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SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Trade Practices Legislation Amendment Bill (No. 1) 2007; Trade Practices Amendment (Predatory Pricing) Bill 2007; Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007; Tax Laws Amendment (2007 Measures No. 4) Bill 2007 and related bills; Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007; and Corporations (National Guarantee Fund Levies) Amendment Bill 2007

FRIDAY, 27 JULY 2007

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SENATE STANDING COMMITTEE ON

ECONOMICS

Friday, 27 July 2007

Members: Senator Ronaldson *(Chair)*, Senator Stephens *(Deputy Chair)*, Senators Bernardi, Chapman, Hurley, Joyce, Murray and Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Birmingham, Boswell, Boyce, Bob Brown, Campbell, Carr, Conroy, Cormann, Eggleston, Chris Evans, Faulkner, Ferguson, Fielding, Fifield, Fisher, Forshaw, Hogg, Kemp, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, Sandy Macdonald, McGauran, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Bernardi, Chapman, Fielding, Ronaldson, Stephens, Webber

Terms of reference for the inquiry:

To inquire into and report on: Corporations (National Guarantee Fund Levies) Amendment Bill 2007; Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007; Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007; Tax Laws Amendment (2007 Measures No. 4) Bill 2007; Trade Practices Amendment (Predatory Pricing) Bill 2007; Trade Practices Legislation Amendment Bill (No. 1) 2007.

WITNESSES

Committee met at 9.05 am

CHAIR (Senator Ronaldson)—Good morning. I declare open this meeting of the Senate Standing Committee on Economics. This hearing has been convened to receive evidence in relation to the inquiry into the following bills: the Trade Practices Legislation Amendment Bill (No. 1) 2007 and the Trade Practices Amendment (Predatory Pricing) Bill 2007; the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007; the Tax Laws Amendment (2007 Measures No. 4) Bill 2007 and related bills; the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007; and the Corporations (National Guarantee Fund Levies) Amendment Bill 2007. The committee will receive evidence for these bills in the order that they are listed.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken, and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

These proceedings will commence with evidence from Treasury. I remind senators that the Senate has resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy, and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. Any claim that it would be contrary to the public interest to answer a question must be made by a minister and should be accompanied by a statement setting out the basis for the claim.

[9.07 am]

HOLDAWAY, Ms Hae-Kyong, Manager, Competition Policy Framework Unit, Competition and Consumer Policy Division, Department of the Treasury

ROGERS, Mr Scott, Senior Adviser, Competition Policy Framework Unit, Competition and Consumer Policy Division, Department of the Treasury

CHAIR—Welcome. Do you wish to make an opening statement?

Ms Holdaway—Yes, thank you. I would like to thank the committee for the opportunity to go through the details of the Trade Practices Legislation Amendment Bill (No. 1) 2007. As you are all aware, on 20 June the bill was introduced into the House of Representatives and is currently before the House. We thought perhaps, as an opening statement, it might be useful for Mr Rogers to go through the content of the bill and explain what is captured in the bill.

Mr Rogers—The government's bill represents the government's response to this committee's March 2004 report *The effectiveness of the Trade Practices Act 1974 in protecting small business* in so far as it relates to the amendment of section 46 and section 51AC of the Trade Practices Act 1974, the TPA. It also makes changes to the TPA to implement the government's announcement of a second deputy chair position at the Australian Competition and Consumer Commission, the ACCC. The bill is the result of extensive consultation with stakeholders, including small business groups, in relation to the amendments. Following the passage of the government's Trade Practices Legislation Amendment Act (No. 1) 2006, or the Dawson act, the government met with stakeholders, including small business groups, on a number of occasions in relation to the amendments in this bill.

I will give you a brief overview of amendments in the bill. The bill itself contains three schedules. All the amendments in the bill commence on the day after its royal assent.

Schedule 1 concerns the deputy chairpersons provisions of the TPA. It amends the TPA to create a second deputy chair position at the ACCC. At present, part II of the TPA provides that the commission of the ACCC shall consist of a chairman, a deputy chair and a number of full-time commissioners for a maximum term of five years per appointment. The TPA also permits the appointment of associate and ex officio members. The bill implements the government's decision to create an additional deputy chairperson position at the ACCC. This was announced in July 2004 as part of the government's *Committed to small business* statement. At present, the wording of the TPA contemplates one deputy chair. The amendments in schedule 1 provide for the creation of a second deputy chairperson position and allow for the effective operation and governance of the ACCC with that additional position.

Section 7 of the TPA currently requires that the minister must be satisfied that a person to be appointed as a member of the ACCC has knowledge or experience in industry, commerce, economics, law, public administration or consumer protection, as well as considering whether they have knowledge or experience in small business matters. The amendments in this bill do not change that. The government has announced that it intends for the additional deputy chair position to be filled by a candidate who is experienced in small business matters.

Schedule 2 concerns itself with the misuse of market power and the amendment of section 46 and consequential amendments. The government's bill makes a number of changes to section 46 flowing from the recommendations made by the committee's inquiry into section 46.

Item 1 of the bill deals with the leveraging of market power. At present, section 46 does not explicitly state whether the market in which substantial market power is misused must be the same as the market in which that market power is established. Some submissions to the committee raised concerns about this lack of clarity, and the committee recommended that section 46 be amended. The government accepted this recommendation. It is appropriate for section 46 to prohibit the leveraging of substantial market power from one market into another. Accordingly, the bill amends section 46 to provide that a corporation must not take advantage of a substantial degree of market power, either in the market in which the power is held or in any other market.

Item 2 of the bill concerns itself with coordinated market power. The TPA recognises that corporations may obtain market power in their own right or through interactions with other corporations in the market. For example, at present subsection 46(2) requires that related subsidiaries or holding companies in the same corporate group be taken into account when assessing market power. The committee recommended that section 46 go further, to take account of a firm's interactions with corporations not in the same corporate group or related to the firm. The government agreed and the bill provides that, in assessing whether a corporation has 'a substantial degree of power in a market', a court may take into account any market power the corporation has which results from agreements with others.

Item 2 of the bill also concerns itself with the determination of market power. The committee made a number of recommendations concerning the determination of market power and the government has included amendments in this regard. The committee recommended that the threshold of 'substantial degree of power in a market' be clarified to provide that it does not require the corporation to substantially control a market. The bill provides that without limiting the matters to which a court may have regard. A substantial degree of market power may exist without substantial control of the market. This change emphasises the difference between the current drafting of section 46 and the pre-1986 version of that provision, which referred to the need for a corporation to be in a position substantially to control a market.

The bill also clarifies 'market power threshold' by providing that a body corporate may have a substantial degree of power in a market, even though it does not have absolute freedom from constraint by the conduct of its competitors or persons to whom or from whom it supplies in that market. Finally, to avoid doubt, the bill provides that more than one corporation may have a substantial degree of power in a market. This is consistent with recent court judgements—for example, the court decisions in the Safeway case, which held that relatively lower levels of market control can be enough to reach the required threshold triggering the effect of section 46. Item 3 of the bill concerns itself with below-cost pricing.

The bill amends section 46 to emphasise that courts may take into consideration any conduct by a corporation that consists of supplying goods or services for a sustained period at a price that is less than the relevant cost to the corporation and the reasons for that conduct.

The amendments to section 46 in this regard do not direct that a court must have regard to below-cost pricing when considering a breach of section 46, but rather it is a factor.

The remaining items of schedule 2—items 5 through 11—are consequential amendments flowing from and essentially mirroring the changes to section 46. The amendments are made to part XIB of the TPA, which provides for a telecommunications specific prohibition on the misuse of market power. The bill ensures continued consistency between section 46 and part XIB—for example, in relation to the leveraging of coordinated market power and predatory pricing. Schedule 2 also amends the version of section 46 found in part 1 of the schedule of the TPA. This is the version that applies throughout the states and territories by virtue of application legislation they have passed in accordance with the 1995 competition code agreement.

Schedule 3 of the bill concerns unconscionable conduct under the TPA. Part IVA of the TPA prohibits corporations from engaging in unconscionable conduct in their transactions with both consumers, under section 51AB, and business consumers, under 51AC. In its report the committee identified several issues in its consideration of the unconscionable conduct provisions. It concluded that section 51AC is a relatively new section, but it did recommend some changes to 51AC.

Items 7 and 8 of schedule 3 amend the threshold that applies in relation to 51AC. At present 51AC is subject to two things. Firstly, listed public companies are not protected by section 51AC; and, secondly, it does not apply where the supplier acquisition of the goods in question is at a price greater than $3 million. The government's bill extends this price threshold to $10 million. This represents a second increase in the threshold; it was also done in 2001, where the limit was raised from $1 million to the current $3 million.

Items 5 and 6 of schedule 3 concern unilateral variation of contracts. When considering whether a corporation has engaged in unconscionable conduct in business transactions, a court may have regard to a non-existing list of factors currently in 51AC. Subsections 51AC(3) and (4) provide lists that are tailored for businesses that either supply or acquire the goods or services in question. The bill amends both subsections (3) and (4) to explicitly provide that a court may consider unilateral variation contract terms when determining whether there has been a breach of section 51AC; however, it does not direct that a court must consider such clauses. Finally, there are consequential amendments in schedule 3, items 1 through 4, which deal with amendments to the Australian Securities and Investment Commission Act, in relation to unconscionable conduct in the context of the supply or acquisition of financial goods or services, mirroring those that are outlined for 51AC of the TPA.

CHAIR—Thank you, Mr Rogers.

Senator STEPHENS—Thank you both for attending this morning. It is nice to see that we are having some legislative response to the Trade Practices Act, given the amount of work that has been done by this committee on that issue over a long period of time. If I could go straight to the detail, you reflected on the work of the previous Senate inquiry and the submissions to it. Have you had a chance to look at the submissions that have been provided to this inquiry

and the commentary that has been provided from a range of stakeholders, I suppose, in relation to the proposed changes?

Mr Rogers—Yes, we have.

Senator STEPHENS—Could you tell me what you think of the claim in submission No. 2, which is from the Shopping Centre Council of Australia? They make fairly hefty criticism of the predatory pricing bill, in particular, and they make two significant criticisms. They say that the predatory pricing bill is essentially flawed and, as it stands, limited to only three markets but that list could grow if the bill is passed. Secondly, in the third paragraph of their submission they make the point that the threshold of unreasonably low prices provides vague, subjective and unsatisfactory protection. What is Treasury's view of this bill?

Ms Holdaway—The Treasury's position and the government's position have been reflected in our section 46 bill, which Mr Rogers has outlined. In that bill, we talk about the need for the court to consider predatory pricing activities by businesses. The senator has asked for Treasury's view on the predatory pricing bill as such. It is difficult for us to say. Unless you have a particular question about what is being used, I guess it is fair to say that we do not really have a view, as such, on the bill on predatory pricing.

Mr Rogers—I might make a couple of comments. In relation to the limitation of it to particular industries, I make the observation that it is a departure from the way the TPA currently applies. At the moment it is an act of general application for the most part, particularly part IV. It is not limited in any way to specific sectors, markets or industries. That is the intention of the act, and the competition policy and reforms behind it are so that competition policy and competition law apply throughout the economy. The only comment I make in relation to the unreasonably low prices is that the government's bill contains a provision to deal with below-cost pricing which, in essence, deals with that issue.

CHAIR—Senator Stephens, I have made a bit of a mistake here. I had forgotten that we were going to have Treasury to just give an overview and then take questions after we had heard from other witnesses in relation to other matters. So I think we will go to Professor Zumbo and then we will come back to Lieberman and Associates after that. Thank you. I apologise, colleagues.

[9.26 am]

ZUMBO, Associate Professor Frank, Private capacity

CHAIR—Welcome. I gather you have appeared before other parliamentary committees, and you were here for my opening statement. Do you wish to make an opening statement to the committee?

