in good faith is found in Clause 45(1) of the Mandatory OilCode which provides:[15]

45 Provision of mediation and assistance

(1) All mediation … provided under this Part must be carried out in good faith.

A convenient summary of the nature and scope of an implied duty of good faith was recently provided by Gordon J in *Jobern Pty Ltd v BreakFree Resorts (Victoria) Pty Ltd*:[16]

> 146 Specific conduct has also been identified by various courts as constituting '*bad faith*' or a lack of '*good faith*' including:
> (1) acting arbitrarily, capriciously, unreasonably or recklessly: e.g. see Viscount Radcliffe in *Selkirk v Romar Investments Ltd* [1963] 1 WLR 1415 at 1422-23 cited by Gyles J in *Goldspar* at [173]; and *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65];
> (2) acting in a manner that is oppressive or unfair in its result by, for example, seeking to prevent the performance of the contract or to withhold its benefits: *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2005] FCA 288 at [65]-[66];
> (3) failing to have reasonable regards to the other party's interests: *Overlook Management BV v Foxtel Management Pty Ltd* (2002) ACR 90–143 at [67] …
> (4) failing to act 'reasonably' in general. …

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[14] See for example *Renard Constructions (ME) Pty Limited v Minister for Public Works* (1992) 26 NSWLR 234; *Alcatel Australia Limited v Scarcella* [1998] NSWSC 483 (16 July 1998*); Burger King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187: *Overlook v Foxtel* [2002] NSWSC 17 (31 January 2002); and *Vodafone Pacific Ltd & Ors v Mobile Innovations Ltd* [2004] NSWCA 15 (20 February 2004).

[15] *See Trade Practices (Industry Codes - Oilcode) Regulations 2006*

[16] [2007] FCA 1066 (23 July 2007).

> 147 A requirement to act '*reasonably*' when acting in good faith was first articulated in Australia by Priestly JA in *Renard Constructions* where his Honour observed that reasonableness had "*much in common with the notions of good faith"*: at 263. Following this decision, courts have favoured '*reasonableness*' as one of the requirements of good faith. Finkelstein J in *Garry Rogers Motors* stated that *"provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied"*: at [37].

Significantly, Gordon J also outlined apparent judicial consensus as to what is *not* encompassed by a duty of good faith:

> 149 …a duty of good faith:
> (1) is not fiduciary in nature;
> (2) does not require a party to subordinate its own interests, let alone act selflessly; and
> (3) does not require a party to restrict decisions and actions, reasonably taken, which are designed to promote the legitimate interests of a party and which are not otherwise in breach of an express contractual term.

Clearly, the concept of good faith has not only received strong judicial support, but now has reached the point in Australia where its nature and scope is being defined with an increasing degree of precision. Consequently, there is a ready body of law on which a statutory duty of good faith could quite readily and usefully draw upon in seeking to promote ethical business conduct.

A statutory duty of good faith would represent a positive statement of what is considered ethical conduct within a business context and would provide an appropriate and well accepted benchmark of appropriate standards of ethical conduct with the Australian dairy industry.

Enacting a new legislative framework within the Trade Practices Act to deal with unfair contract terms in business agreements in the Australian dairy industry

Ensuring greater judicial scrutiny of unfair terms in business to business agreements involving small businesses and farmers would go a long way to promoting ethical business conduct in the Australian Dairy Industry. Such judicial scrutiny of unfair contract terms is currently lacking and unfortunately can act as a green light to unethical industry participants that are intent on including contract terms that go beyond what is reasonably necessary to protecting their legitimate interests. In such circumstances, a new national legislative framework within the *Trade Practices Act* is needed to deal with unfair terms within business to business agreements.[17] Such a framework would help promote greater judicial scrutiny of substantive unconscionability and could be based on the United Kingdom[18] and Victorian[19] legislation for dealing with unfair terms in consumer contracts.[20]

Needless to say, the acceptance of the need for a new legislative framework to deal with unfair contract terms is a vital first step in a process that leads to designing and then implementing such a legislative framework. Clearly, further work needs to be undertaken to give full effect to the growing consensus that Australia needs to implement a world's best practice legislative framework dealing with unfair contract terms. Such a framework should have the following features;

- a clear definition of an unfair term;
- include a comprehensive listing of potentially unfair terms which provides clear statutory guidance to consumers, businesses and the Courts regarding the types of terms considered to be unfair;
- contain an ability to prescribe particular terms or classes of terms as "unfair" so that widespread consumer detriment can be prevented in advance and without the need to separately pursue each individual use of the unfair term or terms;
- impose a penalty for using a prescribed unfair term as a necessary deterrent against the use of terms recognized as being unfair;

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[17] See Zumbo F., Promoting Fairer Franchise Agreements: A Way Forward?" (2006) *Competition and Consumer Law Journal*, Vol. 14, 127 – 145.