Prof. Zumbo—Yes. Firstly, I would like to thank the committee for the opportunity to appear today and for the support the committee has provided so that I could attend this hearing; I appreciate that opportunity. The issues and legislation before the committee today in terms of the trade practices amendment bills go to the heart of competition and fair trading law in Australia. Central to this debate is the question of whether or not the Trade Practices Act is effective in preventing anticompetitive conduct. On this question there is growing evidence that key sections of the Trade Practices Act are not operating as intended by the parliament.

One of the key sections not operating effectively is section 46. This section should deal with predatory conduct but, following the High Court's decision in the Boral case in 2003, section 46 is not operating as intended by parliament. Section 46 is intended to stop firms with substantial market power from taking advantage of that power for an anticompetitive purpose. In order for there to be a breach of section 46, the firm must have substantial market power as defined by the courts or the legislation, if that is appropriate.

As a result of a series of High Court decisions a firm will not have substantial market power unless it has the power to raise prices without losing business to rivals. This test—the ability to raise prices without losing business to rivals—has become the key test for substantial market power. It is highly restrictive, as few, if any, firms would have the ability to raise prices without losing business to rivals. This key test is such an onerous and restrictive test that section 46 cases have become almost impossible to mount, as shown by the fact that the ACCC has not brought any section 46 cases to court since the Boral decision. This means that section 46 is currently not operating as intended by parliament. In particular, because the question of substantial market power is a threshold issue triggering the operation of section 46, a failure to establish that a firm has substantial market power means that the firm's conduct escapes scrutiny. This means any anticompetitive conduct by the firm will also escape scrutiny, so, unless the firm comes within that threshold, it is not covered by section 46. So, unless the concept of substantial market power is appropriately defined, section 46 will remain ineffective.

There are also other problems with section 46. There is a second threshold issue of whether the firm has taken advantage of its substantial market power. Once again as a result of a series of High Court decisions, that test of 'take advantage' is also an onerous and restrictive test which basically comes down to the proposition that if a firm could engage in the same conduct with or without market power then engaging in that conduct is a 'taking advantage' for the purposes of section 46. Unfortunately, the bills before the committee do not insert an appropriate definition of 'substantial market power'. They simply dismiss a number of issues that the court does not need to take into account. With all due respect, the court does not take

into account those factors anyway. No court has said under this current section 46 that you need to establish that the firm has substantial control or that the firm is absolutely free from constraints. Those issues were not even been required to be examined by the High Court in the Boral decision. To say that a firm can have substantial market power even though it is does not have the ability to control a market or to be absolutely free from constraint simply dismisses matters that are not taken into account and are not the tests used by the High Court.

In short, the bills do not change the High Court's highly restrictive interpretation of substantial market power. The bills are silent on the issue of 'take advantage'. Unless both those issues are defined appropriately in keeping with the parliamentary intention behind those two concepts then section 46 will remain ineffective. The point is that unless you define 'substantial market power' the current High Court decisions will apply and section 46 will not be triggered and will remain ineffective in stopping anti-competitive conduct.

Section 46 is not the only problem that needs to be fixed. It is the biggest problem, but there are a number of other problems. For example, there are problems emerging with other provisions of part 4—and I will be very quick in speaking on those. There are issues in relation to cartel behaviour perhaps going undetected. Because of recent decisions, it is clear that the ACCC has insufficient powers to obtain evidence that will stand up in court. There specifically I am talking about the need for the ACCC under judicial supervision to be able to tap phones and covertly record meetings in the same way that the FBI in the United States is able to and to move quickly to make cartel behaviour a criminal offence.

The issue of creeping acquisitions is not dealt with in the bill before the committee. Creeping acquisitions are a series of small-scale acquisitions which in themselves may not substantially lessen competition in breach of section 50 but collectively may substantially lessen competition over time to the detriment of consumers. There are problems with making section 45 cases stick, problems with trying to get section 46 cases even before the court and problems with creeping acquisitions that could be used as a way to get round section 50. Further, there are holes emerging in key sections of part 4, the competition law provisions of the Trade Practices Act.

In terms of fair trading, section 51A(c) is intended to deal with unconscionable conduct. But that has been narrowly interpreted by the courts, with a heavy procedural unconscionability focus, which simply looks at the surrounding conduct and does not drill down to potentially unfair contract terms. The question of unfair contract terms is also described as 'substantive' unconscionability. That issue has not been dealt with. Simply adding a factor or another 10 factors or more to the non-exhaustive list of factors will, with all due respect, do nothing other than add to the non-exhaustive list. It will not define unconscionable conduct. Simply having that factor does not mean that conduct is unconscionable. Quite simply, the courts can take into regard any matter that they deem relevant and simply adding to that non-exhaustive list will not remove the ability of the courts to look at any factors that they feel are relevant.

Similarly, adding a factor that the courts may have regard to below-cost pricing adds nothing to what the courts already do. In fact, in the Boral High Court decision the court had very close regard to below-cost pricing. Simply saying in the legislation that you may have regard to below-cost pricing does nothing. The courts already have that ability and they would

certainly look at that. Overall, therefore, it is respectively submitted that the bills before the committee fail to address a number of major problems with key sections of the Trade Practices Act. Unless those problems are addressed, Australia's competition and fair trading laws will not be operating effectively to the benefit of Australian consumers.

Senator STEPHENS—Thank you, Professor Zumbo. Welcome back to the committee. You will notice that we have a new chair who does not have the forensic knowledge of the Trade Practices Act that our former colleague did, but nevertheless we will try to engage you at a level that does not shame us!

Prof. Zumbo—I am sure the chair brings other strengths!

Senator STEPHENS—Sure, but we spent many hours engaging in forensic analysis of certain sections of the Trade Practices Act under Senator Brandis. You made some very important statements in your presentation. I want to go to some of them first of all, if I may. Your argument really is that section 46 as it currently stands does not protect small business and that, as the bill proposes, the amendments still do not protect small businesses. Can you elaborate for us on why you say that the concepts of substantial degree of market power and taking advantage are still not well enough defined and therefore still the problem?

Prof. Zumbo—I will start out by saying that the proposition I bring before the committee is that section 46 does not protect competition sufficiently. As a result, that may have an impact on small businesses, but the proposition I put is that an effective section 46 is essential to protecting competition, ensuring that competition is as vigorous as possible and that consumers get the best possible deal. There is obviously a fine line between competitive conduct and anticompetitive conduct. Obviously we do not want to stifle competitive conduct, but similarly we do not want to allow anticompetitive conduct to go undetected or unpursued in some way.

The problem with section 46 and the concern that has galvanised this argument and debate for the last four or five years is that the High Court decision in Boral set a trend whereby the concepts of substantial market power and taking advantage have been interpreted in such a way that one would see that the section effectively would not operate in preventing anticompetitive conduct. The ACCC has not brought cases. The concepts have been defined in a narrow way. We know how the concepts have been defined by the High Court, and they are defined in such an onerous way. As a result, there will be conduct that would ordinarily be a breach of section 46 that is not being looked at.

The concern that one has is obviously that we do not even get to look at whether conduct is unconscionable under section 46. We do not even get into section 46, because section 46 is not triggered unless you have a substantial degree of market power. Unless that is triggered then the firm is not covered by that section, and if the firm is not covered by that section it can engage in any conduct that would otherwise be a breach of section 46 but is not because it is not covered by section 46. There may be breaches of other sections of the Trade Practices Act, of course, but section 46 will not be relevant to that firm's anticompetitive conduct in seeking to stop that anticompetitive conduct.

Yes, there is a debate about big business versus small business, but this is really a debate about protecting consumers, protecting competition, ensuring that competition is as vigorous

as possible, and sometimes a discussion about big business versus small businesses sidelines some of those more fundamental issues about the importance of promoting competition. Section 46 is a very important provision to promote competition, and because it is not working there is always a doubt that conduct that is unconscionable is going undetected.

Senator STEPHENS—In your analysis of the amendment bill, you have made some constructive proposals that you think will address the issues that you believe are the weaknesses of the bill. Perhaps it would be constructive if you were to work your way through the proposals and why you think those proposals would address the shortcomings of the bill.

Prof. Zumbo—My proposals, Senator?

Senator STEPHENS—In your submission, yes.

Prof. Zumbo—I make a number of suggestions. Firstly, and quite obviously, there needs to be some attempt to define 'substantial degree of market power'. Alternatively, if we have the approach of saying that there can be substantial market power even though something is not proven, saying that even though the corporation does not control the market or acts absolutely free from constraint is not sufficient. You would need a statement to the effect of 'a corporation can have substantial market power even though it does not have the ability to raise prices without losing business to rivals'. That would knock out that factor as the key, sole overriding factor and would require the courts to have a much more sophisticated analysis as to the level of constraint in the marketplace—the way the firm is operated, the way the terms are dictated, for example, a refusal to supply, how long it sustained a conduct. It is not simply a throwaway line that the firm does not have the ability to raise prices without losing business. The message came through quickly and clearly that the concern in the High Court is that if you do not have the ability to raise prices without losing business rivals, you do not have substantial market power. Justice McHugh's judgement starts off with the proposition that Boral did not have substantial market power because it did not have the ability to raise prices without losing business. So having the proposition that you can have substantial market power even though you cannot raise prices without losing business would require the courts to look more broadly, and would be in keeping with the parliamentary intention because the intention was to have a broad analysis of the relevant market characteristics and behaviour of the firm.

There would need to be a definition of 'take advantage'. Suggestions were made in the previous Senate Economics Committee report, which these bills are in response to, that perhaps more needs to be done in that regard than simply those recommendations. One suggestion is to try to move the courts away from a focus of looking at what the firm could have done without the market power. If you can engage in the same conduct with or without market power, that covers anything. You can engage in predatory below-pricing without a market power. You can refuse to deal without market power, but the ultimate difference is you cannot sustain that predatory conduct for too long if you do not have market power because you will lose business to your rivals. People will stop dealing with you, and if you refuse to supply, for example, 50,000 street directories, someone will go elsewhere, because in a competitive market there is a competitor to supply. But if you make a comparison between conduct with and without market power, you have knocked out almost any conduct, and I

struggle to think of any conduct that would come within that test, which is evidenced also by the fact that key High Court decisions have been knocked out on an inability by the ACCC to show it taking advantage.

One suggestion would be to provide a definition of 'unconscionable conduct', which makes it clear that it is a broader provision than the old common law principles of unconscionable conduct. But clearly there may be time to consider a new framework to deal directly with unfair contract terms. Victoria and the United Kingdom have a framework for dealing with unfair contract terms in consumer transactions. There has been a Law Commission report in the United Kingdom suggesting that that legislation should be extended to a small business context with time to consider not only having that in consumer transactions but certainly in small to big business relationships.

CHAIR—In relation to the point that the senator raised, do you have a definition of 'substantial market power'?

Prof. Zumbo—No. To use the same model that the government is using when saying, 'You can have substantial market power even though ...' I have suggested that you can have substantial market power even though you do not have the ability to raise prices. If that was implemented I believe that would restore the pre-Boral position in a way that unfortunately the government's attempt does not.

CHAIR—So that would be your only change to a definition, or only addition to a definition, would it?

Prof. Zumbo—At this point that would be my submission.

CHAIR—What do you mean by 'at this point'? Is that subject to change?

Prof. Zumbo—Well, no. That is what I would be looking for. If that was implemented, I believe that section 46 would be restored to its pre-Boral position. Of course there is the question of recoupment. I do not believe there is a need to show recoupment, so on that point I would say that you need to knock out any requirement to establish recoupment. The problem there is you are requiring a finding as to the future—that is, you need to establish that someone is going to do something in future, recoup it in future. It may be part of economic theory, but we are talking about a law—section 46—that does not mention recoupment in the legislation.

Senator STEPHENS—So on that point, Professor Zumbo, would amending the act to explicitly state that recoupment is not required to prove predatory pricing add significantly to section 46?

Prof. Zumbo—Absolutely. I do believe that not only have you got a high threshold in terms of substantial market power but you have also got this further hurdle that the High Court has imposed of a requirement to show recoupment. If that was removed, that would be in keeping with the parliamentary intention behind section 46. Section 46 is not a prohibition against predatory pricing. It is a prohibition against abuses of market power. To insert by judicial comment the concept of recoupment is not in keeping with the original intention. It is simply an economic concept that has crept into a law. In theory that may be fine, but in practice—in proving a legal point—you are requiring proof of an event in the future.

Recoupment may also be very subtle. It may not simply be the ability to raise prices later on. It may be providing a very strong warning to your competitors that if they come after you in one market then you will go after them in another market. So to rely on the concept of recoupment in terms of raising prices at some future point is, with all due respect, unsophisticated, because there are different ways that you can carry out your threat and destroy and foreclose competition at a later stage than simply being able to raise your prices.

Senator STEPHENS—You made another point about creeping acquisitions and how they may be used to get around section 50. Can you elaborate on that for the committee, please?

Prof. Zumbo—The problem with creeping acquisitions is that individually, small-scale acquisitions may not substantially lessen competition and therefore are not a breach of section 50. Section 46 really looks at individual acquisitions. However, if you stand back and look at the effect of these small-scale acquisitions over a period of time—say, five years—they could be significant. For example, if those individual acquisitions had happened at one point in time—that is, they happened all together—then they may have been a breach of section 50. But because they happen, in a sense, by stealth over a period of time, individually they are not substantially lessening competition. Collectively they are, but under section 50 you are not able to consider them together as a group. The suggestion there would be that they should, within a relevant period of time, in that market, by that firm making the acquisitions to have an assessment as to whether that does substantially lessen competition over time. At the end of the day we are concerned about protecting competition and consumers. If that competition has been diminished over a period of five years and those acquisitions happening together could have substantially lessened competition, why can't they be considered to substantially lessen competition if they happen over a period of time—say, five years?

CHAIR—What is your suggested amendment to address this?

Prof. Zumbo—The suggested amendment would be an ability for the ACCC under section 50 to consider a series of creeping acquisitions in that market by the firm within a relevant period of time, which could be five years—that is my suggestion in that regard.

CHAIR—But do you acknowledge that it is difficult to determine when an acquisition has substantially lessened competition? Is that the extent of the test over five years?

Prof. Zumbo—Any regard to whether conduct substantially lessens competition is a complicated exercise. It is a complicated exercise with large acquisitions, of course. What I am saying is that that would not be any harder if you looked at acquisitions over a period of time, because you are making the same assessment as to the reduction of competition, how that adversely affects consumers and how that adversely affects the level of competition in the market. Looking at something over a period of five years or six months is always going to be a complicated exercise. It is not going to be any more complicated to look at how creeping acquisitions have had an impact on competition over five years. In fact, it might be easier, because over a period of five years you have a better fix on how these creeping acquisitions have impacted on competition. If they have, there is an issue; if they have not then it is not an issue, in the same way that if you had one big acquisition at one point in time it would not be an issue.

CHAIR—So you are you suggesting an arbitrary five-year period?

Prof. Zumbo—In the sense of providing certainty, yes, five years. You get an ability to have a fix over a period of five years. But you could pick four years or six years; at the end of the day, it is no different to having a threshold that has three million or 10 million. Some things are going to be covered; others are not going to be covered.

CHAIR—There is a very substantial difference. One is three and one is 10. Are you suggesting three years, four years, five years, six years?

Prof. Zumbo—I suggest five years.

CHAIR—Is there not a risk, with an arbitrary period like that, that you will potentially impact on small business if, indeed, there is clear evidence of conduct inside that five-year period?

Prof. Zumbo—No, it would not impact on small business in any way. It would be simply a question of whether it has impacted on competition. This is not about protecting small business; this is about protecting competition. If an assessment is made over that five-year period that there has been a substantial lessening of competition then I am sure we would be concerned about that. To say, 'Five years is arbitrary, therefore we shouldn't worry about it,' with all due respect, misses the point about focusing on the reduction in competition rather than seeking to do something about it.

Senator BERNARDI—Wouldn't it be the case that, where there was an accretive lessening of competition over a period of time, smaller transactions or acquisitions would have an increasingly disproportionate effect on reducing competition?

Prof. Zumbo—Decidedly, yes.

Senator BERNARDI—Isn't that then a natural regulation in itself—that, over the course of time, if a business had a significant market share, it bought a smaller competitor and it continued to acquire small competitors, each one could be viewed on its own? Is it really necessary to view them in the context of what has happened in the past?

Prof. Zumbo—It is, for this reason. Take the example of a retail grocery. You have Coles and Woolies with significant market shares, and that has been through natural growth and acquisitions of competitors. In that context, if Woolworths or Coles buy one additional independent retailer then that is a very small-scale acquisition. With regard to your point, they may have gone from X to Y, and Y is a greater market share—some people are suggesting upwards of 80 per cent. The fact that they still acquire one small retailer does not work within the example that you have provided, because that small independent retailer would be such a small part of the market that it would not be caught under section 50, even though Coles and Woolies have a significant market share. But, over a period of five years, there may have been 100 independent retailers acquired and there perhaps has been a reduction in competition. We do not know, because that question is not looked at under section 50 of the Trade Practices Act.

Senator BERNARDI—If, in that circumstance, Coles and Woolworths had 80 per cent market share and they decided to buy another small chain that had one per cent of the remaining market, it would be effectively a five per cent reduction in competition. It would be quite significant.

Prof. Zumbo—It could be more. We do not know the figures. One individual retailer is not going to trigger section 50, but over a period of five years, as I said, there may have been 100, which may amount to eight per cent, 10 per cent or three per cent—it depends on the individual market. You do not look simply at the national market; you look at the regional market. Within a particular area there may be concern that Coles and Woolies effectively have become the only two competitors in that regional market because over a period of five years they have taken out all those independents. Perhaps it would be over a much longer period, but for the purposes of this exercise we would group them together for five years to see how the competition has been reduced. Your point that as they get bigger there is a snowballing effect is true. I completely agree. That is why we need to group them together and consider the more recent acquisitions over that five-year period to see whether they are having a disproportionately negative impact on competition.

Senator BERNARDI—I understand what you are saying; I am trying to reconcile it in my own mind. Going back to your regional example, over the course of time, if you examined it in isolation, it would prove my point that if there were three retailers and Coles and Woolworths, and Coles decided to buy the other two retailers, each one would be a significant reduction in competition itself. It is almost like a natural regulation, because one would have 60 per cent or 66 per cent of the market if he bought one of the additional retailers, and to go for the third one would be a significant reduction in competition again.

Prof. Zumbo—Then you have a bigger problem, because, in theory, you could end up allowing, under the current section 50, acquisitions to occur to a point where you have a duopoly. There is some support for the view that a merger will not substantially lessen competition unless the merged entity does have substantial market power—that is, the ability to raise prices without losing business. We are getting a highly concentrated market and maybe we need to carefully look at how section 50 operates. I am looking at one issue—that is, creeping acquisitions—but if you want to look at the dangers of growing market concentration, that is a very legitimate issue and one I would be very happy to explore, because there is a growing concern about growing market concentration. It is not just about creeping acquisitions. The fact is section 50 is allowing some very big mergers to go through that perhaps one would have looked at more carefully than has been the case.

Senator BERNARDI—I would rather confine it to creeping acquisitions at this point.

Prof. Zumbo—Absolutely, but I just wanted to put it into context.

Senator BERNARDI—Thank you for explaining your position to me with regard to that and I thank you for allowing me to ask the question.

Senator STEPHENS—Given that conversation and the answer to the previous question, it might be helpful if you could explain to the committee the kinds of problems that a small business would currently face in trying to recover damages once the ACCC has successfully prosecuted a large business.

Prof. Zumbo—That is a very real concern. Let us assume you can get a successful section 46 finding, and we have discussed that: if there were a successful section 46 finding, in that context, if a small business person or anyone else has suffered damage, they would have to start proceedings in the Federal Court. The suggestion I make in my submission—and it is a

suggestion made by the majority report in the Senate inquiry—is that there should be the ability for small business, where there has been a finding of fact in relation to section 83 from a prosecution by the ACCC, to take that section 83 finding of fact to the Federal Court to merely prove their damages. There would be enormous advantages there from an access to justice point in being able to recover your damages in a timely manner.

Senator CHAPMAN—You probably recall the original Senate inquiry on this issue—

Prof. Zumbo—Very well.

Senator CHAPMAN—and the fact that the then chairman, Senator George Brandis, who has considerable technical expertise in this area, and I, who may lack the technical expertise but who has certainly had a long interest in this area, gave considerable attention to these issues and dealt with the majority of recommendations and made recommendations in a minority report. As I examine the legislation, the only area of inconsistency that I can find between what Senator Brandis and I recommended and the legislation is the failure to extend to the Magistrate's Court the power to deal with breaches of competition provisions of the Trade Practices Act, which is a matter which you draw attention to. Can you identify any other areas where the legislation is inconsistent with, for want of a better term, the Brandis-Chapman recommendations?

Prof. Zumbo—I can. A lot of good work was done by you and Senator Brandis and I remember that previous inquiry very well. Recommendation 1, substantial market power, picked up a number of principles that the ACCC had recommended should be adopted to clarify substantial market power. Some of those have been picked up, not all of them have been picked up. From memory, in one point—I do not think they were numbered—there was a suggestion that you could have substantial market power even though you cannot control the market.

Senator CHAPMAN—The ACCC did provide numbers, I think.

Prof. Zumbo—Have you got the report in front of you, Senator?

Senator CHAPMAN—Yes.

Prof. Zumbo—It is on page 14.

Senator CHAPMAN—Page 11.

Prof. Zumbo—It actually appears a number of times. In the majority recommendation there was a further point about it being sufficient if the firm exercises significant control. In looking at the recommendation made by Senator Brandis and you, and then looking back to the majority in terms of what was accepted, there are some nuances there that have not been picked up. That is one point. It comes down to a word-by-word analysis.

Senator CHAPMAN—In relation to recommendation 1, regarding the four principles, we said that the first was not really a test at all and we doubted its appropriateness or utility; and that the second, third and fourth principles would not, in our view, change the scope of section 46 although they may be of use in clarifying the meaning. We did not really have a strong view on recommendation 1, in that sense.

Prof. Zumbo—But the government has adopted elements of recommendation 1 and in doing so has not picked up all the points. That is the point I am making.

Senator CHAPMAN—They probably picked it up to the extent that we regarded it as being irrelevant.

Prof. Zumbo—That may be so, Senator, but it is not clear from the statements that I have read.

Senator FIELDING—Thank you for your comprehensive submission. I note your support for the concept of substantial financial power as an alternative to the concept of a substantial degree of power in a market. Would you mind telling us why substantial financial power is a useful concept?

Prof. Zumbo—Substantial financial power is a useful concept because financial strength is ultimately what allows the anticompetitive conduct to be sustained for a period way beyond what it would have been in a context where the firm had no market power or substantial power. So the 'deep pockets' aspect is very important to fund the anticompetitive conduct—or the allegedly anticompetitive conduct. The High Court has said that financial power is not a factor that should be taken into account. I respectfully disagree because, if we are trying to assess whether conduct is procompetitive or anticompetitive and if what the firm actually does when it has substantial market power has an adverse effect on competition, we should be looking very carefully as to how that financial power has been used.