[18] The UK legislation was implemented first and is now found in the *Unfair Terms in Consumer Contracts Regulations 1999*. These Regulations came into force on 1st October 1999.

[19] The Victorian legislation is found in Part 2B of the *Fair Trading Act 1999* and came into force on 9 October 2003.

[20] For a discussion of the operation of the United Kingdom and Victorian legislation see Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: Is Australia Falling Behind?" *Trade Practices Law Journal*, Vol. 13, pp. 70 - 89; Zumbo, F., (2005), "Dealing with Unfair Terms in Consumer Contracts: The search for a new regulatory model," *Trade Practices Law Journal*, Vol. 13, pp. 194 - 213; and Zumbo, F., (2007), "Promoting Fairer Consumer Contracts: Lessons from the United Kingdom and Victoria", *Trade Practices Law Journal*, Vol. 15, pp. 84-95.

- have a well resourced Government enforcement agency to respond to allegedly unfair contracts terms in a timely and pro-active manner to minimize the actual or potential detriment arising from the term;
- provide guidance and education to both businesses and consumers to maximize awareness and understanding of the legislative framework;
- allow for enforceable undertakings to be provided to Government agency to enable matters to be resolved quickly and without recourse to the Courts;
- allow for advisory opinions by Government enforcement agency to enable particular businesses and industries to seek specific guidance in advance of using terms considered at risk of being viewed as unfair;
- allow for advisory opinions by quasi-judicial body to provide businesses or the Government enforcement agency the opportunity to secure a binding opinion as to the whether or not a particular term is unfair; and
- allow for private enforcement of the framework to enable those affected parties to recover any loss or damage arsing from an unfair contract term.

A single legislative framework for dealing with unfair contract terms in relation to consumers and small businesses would play a central role in the promotion of ethical business conduct. [21]

Minister Emerson's reversal of the previous Minister's and Federal Cabinet's endorsement of the need to include small businesses in the unfair contract proposals

A major omission from and, therefore, a major flaw in the unfair contracts proposals currently before Federal Parliament relate to Minister Emerson's decision, upon becoming Minister for Competition Policy and Consumer Affairs, to reverse the previous Minister's (Chris Bowen) position regarding the application of the Federal Government's new unfair contract terms proposals to small business. In effect, Minister Emerson has decided to exclude small businesses altogether from the protection to be given to consumers under the Government's unfair contract terms proposals contained in the proposed Australian Consumer Law.

The following is a summary of the issues in relation to unfair contract terms in business to business contracts involving small businesses and farmers.

Under Minister Bowen's proposals, small businesses would have been included in the unfair contracts proposals if the standard form contract was for $2 million or less. Importantly, Minister Bowen's proposals were intended to provide both "consumers and small businesses" with protection from unfair contract terms.

In his media release of 5 June 2009 Minister Bowen stated:

[21] Zumbo, F., (2007), "Are Australia's Consumer Laws Fit for Purpose", *Trade Practices Law Journal*, Vol. 15, p. 227, at 232 -236.

> "Last year, COAG agreed that Australia should have a national unfair contract terms law and the Government is committed to ensuring that consumers and small businesses can access protection from unfair contract terms," Mr Bowen said."[22]

Minister Bowen's proposals would have excluded standard form contracts above $2 million. This was noted by Minister Bowen in his media release where the Minister stated that his unfair contract proposals would include:

> "…an exclusion of a standard-form contract where the upfront price payable for the services (including financial services), good or land supplied under the contract exceeds $2 million;"[23]

However, on becoming Minister for Competition Policy and Consumers Affairs, Craig Emerson announced that small businesses would be excluded altogether from the unfair contract proposals to be introduced into Federal Parliament. In his media release dated 24 June 2009 Minister Emerson stated:

> "The Bill will also introduce a national unfair contract terms law that will apply to standard form business-to-consumer contracts.
>
> In relation to business-to-business contracts, the Government is currently reviewing both the unconscionable conduct provisions of the Trade Practices Act and also the Franchising Code of Conduct.
>
> Since these reviews relate to business-to-business contracts, the Government will consider the issue of business-to-business standard form contracts when these reviews are complete."[24]

By applying the unfair contract proposals only to business to consumer contracts, Minister Emerson has changed the Federal Government's previous position and excluded small businesses altogether from the unfair contract proposals.