Senator FIELDING—I note that you also support the idea that predatory pricing can be proved, even if there is no intention to recoup costs. Could you tell us why? Do you think such an amendment—such as section 46AA(iv) of the Family First bill—would pose a danger to the importance of the possibility of recouping the losses being overlooked?

Prof. Zumbo—Sorry, is your question whether we should have a provision that says we do not require proof of recoupment?

Senator FIELDING—Yes.

Prof. Zumbo—Okay. If that is the question then we do not need proof of recoupment, because recoupment is not mentioned in section 46. You have substantial market power and you take the advantage of that market power for an anticompetitive purpose. That is conduct at a point in time. If at a point in time you have substantial market power and substantial financial power and you use that power in an anticompetitive way—that is, you behave at that point in time to destroy competition, to deter competition or to prevent competitive conduct—then that should be the only issue that is relevant under section 46, because that is how section 46 is worded. To introduce new concepts is to add new hurdles by judicial law making.

Senator FIELDING—So you think it makes it more difficult to even come close to—

Prof. Zumbo—If you have a recoupment element, it becomes almost impossible because you are asking for proof about the future. And if you are asking for a dead body—that is, that the small business or the smaller player has been driven out of business—as an element of proving a breach of section 46 then section 46 is not working effectively to protect competition because the competition is gone; it is once you have proven that.

Senator FIELDING—Do you think there is any merit in the government's bill?

Prof. Zumbo—Any merit? No.

CHAIR—In your submission you said that there was now quite a restrictive interpretation given to the definitions of substantial market power et cetera and that that did not align in any way with the key concepts of section 46.Why would you oppose these amendments when indeed they outline areas that the court could take into account when establishing the degree of power that a company has in the market? Why would you oppose those?

Prof. Zumbo—They can already do that. If they can already do that, why do you have to say it?

CHAIR—Why would you not put that in by way of definition?

Prof. Zumbo—Because it adds nothing. It adds nothing to what the courts are already saying. It is creating a false expectation that these changes will resuscitate section 46. These changes, with all due respect, will not resuscitate section 46. As to section 46, the government's changes will not resuscitate section 46. In that case, they add nothing—and if they add nothing then why are we doing it? They do not address the key problems that need to be addressed—the key problems that I have outlined this morning.

CHAIR—'Key problems' on your submission.

Prof. Zumbo—I come to this committee to provide evidence about my opinion. You can accept or reject that opinion. My opinion is based on many, many years of research, and that is the point I am making.

CHAIR—Sorry, Professor; I am just clarifying that they were your views about the legislative interpretation now of section 46.

Prof. Zumbo—Is that a question as to whether they are only my views or whether other people share those views?

CHAIR—They are—

Prof. Zumbo—There are other people that share my views.

CHAIR—Excuse me, but that was put in the context of your views that these court interpretations have had this effect on section 46. If indeed that is not right, do these amendments add value to the courts' interpretation of substantial market power?

Prof. Zumbo—No.

CHAIR—We will have a very quick question, Senator Webber, because I am mindful that we are well over time.

Senator WEBBER—Indeed, Chair, and it is my one and only question to this witness. Thank you for making yourself available to the committee, Professor. I was part of the committee's previous work as well. I note that the committee initially reported in March 2004 and we are now in July 2007. Is it your view that the government's proposed amendments to the TPA are that complex that it would taken three years to draft them?

CHAIR—You are asking this witness to make—

Senator WEBBER—I am asking for his advice on the complexity of the amendments.

CHAIR—With the greatest of respect, this witness has had a lot of time to think about things and has not even put interpretations, definitions or proposed changes to definitions. This witness cannot comment.

Prof. Zumbo—That is not true.

CHAIR—This witness cannot comment on what motivated or drove this, or did not drive it at all.

Senator WEBBER—No, and I have not asked—

CHAIR—If you want to make a comment about that, that is fine. But this witness cannot, because it is a political comment and not a comment that—

Senator WEBBER—With all due respect, Chair, I do not have the legal experience in drafting changes to the Trade Practices Act and I was not aware that you did. I am asking his advice on the complexity of the government's proposed changes and whether in his view they are so complex that they would have taken this long.

CHAIR—That is not a relevant question to ask this witness at all. If you want to make a political point about it taking X amount of time, that is fine. I am quite comfortable with that; that is entirely your right. But this witness is not, in my view, in a position to answer that sort of question. You have made your political point and this witness is not in a position to answer that.

Senator FIELDING—Following on from Senator Chapman's reference to the Senate Economics References Committee recommendations, did you have a look at the Fair Trading Coalition's submission at all?

Prof. Zumbo—Yes, I have read it closely.

Senator FIELDING—There is a table on page 10 of their submission that has an attachment that has the recommendations. It goes through all the recommendations in quite a good summary, and I thank Senator Chapman for mentioning them. Quite a few have been accepted in the bill and quite a few of the components have not been accepted. Have you any comments about those generally?

Prof. Zumbo—A number of those were not accepted. A number of points that even the majority made could be strengthened. In coming here today I am concerned about strengthening the Trade Practices Act to ensure that it is effective. In one way you can look at a blank sheet and say that we have got a problem and how do we identify that—and to a large extent I have done that. In terms of addressing the report, things have moved on from that report. Other cases have added to my concerns. They were not expressed in that report because of subsequent court cases. So the debate has moved on a little bit. At that point in time the report was an accurate reflection of events then but further cases, further research and further thinking suggest that the problems are getting bigger and bigger. The issues have been known for a while, and there are relatively straightforward amendments that could be made to effectively deal with the problems. So if the question is: are we drafting laws to change a mistake in the judicial interpretation or to change an incorrect interpretation or to change a

judicial interpretation that is not in keeping with the parliamentary intention, those amendments can be drafted fairly simply and quickly in order to address those problems.

CHAIR—Thank you for attending, Professor.

[10.13 am]

CILENTO, Ms Melinda, Deputy Chief Executive, Business Council of Australia

PODDAR, Mr Dave, Business Council of Australia

CHAIR—Good morning. I am sure that I do not need to go through the opening statement as you understand about parliamentary privilege et cetera. Would you like to make an opening statement to the committee?

Ms Cilento—Yes, thank you. The Business Council appreciates the opportunity to appear before the Senate Standing Committee. I would like to make a brief opening statement regarding our position in respect of the government's proposed amendments to the Trade Practices Act and in relation to Senator Fielding's proposed predatory pricing bill. By way of background, we consider that over the past two decades Australia's commitment to free markets, national competition policy reform and the winding back of regulation that inhibits competition has helped businesses large and small to prosper and that this has delivered benefits to consumers and the wider economy.

Technological change, globalisation and other long-term trends mean that Australian businesses face an increasingly competitive market place, and we must look to position the economy and its businesses for long-term competitiveness and growth. A comprehensive reform agenda including the areas of education, skills, innovation, infrastructure, taxation and regulation is required to position Australia well to face these challenges and the opportunities presented. We think this policy should enable strong growth across all regions and sectors, but we should not seek to favour one group over another.

We recognise that regulation is necessary to make sure that the interests of business, the community and consumers are protected. However, the BCA's position is that there must be a high level of confidence amongst businesses and the wider community that there is a demonstrated genuine and real need for new laws and regulations, that what is being proposed will be effective in targeting the issues raised and that the regulations will not impose costs or distortions that are out of line with their expected benefits.

Our philosophical position with the proposed amendments to the Trade Practices Act is that we are not in favour of codification of case law to the extent that it adds unnecessary additional regulation. While there may sometimes be aberrations in some court decisions, our view is that it is not clear that the High Court's position on section 46 is incorrect and our preference would be that no additional regulation be imposed through changes to the Trade Practices Act. However, we are also mindful of the prevailing political environment and the calls from small business associations of the need to clarify the operation of section 46. We have read the concerns expressed by the Fair Trading Coalition in their submission, and the BCA would not oppose the government's amendments to the extent that they are a compromise and increase clarity for small businesses in this important area of commercial conduct.

As you would have noted, our submission has made some suggestions for improvements to drafting language. However, the BCA is not supportive of further substantive changes to the

bill that may change the underlying economic principles or that introduce regulatory uncertainty for business which may stifle legitimate business conduct. If some of these additional changes which introduce new and uncertain concepts are sought, they will require additional changes to counterbalance and to ensure procompetitive consumer activity is not stifled. The very real likelihood is that the changes proposed will increase the regulatory burden and cost and, in creating significant uncertainty, will result in less competition and higher prices for consumers. From our perspective, such changes will increase the regulatory burden with questionable benefit to consumers.

In conclusion, sound economic management in this important area of the law calls for certainty in the application of regulation of market behaviour. The BCA's view is that great care should be taken to provide an appropriate balance in this area of competition policy, and it is important to assess such changes against the fundamental question of whether such changes add to the benefit of all regions and sectors of the economy and Australian consumers in general.

Senator STEPHENS—Thank you for your submission. I would like to go to the actual detail of your submission, because you do raise some significant concerns. The first of those concerns that you enunciate on page 3 of your submission is about the amendments to proposed subsection 46(3C), and you commented in your opening statement about tightening drafting language. Perhaps you could elaborate on what your concerns are there and why what you are proposing would make a difference to what we have before us.

Mr Poddar—The issue that this comment seeks to deal with is that when you consider what actually involves a substantial degree of market power you have to look at a range of factors. You have to look at a corporation's market share, you have to look at the extent of barriers to entry and you have to look at the extent of a corporation's financial power. All that we were saying about the way this section is drafted was that care needs to be taken that, in interpreting this new section, a court does not believe that these factors are the sole factors or the primary factors that should be considered. That is what we were driving at in our suggestion.

Senator STEPHENS—Was there some kind of exposure draft or any consultation about the draft amendments?

Ms Cilento—We have had consultations and we have made clear our concerns throughout the process.

Senator STEPHENS—Tell me what the impact of your proposed changes, on pages 4 and 5, would actually deliver. You are suggesting your preference for the wording of 46(3C) and 46(3B). Could you just explain again to the committee what the impact would be and why you think that is important.

Mr Poddar—It comes back to what we are looking to address here: a court should refer or be allowed to refer to a range of factors. If you solely refer to 'it does not substantially control the market' or 'is not absolutely free from constraint in the market', they lead to a whole host of interpretation questions. So all we are saying here is that you need to be very careful if you are going to start to add to or codify the law—that you need to give the court sufficient flexibility to look at the factors to ensure that, in the particular assessment of the facts that it is

looking at, it is not limited simply to two or three items which are referred to in the subsection. That is all we are seeking to do by putting our suggestion of a subsection to clarify that language. I think that would assist in dealing with some of the issues that we have commented on in this submission, of being mindful of not seeking to codify case law, because, if you start to put in a limited range of factors, do you give the judge or judges sufficient discretion to take into account all factors that may be relevant? That is simply the reason for that additional clarification requested on page 4.

Senator CHAPMAN—Given the wording of the legislation, which says, firstly, 'without limiting the matters to which the court may have regard for the purpose of determining whether a body corporate has a substantial degree of market power', it is not limiting it to those factors that are subsequently prescribed; it is ensuring that those factors may be taken into account, but there is no limitation on what factors may be taken into account.

Mr Poddar—I think the issue is whether, when you interpret each subsection and you have an overriding initial provision, a judge will continue to read down, as you go through each section, and say, 'I need to give preference to the ones which are specifically enumerated by the legislature.' That is the issue we have sought to deal with. There is point in your comment, but the overriding concern that we have is that, whenever you seek to put in codification of case law—and this is the question where we were saying that you have to be very careful in continually adding subsections—every time you do that, a new judge or lawyers will have to interpret the language and say, 'The legislature have directed us to look at these factors specifically, and in subsections they have directed us to look at this in this order.' A judge or lawyer seeking to interpret that new codification will give those priority. That is the issue.

Senator CHAPMAN—I understand the point you are making, but when it is predicated on the comment that it is not limited to those matters and, perhaps more importantly, it is qualified by the term 'may'—it does not say they 'shall' or 'must'; it says they 'may' have regard—my view is that it leaves it sufficiently open.

Senator STEPHENS—You make the point in your submission that in your view the amendments proposed to section 46 are not required. We have had evidence from several submissions, including from one witness this morning, that says that the proposed amendments that are before us today actually do not make much of a difference in seeking either to protect competition or to protect small business. Do you have a view?

Ms Cilento—What we have said is that clearly a case is being put by some that there needs to be a clarification of section 46, and we are prepared to compromise around that in understanding that a legitimate position is being put by them. Our starting position was that section 46 does not need to be amended and that there is not sufficient factual evidence to justify the changes being proposed. But we understand the position being put by others, so we are prepared to strike a compromise that we believe provides additional clarity, with some risks attached to it, which we think we can accept as being reasonable under the circumstances.

CHAIR—Is it your concern that there is a strengthening of the definition of a substantial degree of market power that is going to, in your view, stifle competition? In relation to the judicial interpretation of that definition, it has been put to us this morning that there will be no change at all. Do you agree or disagree with that?

Ms Cilento—No, we disagree with that proposition. As Mr Poddar has outlined, in seeking to codify, you run the risk of increasing the rigidity of interpretation and/or listing so many things that the practical outcome is less clarity. The risk is that, in interpretation, you are lowering the thresholds. In fact, if you look at a number of submissions—in particular, the interpretations, as I take it, of the submission of the National Farmers Federation—that is in fact the way they are viewing it.

CHAIR—I turn to the Trade Practices Amendment (Predatory Pricing) Bill and take you to page 5 of your submission, where you say:

The BCA therefore strongly opposes the bill as it risks stifling the very competition that the laws are supposed to encourage and support.

Are the ultimate losers in there the consumers, the people who, ostensibly, are the ones this bill was to support or protect?

Ms Cilento—That is very much our view: that the proposals that have been put introduce a degree of uncertainty and lack clarity in a way in which businesses would, as a result, be forced to step back from genuine competition and genuine price reductions, and that the ultimate outcome would be a stifling of competition and in fact higher prices.

Senator BERNARDI—The BCA represents big business. How do you respond to the charge that you do not want to see any changes to the Trade Practices Act simply because your big business constituents are the ones who benefit from the act as it currently stands?

Ms Cilento—I would make two observations. Firstly, in our submission and in the submissions of a number of our individual member companies we have all made the point that we support an effective and strong section 46, so there is no disputing that. The observation about the right balance in regulation is in fact something we all agree with. I do not think we are arguing for self-interest in that respect.

Senator BERNARDI—But you do argue that no change is necessary.

Ms Cilento—The other observation I would make, if I could, is that I think sometimes this is an oversimplification of what is self-interest and not a complete appreciation of the role big business plays. Our members employ roughly one million people. They are responsible for one one-third of Australia's export performance, and they are responsible for a significant share of dividends paid to investors and for a significant market cap in the ASX. To suggest that somehow the interests of big business are divorced from that of the broader economy is, I think, not accurate. Yes, our members are keen to pursue genuine competition for the benefits of their business, their employees and their shareholders but also for the benefits of consumers, who ultimately drive the success of their business.

Another observation I would make is that, even on a simple back of the envelope calculation, if they employ one million people you can start drawing the linkages in terms of the number of people who are directly affected through their business relations with big

business as either employees or suppliers—one in four or five Australians depend directly on the performance of big business for their livelihood and wellbeing. So I think we need to be a bit careful in assuming there is some sort of self-interest that is somehow to the detriment of others in the community.

Senator FIELDING—I note the BCA's concern that 'heavy-handed responses risk stifling competition'. Family First shares that concern, but isn't it also true that a good balance needs to be struck and that the lack of effective regulation to stop anticompetitive behaviour also stifles competition?

Ms Cilento—I would not disagree with that. I guess we have a difference of opinion as to whether or not the current legislation is effective. We believe that the current legislation is effective.

Senator FIELDING—Senator Bernardi raised the issue that BCA represents the top 100 businesses and that you would not be doing your job unless you were looking out for their interests and pressing home their points. But your submission says the bills address 'competitive pressures facing small business'. I have to make the point that they are in fact about the anticompetitive pressures facing small business. Do you agree it is important that there is real competition in the market that is free of anticompetitive practices and that small businesses find it hard to survive anticompetitive practices?

Ms Cilento—I agree wholeheartedly that competition is important. It was interesting to read through the explanatory memorandum: when you look at who is going to be affected by this, you find that it is large business. So it is not surprising that we are here representing their position. We support genuine competition that does not favour one competitor over another. That is the bottom line. We think the right balance needs to be struck but the outcome needs to be that there is competition and that what you target is the misuse of market power. We think the legislation is effective in doing that.

Senator FIELDING—I appreciate the detailed analysis that you have made of the Family First bill and I note your concern over the concept of 'unreasonably low prices'. How would you suggest that such a concept be defined to remove any uncertainty?

Ms Cilento—I am not sure that we have an answer to that—and I think that is our problem.

CHAIR—The Fielding bill—and, from recollection, Senator Joyce's amendment as well—talks about concepts of financial power. Given that a company that has financial power does not necessarily have market power, is there some risk that this amendment will have unintended consequences and create uncertainty when determining market power?

Ms Cilento—That is our view. We think it creates a high degree of uncertainty. It potentially captures a range of businesses that would not be intended to be included in it. Dave, you might like to make some more specific comments.

Mr Poddar—Certainly. The concept of financial power is only one of the factors that is taken into account in determining whether or not a participant in a market has a substantial degree of power. If you sought to rely on financial power, or whatever financial power may mean, you have a risk of making a large number of corporations subject to a test where they in

fact have no real power in that market; they are subject to constraints; they have no pricing power; and they have an ability for a party to come in and compete with them vigorously. If you look at, for example, the grocery industry, you could argue that a corporation such as Aldi, which has a much smaller share, has a high degree of financial power because of its parent company in Europe. The question is: is it intended that all of a sudden you would make that company, with a very low share in regions of Australia or no share in parts of Australia, subject to the test?

Really, these are parts of the submission that the BCA is making—that care needs to be taken in putting additional sections into the law, because you may have unintended consequences. The question is: if you start to put additional thresholds or additional issues that a court may or must take into account, you may make a whole host of corporations subject to additional regulation, subject to additional concerns about whether they are doing something which now may be unlawful. Having regard to the substantial penalties under the law, the issue that the BCA is raising is that care needs to be taken, in terms of an important section of competition law, not to inadvertently proscribe competitive behaviour which is to the benefit of consumers. That is the concern about putting financial power on a greater pedestal.

One of the arguments the BCA used many years ago is that, just because a corporation has a loan facility, that does not mean that that corporation will actually use that loan facility to engage in buying new plant or new business, because the relevant management may consider, quite sensibly and commercially, that that investment will not return sufficient money for them. So, just because they have resources—head office may say, 'No, you can't make that investment,' or alternatively the particular managers may say, 'No, we're not going to do that because that is not prudent.' So the issue we raised is that, if you use financial power or even things such as market share alone as pedestals as to what should make corporations subject to this section, then you are not taking into account the full range of factors which the court currently does. That is the issue with the suggestion that you should look solely to those types of factors.

CHAIR—What might be some of those unintended consequences from a competition point of view, from a small business point of view, from a consumer point of view?

Mr Poddar—From a consumer point of view, the question becomes: do you have an unintended consequence? This is the comment that was made earlier by Ms Cilento. Care needs to be taken that you do not stifle a corporation from engaging in discounting because it wants to attract consumers, because it wants to have more people buy its goods. If you have a large corporation, that corporation is still subject to constraints; it is subject to many foreign imports; it has a low market share, but it has significant bank facilities or it has a significant parent company overseas. If it has that ability, you will all of a sudden make that corporation subject to the test, if you go for sole types of factors such as financial power. The executives would be very concerned. An important factor is that the business community seeks to comply with the law. You need to be very clear what the law actually is, because executives are careful. They try not to cross the boundary, on the whole. So the question becomes: if you suddenly make someone subject to a law which is unclear or you put them in a zone, will they suddenly stop competing so vigorously, and do you stifle competition? Do you have less

aggressive pricing or discount sales? People will be concerned not to have discount sales. People may be concerned not to have $1 airfares. Is that bad for consumers such as you and me? Those are the types of questions that we would ask you to be careful of in making additional changes to this area of the law.

CHAIR—Do you have anything further to add in relation to the unintended consequences for those other groups that I have referred to?

Ms Cilento—No.

Senator FIELDING—I want to ask a question against the backdrop of the High Court decision in Boral v Australian Competition and Consumer Commission [2003] HCA 5, in which Justice McHugh said:

> As I have indicated, neither s 46 nor any other provision of the Act defines or even uses the term "predatory pricing". And the terms and structure of s 46 suggest that it is not well suited for dealing with claims of "predatory pricing". In the context of a "predatory pricing" claim, s 46 seems under- and may be over-inclusive. Conduct that is predatory in economic terms and anti-competitive may not be captured by s 46 simply because the predator does not have substantial market power when it sets out on its course to deter or injure competitors[113]. That may be because until it achieves its object it has no substantial degree of market power. … Section 46 is ill drawn to deal with claims of predatory pricing under these conditions.

That clearly says there is a gaping hole in the Trade Practices Act—and using the term 'financial power' goes to fill that hole. Do you have any comments?

Mr Poddar—I always look at practical examples. One judge will say it is difficult to apply the particular section to all of the facts. But the proof is in the pudding. There was another case recently in which the ACCC has expressly been successful in a predatory pricing matter—and I will try to find it for you. One judge may say it is difficult to find, on that particular matter, predatory pricing. His interpretation may be that it is difficult, but I would say that the proof is in the pudding. If you have a regulator who is able to find a case of predatory conduct and they are successful in prosecuting that case of predatory conduct under section 46, it is not clear to me in that situation that the section is so ill drawn that you cannot make out a case. I would say it is in fact the opposite: if the regulator has been successful in a predatory pricing case, then the section is able to be used.

Senator FIELDING—I would beg to differ.

CHAIR—I thank you most sincerely for your attendance today. The BCA is always very generous with the time and effort it puts into these inquiries, and I thank you for that.

Proceedings suspended from 10.43 am to 11.18 am

SHEEHAN, Mr Maurice, Director, Victorian Branch, Pharmacy Guild of Australia

SCOTT, Mr William James, Representative, Pharmacy Guild of Australia

CHAIR—I welcome the witnesses from the Pharmacy Guild of Australia, Mr Maurice Sheehan and Mr William Scott. I think one or both of you have appeared before parliamentary inquiries before.

Mr Sheehan—I have not appeared at Commonwealth parliamentary inquiries before, but certainly I have appeared before state inquiries.

Mr Scott—I have not appeared before any inquiries.

CHAIR—This hearing has been convened to receive evidence in relation to the inquiry into the following bills: the Trade Practices Legislation Amendment Bill (No. 1) 2007 and the Trade Practices Amendment (Predatory Pricing) Bill 2007; the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007; the Tax Laws Amendment (2007 Measures No. 4) Bill 2007 and related bills; the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007; and the Corporations (National Guarantee Fund Levies) Amendment Bill 2007. I take it that you are aware of the bills. We have been receiving evidence on the bills in the order that they are listed. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera.

I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as contempt. It is also contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the grounds upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the grounds which it is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may of course also be made at any other time. Mr Sheehan or Mr Scott, would one of you like to make an opening statement to the committee?