Minister Emerson's decision to remove small businesses from the unfair contracts proposals is extremely disappointing given Federal Cabinet's previous endorsement of Minister Bowen's decision to apply the unfair contract proposals to both consumers and small businesses.

With all due respect, Minister Emerson's change of position is particularly troubling for a number of reasons. First, and most importantly, Minister Emerson's decision runs directly contrary to the position of the previous

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[22] Minister Bowen's media release can be accessed at: http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/060.htm&pageID=003&min=ceb&Year=&DocType=

[23] Ibid

[24] Minister Emerson's media release can be accessed at:http://minister.innovation.gov.au/Emerson/Pages/ONENATIONALCONSUMERLAWFORAUSTRALIA.aspx

Minister (Chris Bowen), as well as the Federal Cabinet, who had all agreed that the unfair contract proposals needed to apply to both consumers and small businesses.

The position of the previous Minister and the Federal Cabinet to include small businesses in the unfair contracts proposals was reached after extensive consultation, but sadly was reversed by Minister Emerson within only 3 weeks in circumstances where the level of consultation by Minister Emerson, if any, could have only have been a very small fraction of the very extensive consultation undertaken to reach the previous Federal Cabinet-endorsed decision to include small businesses in the unfair contracts proposals.

So while there is undoubtedly a need to strengthen the unconscionable conduct provisions of the Trade Practices Act to deal with unethical business conduct, such strengthening in relation to procedural unconscionability cannot be considered a substitute for the need to deal with the issue of substantive unconscionability through the inclusion of small businesses or farmers in the unfair contract terms.

In fact, an effective legal framework for dealing with unfair contract terms in a business to business context involving small businesses or farmers is an essential adjunct to effective laws dealing with procedural unconscionability. Since currently there are no Federal laws dealing with unfair contract terms in business to business context involving small businesses or farmers, it is clear that the previous Minister and Federal Cabinet recognised the pressing need to close that gap which has long disadvantaged small businesses and farmers by denying them an avenue for challenging unfair terms in their contracts with larger businesses.

Within this context, a clear flaw of the *Trade Practices Amendment (Australian Consumer Law) Bill 2009* as introduced into Federal Parliament is that the proposed new unfair contract provisions of the Bill will only apply to a "consumer contract:"

> **2 Unfair terms of consumer contracts**
>
> (1) A term of a consumer contract is void if:
> (a) the term is unfair; and
> (b) the contract is a standard form contract.

A consumer contract is defined in the following terms in the Bill:

> (3) A ***consumer contract*** is a contract for:
> (a) a supply of goods or services; or
> (b) a sale or grant of an interest in land;
> to an individual whose acquisition of the goods, services or interest is wholly or predominantly for personal, domestic or household use or consumption.

This definition of a consumer contract makes it clear that business to business contracts involving small businesses are excluded from the unfair contract provisions of the Bill.

Again with all due respect, there is no justification for Minister Emerson's decision to exclude small businesses as there are more than enough safeguards in the unfair contract proposals to maintain business certainty, while still giving small businesses a new and effective avenue to be able to challenge unfair contract terms.

There are ample safeguards in the unfair contract proposals to strike an appropriate and objective balance between the ability of larger businesses to protect their legitimate business interests and the ability of small businesses to challenge unfair contract terms. These safeguards include:

(i) a term is 'unfair' only when it causes a significant imbalance in the parties' rights and obligations arising under the contract and it **is not reasonably necessary to protect the legitimate interests** of the larger business. The unfair contract proposals do not prevent a larger business from protecting its legitimate business interests. This is the most important safeguard as the larger business is able to protect it legitimate interests. It is only when the larger business goes beyond what is reasonably necessary to protect its legitimate interests that the term becomes unfair. This safeguard alone is more than sufficient to allay the ill-conceived and irrational fears by larger businesses and their legal advisers regarding the unfair contract proposals in the Bill;

(ii) the proposals only relate to standard form contracts. These are offered on a take-it-or-leave-it basis. If the contract is not a standard form contract it will not be covered by the proposals.

(iii) some terms will not be able to be challenged under these provisions. These relate to:

- the main subject matter of the standard-form contract;
- the upfront price payable under the standard-form contract;

(iv) the proposals only operate in relation to contracts entered into or varied after the commencement of the proposals.