Mr Sheehan—The Pharmacy Guild has presented a submission to you primarily addressing the issue of predatory pricing. We were looking at section 46A. I speak also as a member of the Fair Trading Coalition, who are not to present at this hearing.

CHAIR—They were invited and were coming and then something has obviously happened which has precluded their attendance.

Mr Sheehan—The Fair Trading Coalition have also addressed the issue of 51AC. We would like to refer to that area as well as to 46A. Our submission is brief. It endeavours to spell out that community pharmacy has concerns with the predatory pricing practices which we recognise, through our members, are taking place across the community. Approximately 70 per cent of business that goes through pharmacy is under the Pharmaceutical Benefits Scheme; those prices in the main are certainly controlled by government, but there are areas

that concern us. It is predominantly the remaining 30 per cent that cause us concern—in some respects, the pricing practices of organisations dealing with community pharmacy. As you will be well aware, community pharmacy is small business. In that capacity, there are some buying groups that exist within the spectrum of community pharmacy, but a lot of smaller pharmacies operate individually and without the ability to enjoy some of the enlarged buying skills and abilities that are there.

Moving on to 51AC, the area of leasing and rentals for pharmacies is of prime concern to the guild, particularly in shopping complexes and shopping centres. The Pharmacy Guild has recently undertaken a study of the costs associated with community pharmacies in strip shopping centres and in rural and regional shopping centres. I would be delighted to provide copies of this document to the committee for your review; it clearly outlines the areas—particularly in shopping centres—where we believe community pharmacy is being considerably disadvantaged. We are currently undertaking a review across Australia of all rental pricing that our members are currently paying. Once we have obtained that information, we would welcome the opportunity of providing it to the committee as an update, to ensure that the information that we are providing you with is current and reflects what we see as the current trends occurring in community pharmacy.

CHAIR—Would you like to table that document?

Mr Sheehan—Yes.

Senator BERNARDI—This document, and what you just said, is in relation to the rental costs that your members are paying in shopping centres and strip shopping centres?

Mr Sheehan—That is correct.

CHAIR—It is a substantial document, so we will get Mr Sheehan to provide some copies rather than the secretariat photocopying eight or 10. Would you be happy to provide those?

Mr Sheehan—I can have those delivered to Parliament House this afternoon, if you wish.

CHAIR—Monday would be fine.

Senator STEPHENS—Gentlemen, thank you for your submission. I note that you are also members of the Fair Trading Coalition. Although they are not appearing before the committee today they provided a submission, which you have endorsed.

Mr Sheehan—Yes.

Senator STEPHENS—That includes the recommendations in relation to this legislation?

Mr Scott—Yes.

Senator STEPHENS—Just before I go to your substantive submission, you were saying that you are currently collecting data. When do you expect that will be available?

Mr Sheehan—We have asked members to provide the information as soon as possible. We have not put a closing date on that because there is some other information which we know will take them some time.

Mr Scott—I am not sure. The survey has only just gone out in the last 10 days.

Senator STEPHENS—You understand that the reporting date for this report is next Wednesday?

Mr Sheehan—To be practical, I do not believe we will be in a position to provide you with that information by then.

Senator STEPHENS—We will just go to the important points that you make in your submission. In relation to the concern that you have raised about predatory pricing and about the definition, you suggest that the predatory pricing amendment does not go far enough in strengthening section 46. You comment about the wording. Several other submissions say that perhaps some of the wording needs to be tightened up. Could you go through what changes to those amendments you would like to see happen and what you believe those changes would affect?

Mr Scott—As a layman—I am not a lawyer—I have read through the wording that is there and I cannot attribute value to the points in the way they are made. But there is clearly an issue—

Senator STEPHENS—Specifically in relation to relevant cost?

Mr Scott—Yes. By way of example of how a product is priced, when you purchase a product you are aware that there might be allowances for the volume that a person may buy. As long as you are able to reach those volumes you would be able to buy it at a price less than someone else could buy it. When you purchase a product, either on your own or in cooperation with a group of others so that you get that maximum volume discount, and you then find that that product is available for sale for less than you have been able to buy it for and you question the company that you purchased it from—I can personally relate this to film which I purchased from Kodak, not in the last few years but in the past when film was a significant item—something is wrong. Either the company is not being honest about what the cost price is or, alternatively, the other group is selling it for less than it purchased it for. Either way, those things are commonly used to cause the opposition to go out of business or to cause the opposition considerable trouble. I do not believe they are reasonable ways for trade to take place.

Senator STEPHENS—Is it your view that the government amendments to section 46 go far enough to lower the hurdle of substantial market power?

Mr Scott—The view of our organisation is that no, they do not, and that these additional words are necessary. But, as I say, I am not a lawyer and I cannot adequately evaluate this, I am sorry.

Senator STEPHENS—That is okay. Can you comment on your second clarification, on relevant costs? What about clarifying the concept of 'take advantage', which is one of the issues that has been raised through submissions, and including financial power in the list of factors that a court must consider when determining whether a corporation has substantial market power? Do you think that would strengthen section 46?

Mr Scott—I do, yes.

Senator STEPHENS—You do not mention the issue of creeping acquisitions in your submission, but the Fair Trading Coalition does. That submission makes the very important

point that the issue is not addressed but needs to be. It makes a recommendation about an amendment to consider that. Let us go to the Fair Trading Coalition's recommendations so we can work through them. The first is:

- that s46 be amended to clarify the concept of take advantage;

You are supporting that. The second is:

- that a corporation's 'financial power' can contribute to its market power;

Do you want to comment on either of those?

Mr Scott—Where a corporation has enormous financial backing, if somebody in small business were to get involved in legal action in those circumstances it would be absolutely impossible for the small business to win, because they could not go through the process. There have been a number of occasions in my own business career where I have not pushed an issue where I had a right to, because I knew that I was not prepared to go to the huge costs that would be involved for the benefit that I would receive at the end. A corporation can spread its costs out over a broad area; as an individual owner of a small business you cannot do that. And as these organisations get bigger and bigger—and that certainly is the trend in Australia—they have more and more financial power.

Senator STEPHENS—Thank you. To go back to the issue of creeping acquisitions, it would be helpful to the committee if you could elaborate on whether or not that is a concern for your particular industry and perhaps give some examples of what is happening in the pharmacy sector.

Mr Scott—One of the difficulties with the pharmacy sector is that, while we get upset about pricing issues, there are professional issues that are superimposed upon them, and usually the predatory pricing or the extreme market activity is joined with activity of an unprofessional nature. So the boundary gets blurred a bit between an economic issue and a professional issue. But there are examples currently of groups of pharmacists gathering together to generate a business and a banner covering that business; they have now spread interstate, which was not the case four or five years ago. These people then sell product at a price at which the normal pharmacist cannot even buy it. A non-professional example would be the sale of perfumes, where they sell product at prices at which, if you were buying it from the manufacturer, you could not possibly buy it. Even allowing for the large quantities that these groups are prepared to get together and buy, if I joined business with 10 of my colleagues with reasonably significant businesses, we still could not compete with these people.

On the other side there are professional issues where, because of their market power and their ability to buy, they will then sell the 30 per cent of non-prescription items that Mr Sheehan has referred to at prices which a normal pharmacy could not sell them for. The level of penetration of the market that those groups have is increasing daily. I am not sure whether that answer helped. It is a factor in our industry currently.

Senator STEPHENS—Yes, that helped. I turn now to section 51AC of the Trade Practices Act. The Fair Trading Coalition made a recommendation that the act be amended to proscribe conduct. They list four particular points of conduct in their submission, which are:

- unilateral variation of contract or associated documents;
- the termination of contract by one party without just cause or due process (though it is not intended that the rights of parties to repudiate a contract be removed);
- the bringing into existence of documents or policies after the signing of the contract which are then binding and which can also be used to vary the original agreement or contract; and
- the presentation of 'take it or leave it' contracts or agreements.

Some would say that that is a very heavy-handed approach: to be proscribing activities and have those embedded in the Trade Practices Act. Do you have any comment on that?

Mr Scott—I have come to this quite late today to provide the pharmacists' view. I do not feel that it is appropriate for me to speak for the Fair Trading Coalition. However, I can say that I do share their frustration with the reverse of these things, which commonly occurs in rental negotiations in shopping centres with some of my own colleagues. Again, as a non-lawyer I would not like to specify the exact nature of what will be in the act. But I clearly appreciate the reasons why these people are making these comments. People do give 'take it or leave it' contracts in shopping centres and they do have things put upon them after they have signed documents. They really have little ability to do much about it.

In our own industry somebody can build a pharmacy within a shopping centre and then, because there are location rules for pharmacies where you could not normally get a new business in that area, if the shopping centre kicks the current owner out then they can bring somebody in because they have a right to have one pharmacy for every shopping centre with 30 shops, two pharmacies for every shopping centre with 100 shops, and three pharmacies where they have 200 shops. So there is an issue where they hold out the fact that they can get somebody else in tomorrow who has not spent the time building up the business or whatever. They can kick you out and get somebody else in tomorrow. So they do have considerable power over pharmacists in those circumstances. I guess that relates to this area.

Senator STEPHENS—I have one final question in relation to section 51. The government has proposed increasing the threshold to $10 million. Do you think increasing the threshold from $3 million to $10 million will make a difference?

Mr Scott—Yes, I believe that that will make a significant difference and that it is necessary. It has been given lip service at present.

Senator STEPHENS—Mr Sheehan, do you have anything to add?

Mr Sheehan—Again, that is a common view because one of the concerns of our members is that their objections are not really taken seriously and that the ramifications of those, then, are just wiped aside. So, insofar as our position is concerned, we fully support that increase to $10 million.

CHAIR—I just need to clarify a comment I made earlier on. I understand from the secretary that the Fair Trading Coalition were invited to appear but declined the invitation. I thought I should clarify that.

Senator BERNARDI—I must profess that I am not intimately across your industry, but a number of things that you have said to me are cause for some further investigation. If you do

not mind, I would just like to clarify the position of your guild. There are 4,500 community pharmacies. Roughly how many individual owners of those pharmacies are there?

Mr Scott—Around 3,000. Most pharmacists only own one business. I believe that there are probably around 3,000 owners.

Senator BERNARDI—How many of those would own multiple pharmacies?

Mr Scott—About half. For argument's sake, in my own situation, there is my wife, my business partner and me. We own four pharmacies between the three of us. It is not unusual in modern practice for there to be more than one owner, because we are commonly open long hours these days.

Senator BERNARDI—How many non-guild pharmacists are there?

Mr Scott—We represent about 75 per cent of all pharmacies. The friendly societies are not allowed to be members of our organisation and there is another small group that are not currently members.

Senator BERNARDI—Are there buying groups within the guild?

Mr Scott—Yes, there are.

Mr Sheehan—Not within the guild. Within Victoria, you can own up to five pharmacies. That is not necessarily the case in other states. The situation used to be that you could own three and probably two or three years ago that was increased to five. That has increased the number of multiple ownership pharmacies that are there. On the question of buying groups, I will defer to my colleague.

Mr Scott—The guild only runs two buying groups that I am aware of. One is run by the Western Australian branch, but that is more for non-pharmacy items. There is a buying group in the ACT called Marchem which purchases products on behalf of its pharmacist members. Many of the guild members in the ACT are members of Marchem. But most of the other buying groups have nothing to do with the guild but are organised collectively by our members.

Mr Sheehan—If I could clarify that, Mr Scott's role with the guild has been on a national basis. My reason for saying that there are not is that within Victoria there are none in existence. But, as he has indicated, there are in other areas. I wanted to clarify that point.

CHAIR—I do not think that it was going to find its way into the report.

Mr Sheehan—Thanks, Chair.

Senator BERNARDI—Is it the case in the pharmacy industry that there are restrictions on the number of pharmacies that can be owned across Australia?

Mr Scott—Yes. You can own five in Victoria, New South Wales and Queensland. I am not sure about South Australia. In Western Australia and Tasmania, you can own two. There is a limit.

Senator BERNARDI—And there are restrictions, which you mentioned, about competition within certain geographic zones, I guess.

Mr Scott—There are what they call the pharmacy location rules, which were agreed between the government and the guild about 17 years ago now, and they have been modified slightly every five years. The idea behind that is to provide a good geographic distribution of pharmacies so that they are not just in the popular shopping areas but in the local communities, where the elderly can more easily get to them and they are more generally accessible. That has worked incredibly well. As part of that, a fund has been set up to make it worth while for pharmacies to open in rural areas. There are initial grants given to them to open and then there are grants given on a yearly basis. If they fall below the average income they get an additional supplement to increase their income. This is because there is a huge need for pharmacies in rural areas and in some places it is not economic.

Senator BERNARDI—The grants are provided by government?

Mr Scott—The original lot were. We took a small amount out of the dispensing fee across all pharmacies and put that into the rural area, so the agreement is between government and the guild.

Senator BERNARDI—Has there been a history of loans or financial support from product providers, drug companies or health manufacturers?

Mr Scott—In the past there has been a guarantee system from pharmaceutical wholesalers. There are three main ones in Australia—Sigma, API and Symbion. I happen to be on the board of Sigma. They have largely disappeared. The wholesalers or some groups actually assist pharmacists to get loans in the first place because it is difficult to borrow against the goodwill of a business.

Senator BERNARDI—You mentioned 70 per cent of prescriptions were under the PBS. What percentage of business does that represent for a pharmacy?

Mr Scott—In fact, Maurice was right when he said that 70 per cent of business is 70 per cent prescriptions. The issue is that 95 per cent of prescriptions are on the Pharmaceutical Benefits Scheme, so the price can vary for only five per cent. Generally, people stick to Pharmaceutical Benefits Scheme prices. If they do not, it is already illegal. With respect to the revenues in pharmacy they vary a lot but, on average, about 70 per cent of the revenue comes from the prescription business.

Senator BERNARDI—The reason for this background is that I find part of what you have suggested today a little alarming in that you have just established for me that many pharmacists own multiple businesses. There are already rules in place such as location and limits on bulk ownership which to me suggest that the intention of these rules is competition. A significant amount of your business is already price controlled. You get grants for locations—this is a subsidised industry—yet you are complaining about the price of perfume. To me, it seems a little unusual. I do not think it behoves the cause particularly well, but that is my opinion. Now that we have established that I have that opinion, I wonder whether you have a comment on it.

Mr Scott—I understand your view and, as somebody who has represented the guild for 10 years nationally, I am really proud of the outcomes that have been achieved to provide access and equity of pharmaceutical services around Australia. Reflecting on the fact that pharmacy had a bigger workforce shortage than any other profession, you did not get any complaints

about people not being able to get pharmaceutical services in the last 10 years. So, while there are rules, I think they have served the community incredibly well. The reason that I picked the example of perfume—I have to confess I have not come to this hearing as well prepared as I would have liked because I got called in only at the last moment to help—is that it is not a professional issue. In one of my preliminary comments I said that, currently, one issue with predatory pricing in the private prescription business is that not only it is a bad thing from a pricing perspective but professionally it is incredibly poor practice to sell multiple packets of medications to the public et cetera. That is outside the ambit of this hearing. I personally believe that the biggest issue confronting pharmacy is the issue of rents and the way that we are treated and, because of the rules that provide reasonable access to services around the community, we are hit on rents.

With respect to the perfume pricing, it is a fact. I am not going to lose any sleep over it, personally. There are also times in the analgesic market, which is not scheduled and is available to all sorts of traders to sell when, again, that product is purchased by some group and sold by them at prices that we cannot even buy it for. As a standard thing, I think it is reasonable that we should at least have the information in the marketplace so that when somebody wishes to buy something they can say, 'If you buy 500,000 of these, you get this price and, if you buy two, you get this price and there are steps in the middle.' Then you at least know that, if you want to compete, you have to buy 500,000. But the market sometimes does not allow people to have that information.

Senator BERNARDI—Do you have any objections to the Western Australian buying group within your guild, who are negotiating prices on behalf of their members?

Mr Scott—No, I do not. I have to say I am not absolutely across what they do but, no, I do not. I do not have any problem with Marchem either.

Senator FIELDING—Thank you to the Pharmacy Guild for flying the flag of small business. For the record, I state my disappointment that you are the only organisation appearing today representing small businesses. I am sure there are lots of reasons why others could not be here, but it is a bit disappointing, so thank you for being here, first up. You may not be able to answer this, because it may be a difficult one to cover, but would you be able to inform the committee how predatory pricing might affect the Pharmacy Guild's 4,500 community pharmacy members? It may be a difficult one to answer, but there is concern that there is not enough in the current laws. I was interested to know whether you have any idea how your members feel about the issue and how it affects them at all.

Mr Scott—I have come to this meeting, as I said, not as well prepared as I would have liked, and I am sure our organisation is happy to provide some written examples to the committee. The only areas that I am aware of are over-the-counter medicines which, on occasions, in an effort to establish their position in the marketplace, are sold outside pharmacies for prices that most pharmacists could not buy them at. Those are analgesics—paracetamol, ibuprofen and those sorts of things.

Senator FIELDING—Page 9 of the submission from the Business Council of Australia, submission No. 11, expresses concern at how moves to outlaw predatory pricing may affect

pharmacies. Do you have any comments about the Family First bill to outlaw predatory pricing?

Mr Scott—I do not, sorry. I am just not across it well enough.

Mr Sheehan—I am sorry—I cannot add to that.

Senator FIELDING—Other than what you have written down there, do you have any concerns about the government's bill at all in what you are putting forward—other than what is in the Fair Trading Coalition's submission, because I think you said you fully support what is in there?

Mr Sheehan—There are no other concerns that we have. As I said, the key concern for us is 51AC and the issues to do with that. It is probably fair to say that we have concentrated our focus predominantly on that area, even though the submission that the guild has put in does address predatory pricing. The key point, and I think Mr Scott made it, is really with regard to 51AC and leasing. Hence the reason that we have produced the booklet that we have tabled before the committee and the reason we are currently working to update that.

CHAIR—Thank you. Mr Sheehan, the Fair Trading Coalition recommends that the bill be passed. Do you support that?

Mr Sheehan—Yes.

CHAIR—And I take it that that is with or without inclusions?

Mr Sheehan—That is correct.

CHAIR—There being no further questions, I thank the Pharmacy Guild most sincerely. Mr Sheehan and Mr Scott, you are now excused.

Mr Sheehan—Thank you.

Mr Scott—Senators, thank you very much for taking the time to look into this; it is an important issue for small business.

CHAIR—Thank you very much.

[11.56 am]

EDGHILL, Ms Kathryn, Partner, Addisons Lawyers

MAHER, Mr Graham, Partner, Addisons Lawyers

CHAIR—Welcome. Have you appeared before a parliamentary committee before?

Ms Edghill—No, we have not.

CHAIR—I very much hoped you might have been here when I read through something with the Pharmacy Guild at the start of their evidence. Were you there?

Ms Edghill—No, unfortunately.

CHAIR—You are aware of the bills that the committee is considering today. These are public proceedings, although the committee may agree to a request to have evidence heard in camera; we may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground which is claimed. If the committee determines to insist on an answer a witness may request the answer be given in camera. Such a request may also be made at any other time. Would either of you like to make an opening statement?

Ms Edghill—Yes. We would like to thank you very much for the opportunity to appear before you. The purpose of our submission is to look at the bills from a legal perspective. I have advised both large and small clients on trade practices issues for a number of years. At the outset I would disclose, with the committee's indulgence, that we have just received some instructions to assist ANRA with any questions that arise in relation to legal issues. So we may well appear later on, if the committee agrees.

As I said, our submission arises from our concern with the bills, principally the Family First bill. It is not that there is any argument that small business, like big business, should be protected from illegal anti-competitive conduct; our concern is that, particularly with the Family First bill, we will end up with a lawyers heaven—lots more uncertainty, lots more confusion, with the unfortunate result of that confusion probably leading to higher prices, such that the welfare of Australian consumers will not be protected, as the objects of the Trade Practices Act require.

Senator FIELDING—For the record, could you explain who ANRA are and who they represent?

Ms Edghill—They are the Australian National Retailers Association and they are an organisation representing, I believe, large retailers. I cannot tell you their membership; that will be a question you will have to ask them.

Senator FIELDING—Do you know the board members of ANRA?

Ms Edghill—No, I do not.

Senator FIELDING—They are basically large retailers—Coles and Woolies.

Ms Edghill—Yes.

Senator FIELDING—Do you advise clients in the areas of petrol, pharmaceutical products and supermarkets focused on by Family First's predatory pricing bill?

Ms Edghill—I have advised clients in all of those areas as well as a range of clients across a broad range of industries, and those have been clients who are both large and small participants in each of the areas.

Senator FIELDING—Without giving the exact dollar amounts, proportionately how many dollars come in from large business versus small business for your clients?

CHAIR—For heaven's sake!

Ms Edghill—That is not something I can answer.

Senator FIELDING—It just gives us a feel for the size.

CHAIR—I think that is totally inappropriate.

Ms Edghill—In any event, it is not a question I can answer.

Senator FIELDING—You state in your submission—in paragraph 67 on page 18 and paragraph 11 on pages 4 to 5—that Family First's bill is designed to protect particular classes of competitors. That is clearly not true. Family First has identified what it believes to be holes in the Trade Practices Act. Earlier I read out some of those holes in the Trade Practices Act, aired through the High Court, that impact unfairly on small businesses to stifle real competition. That is stated quite clearly. Do you agree that some regulation is needed to ensure fair competition?

Ms Edghill—I believe that regulation is required against illegal, anticompetitive conduct and that that is the benchmark for fair competition. My personal belief is that there are some instances where small business does require perhaps particular protection, hence the unconscionable conduct provisions. My concern is that section 46 is not the vehicle.

Senator FIELDING—I know that you consider many of the government's amendments superfluous. Could you explain to the committee why you do not support the government's bill?

Ms Edghill—I have no particular objection to the government's bill other than a definitional issue in relation to 'relevant costs'. I believe the bill is probably unnecessary because it restates in so many ways what is already the law. I have a fairly firm belief that section 46 is working and that ascribing failure to it because there are not a large number of decided cases where people have been found to have predatorily priced is not a correct view of section 46.

Senator FIELDING—So you would say that there have been relatively few cases upholding predatory pricing because it does not happen, and therefore small businesses are concerned about nothing?

Ms Edghill—I think that is probably—

Senator FIELDING—That would be your premise?

Ms Edghill—I would not say that predatory pricing is not happening; I would say that there is a very fine line between harsh and aggressive competition on pricing and what is illegal and anticompetitive. By ascribing failure to section 46 because there are not a large number of decided cases really looks at it from the wrong perspective. I think pricing and discount pricing benefit consumers. I also think that if you look at the Canadian experience you will find that the Canadian experience with a predatory pricing provision—which is different from the Family First bill but is in many ways very similar—has not resulted in a large number of cases of predatory pricing. My feeling is that, even with the amendments, we are not going to see a flood of successful predatory pricing cases because the difficulty that arises is actually in establishing the crossing of that fine line.

Senator FIELDING—You just stated previously that there are few successful prosecutions under section 46 and that that 'should be regarded as proof of the law working as it should to ensure protection of competition and not as a favour of those laws'. Isn't it just a self-fulfilling argument which could be used to support any ineffective law?