When these safeguards are all considered together they enable larger businesses to protect their legitimate business interests while allowing small businesses the ability to challenge only those terms that go beyond what is reasonably necessary to protect the legitimate business interests of the larger business.

Prohibiting bullying, intimidation, physical force, coercion or undue harassment within business to business relationships involving small businesses and farmers

While of course a larger business participant in the Australian Dairy Industry should be entitled to enforce the terms of a business agreement, it is equally true that small businesses and farmers should be allowed to carry on their business without bullying, intimidation, physical force, coercion or undue harassment from the larger business. Clearly, there is a line between a larger business enforcing its legal rights and the larger business engaging in bullying, intimidation, physical force, coercion or undue harassment of the small business and farmer.

Prohibiting such conduct is well accepted in consumer transactions. It has long been acknowledged that consumers may be vulnerable to conduct that goes beyond normally acceptable behaviour. This is dealt with under s 60 of the *Trade Practices Act*:

> **TRADE PRACTICES ACT 1974 - SECT 60**
> **Harassment and coercion**
>
> A corporation shall not use physical force or undue harassment or coercion in connection with the supply or possible supply of goods or services to a consumer or the payment for goods or services by a consumer.

Such a provision could easily be modified to apply within a business context. After all, small businesses and farmers, because of their captive status once they enter a business agreement, are similarly vulnerable to conduct that goes beyond normally acceptable behaviour. Significantly, s 60 of the *Trade Practices Act* has been subject to judicial comment in a manner which assists in understanding how a proposal for a prohibition against physical force, coercion or undue harassment could operate within a business context.

The following comments regarding the terms “coercion” and “undue harassment” were made by Hill J. in *Australian Competition & Consumer Commission v The Maritime Union of Australia* [2001] FCA 1549 within the context of s 60 of the Trade Practices Act are particularly noteworthy:

> 61 There is an obvious ambiguity which the legislature could easily have solved, either by repeating the word "undue" before each of harassment and coercion or listing the word "coercion" before the words "undue harassment". However, neither course commended itself to Parliament. For my part, I am inclined to the view that undue qualifies only harassment and not coercion.
>
> 62 The word "harassment" in my view connotes conduct which can be less serious than conduct which amounts to coercion. The word "harassment" means in the present context persistent disturbance or torment. In the case of a person employed to recover money owing to

others … it can extend to cases where there are frequent unwelcome approaches requesting payment of a debt. However, such unwelcome approaches would not constitute undue harassment, at least where the demands made are legitimate and reasonably made. On the other hand where the frequency, nature or content of such communications is such that they are calculated to intimidate or demoralise, tire out or exhaust a debtor, rather than merely to convey the demand for recovery, the conduct will constitute undue harassment … Generally it can be said that a person will be harassed by another when the former is troubled repeatedly by the latter. The reasonableness of the conduct will be relevant to whether what is harassment constitutes undue harassment. …

63 "Coercion" on the other hand carries with it the connotation of force or compulsion or threats of force or compulsion negating choice or freedom to act: see *Hodges v Webb* [1920] 2 Ch 70 at 85-7 per Peterson J. A person may be coerced by another to do something or refrain from doing something, that is to say the former is constrained or restrained from doing something or made to do something by force or threat of force or other compulsion. Whether or not repetition is involved in the concept of harassment, and it usually will be, it is not in the concept of coercion.

64 It is clear that the word "undue" suggests that what is done must, having regard to the circumstances in which the conduct occurs, extend beyond that which is acceptable or reasonable. It thus adds, … "*an extra layer of evaluation*". The word "undue", when used in relation to harassment, ensures that conduct which amounts to harassment will only amount to a contravention of the section where what is done goes beyond the normal limits which, in the circumstances, society would regard as acceptable or reasonable and not excessive or disproportionate. It would, however, be somewhat unusual to qualify the concept of coercion with the word undue. If there is such a qualification it would suggest that the policy behind s 60 accepted that some normal level of coercion or force overbearing choice or will was, having regard to the circumstances in which the conduct occurred, acceptable or reasonable in a civilised society and that it was only where that acceptable level of coercion was exceeded so that the coercion became "undue" that coercion was intended to be prohibited. I note that J D Heydon in *Trade Practices Law* (2nd edition at [13.620]) likewise is of the view that undue does not qualify coercion. But if undue does qualify coercion it would not seem to add much to it, whereas I am of the view that qualitatively the word "undue" adds the quality of unreasonableness, unacceptability or lack of proportionality to the general concept of harassment.