Ms Edghill—No, I do not think it is for the reason that low prices benefit Australian consumers. If there is aggressive anticompetitive pricing which breaches the line then section 46 will pick it up. I have acted in a dispute between two very large companies over predatory pricing. It is a very simplistic view to take that large businesses which price at low rates are doing something anticompetitive.

Senator FIELDING—You would put forward to this committee that the concerns of small businesses have no basis? You think the way the Trade Practices Act is sufficient?

CHAIR—Senator Fielding, that is not fair.

Senator FIELDING—Chair, it is a very important question.

CHAIR—You asked whether that is their view. I think you are ascribing to the witness a comment that she did not make.

Ms Edghill—I have said that section 46 is not the vehicle to protect small business. I have not said that small business does not require protection. I think you will find that I did, in fact, say the opposite: that it, like any other business, requires protection from illegal, anticompetitive conduct.

CHAIR—That is my recollection of your earlier evidence.

Senator CHAPMAN—Would it be reasonable to summarise your position as saying that the status quo is satisfactory, that we do not need the sorts of propositions that have been put forward by Senator Fielding nor do we even need the government's bill?

Ms Edghill—I think it would be fair to say that, presently, section 46 adequately covers predatory pricing. As I have said, I do not have any particular problems with the government's amendments other than the definition of 'relevant cost'. I find difficulty with the Family First amendments because I think they introduce a whole raft of problems. The particular problem that I think will arise out of them is that there will be protection of a sector, which will result in such uncertainty all round that we will end up setting minimum floor

prices for particular products. That is perhaps the biggest concern, because I think that distorts the competitive process and does not benefit consumers.

Senator CHAPMAN—So you are not opposing the government's legislation?

Ms Edghill—No.

Senator BERNARDI—We heard earlier from another witness—I am not sure whether you were here for it—that section 46 is completely ineffective and it simply does not work. You are telling us it works exactly as it was intended to work. I know that you can have two lawyers and you can get three, four or five different opinions, but how do you account for the disparity in these views?

Ms Edghill—Lawyers always have different views, as you have just said, but I practise in this area and regularly advise clients. It requires looking back at what section 46 is intended to do rather than looking at it and saying: 'We have a sector of the business community that isn't getting the results it wants out of this.' Section 46 necessarily balances a very fine line of conduct. Competition has to impact on competitors; competition has to damage competitors. It would not be competition if it did not do that. Some people are winners and some people are losers, and the losers will always be the people who are disgruntled by it.

The problem with the section is that you need to set around it some parameters. Market power is a parameter that has been set—and quite fairly. If you introduce concepts such as financial power, for example, you again distort the competitive process. Section 46 is about competition. It is about how markets operate and about regulating that whilst not destroying the benefits of competition. That is why I think section 46 works. Other people will have different views, but I believe I look at it from the perspective of someone with a wide range of client interests.

Mr Maher—Just to reinforce what Ms Edghill has mentioned, if the objective is to promote competition and enhance the welfare of consumers in Australia, section 46 is working. If the objective is to offer protection to a certain section of the market—small business in this instance—because it is considered, for whatever reason, to be unfair that larger business has greater economies of scale or other benefits available to it, we can look at a regulatory solution, if appropriate, to achieve what this bill would probably achieve de facto in any event, which is Senator Fielding's bill, which is to set minimum or floor prices. However, at least with a regulatory solution there would be an element of certainty for business. Unfortunately, if this bill were passed in its current form, businesses would not have that degree of certainty. They would not know, for example, in any given situation whether they had financial power. So, if at any time they were to go about setting—

CHAIR—Just for clarification, are you talking about the Fielding bill?

Mr Maher—Yes, I am, just this concept of financial power, that there is an effects test associated with it, the uncertainty associated with whether pricing in those circumstances may be unreasonably low and that there is very little guidance to be given there. In my view, the cost associated with businesses coming to terms with what all those amendments may mean in any given situation when setting their own pricing policies or strategies is likely to mean not only a waste of lawyers' time but also a very conservative approach to competition in the market so that the competitor in the market who is perhaps the most uncompetitive and has

the fewest efficiencies or even is profit maximising is likely to set the floor price. That will not enhance consumer welfare.

Senator BERNARDI—It is your position that floor pricing disadvantages consumers.

Mr Maher—Ultimately, yes. However, it is a policy decision for government to take as to whether or not a balancing exercise between protecting a sector in the business community or enhancing the welfare of consumers through the provision of lower prices is the way the community wants to go.

CHAIR—Would it be fair to say that a company could have financial power without necessarily having market power? We heard evidence this morning that there might be some unintended consequences flowing from this concept of substantial financial power. Would you agree with that?

Ms Edghill—That unintended consequences flow?

CHAIR—That there could be unintended consequences.

Ms Edghill—Very much so, and particularly in the case of a new entrant—and perhaps I will allow Mr Maher to talk a little on that aspect: what happens with a new entrant with financial power.

Mr Maher—The point is that it is just an example of a situation where we may have someone—an ALDI, a Virgin Blue or someone like that—who wants to come into and compete in the Australian market; it does not have to be a foreign corporation or anything like that. Initially, the cost of their overheads in getting up to speed will be quite significant. If you take as a measure of their cost what they have to price their goods or services at in order to compete, that pricing in the short term is likely to be well below their average variable cost. In those circumstances, just looking at the simple cost model, they may be caught or prevented from engaging in competition in that market because of the concern that they may breach what we propose in 46AA.

CHAIR—You talk of the Canadian experience and judicial decisions. Can you elaborate on that? Is that in relation to the concept of unreasonably low pricing?

Ms Edghill—I am not a Canadian lawyer so I will preface it with that. In the Canadian experience, there is a section which is very similar in that it refers to unreasonably low prices. It still requires a market power test. But since at least 1992, it has had some very lengthy guidelines for what constitutes predatory pricing. Even with those extensive guidelines, there has been only one decided case that has found predatory pricing. I use this example particularly to illustrate what I think is one of the great dangers inherent in a bill which attempts to define predatory pricing, which is that it offers an illusory hope to small business that is not really there. Having acted for a very large company accused by another very large company of predatory pricing, I know that companies do not actually spend their time conducting their accounts and working out their average variable cost or their avoidable costs of production of every single item. The extent to which even a company would need to go in order to ascertain whether it may have breached would just be extraordinary. A small business that attempts to take on a company for predatory pricing under the amendments will also face that. It is illusory to think—

CHAIR—Are you talking about the Fielding amendments?

Ms Edghill—Under the Fielding amendments, and the definition of relevant cost in the government amendments still leaves that open as well. It is not going to provide, I believe as a lawyer, the fix that people may think it will provide. I am concerned that it creates more confusion. I use the Canadian example to show where they have really tried to codify what predatory pricing is, and it has not led to great success.

CHAIR——How will that confusion potentially manifest itself? Is it only in the context of lots of lawyers running around, or are there other potential ramifications?

Ms Edghill—There are always great difficulties with anybody knowing what somebody else's cost structure is. As a lawyer, I often advise on misleading and deceptive conduct in cases where people are given projections. You always have to say to somebody: 'You don't know what somebody's rental costs are' or 'You don't know what their labour overheads are.' You may have a good guess, but a good guess is not going to be enough. Even a good guess will not be sufficient to establish or commence proceedings. The question is whether or not that then throws it back on the ACCC to use their investigative powers. Those investigative powers and an examination of a party's pricing can be a very powerful weapon in the hands of somebody who is disgruntled and simply wants to see prices increase in the market, and this is where I think the confusion has an element of risk with it. As a competition lawyer, I think this is an unacceptable risk.

Mr Maher—It is stated in some part of our submission—I do not know exactly where—that, in Melway, at least some of the judges of the High Court were keen to point out that, given the very punitive nature of the fines which could be imposed for a breach of the provisions of part IV, business was entitled to know with some degree of certainty what their legal obligations were in carrying out their business because of the detriment that may follow. I agree wholeheartedly with that.

Ms Edghill—That applies equally to small business. Small business needs to have that certainty as well before it embarks on what is no doubt only going to put money into lawyers' pockets.

CHAIR—That is right. I suppose implicit in what we have been talking about in the last 10 minutes is that this only relates to large business, but the ramifications can be similar for small business as well.

Ms Edghill—Yes. The sheer cost of having to investigate another party's pricing has all sorts of layers of complication. I am concerned that it will not be the fix; hence, as Graham said earlier, we have no objection to small business being protected; we just do not believe that section 46 is the appropriate vehicle for it.

CHAIR—There is also substantial competition been small business, I assume, as well as between small business and large business.

Ms Edghill—Yes. I am not sure in which of the other submissions I saw an example of a small regional market where the players are not really big business, they are competing small businesses.

CHAIR—Is that the Business Council of Australia, pharmacy or the greengrocer?

Ms Edghill—It might be the greengrocer.

CHAIR—I think it is a good example.

Senator FIELDING—There is no doubt about getting the balance right to make sure we have real competition and not less competition happening. There are certainly concerns about markets that are already very concentrated. The concern you have put forward that the Family First bill does not get it right—I am not too sure: you are saying you will end up with a lot of people being challenged under the laws, a lot of prosecutions from there. Is that what you are intimating? Or are you just saying it is confusion?

Ms Edghill—I am saying it is confusion. I am saying that you may get a lot of people thinking that they will have the ability to succeed in a predatory pricing case, but it creates a lot of confusion. If I can give an example of the grocery market, there is no product market definition in the bill. Does that mean that a small supermarket in Narrandera, for example, which just happens to have a bakery facility there and happens to bake some bread on the premises, cannot sell that for a low price because the bakery down the road is not selling it for that price—even though its cost structures might be widely different? I think it is going to catch a lot of people. The lack of product definition concerns me. Are we talking about the price of razor blades, for example, or do we have to look at the cost of selling everything in that supermarket? Yes, we do, but if every single product needs to be investigated then it is going to be an incredibly detrimental thing for consumers and for Australian business.

Senator FIELDING—I appreciate the picture that you are trying to paint, but if you take into account each of the requirements of financial power, market power, the cost, the timing, the price—I think you are extrapolating unreasonably. You are saying that Canada, which has similar sorts of requirements, has mass confusion over there and they do not know what they are doing. Frankly, that is slander on Canada considering what you are trying to paint here today. Are you trying to say that Canadians have got some law that is creating total confusion and they do not know what they are doing over there? This is about getting the balance right in Australia.

CHAIR—Is this is an explanation of the Fielding amendment or is it a question for the witness?

Senator FIELDING—I am drawing the analogy from some of the responses you have given. Some of the stuff that is being put forward in the Family First bill is very similar to the Canadian model, and to say that it would create great confusion in Australia is extrapolating beyond belief.

Ms Edghill—There are different problems with the Family First bill, which add on to the Canadian experience. My example of the Canadian experience is really there to indicate that trying to codify what is predatory pricing does not lead to a solution that means that people will automatically be able to succeed—large against small, small against small, large against large—on predatory pricing claims.

Senator FIELDING—So this brings us back—

Ms Edghill—If I may just finish. The issue in relation to the Family First bill is that it includes, I believe, a number of layers which create that confusion: financial power without a

need to take advantage, an effects test, its application to industry sectors—not markets within a competition law definition of a market—make it extremely difficult. If I am the local smaller supermarket operator down the road and I am selling my razor blades for X dollars but the larger supermarket up the road is selling toothpaste, for example, at a very low price and people want toothpaste so they happen to go into the larger supermarket and purchase those goods there and they do not buy my razor blades, even though my razor blades in the smaller supermarket are reasonably priced, does that then mean that the smaller supermarket operator has an action against the larger supermarket operator? I believe that is the difficulty with looking at sectors. I believe that that does create a level of confusion that will not assist any business at all. That is my concern about it. The second layer down is the Canadian experience where, even when you do codify it, you do not necessary get the result that I think is the result that Family First would like to achieve, which is some protection for small business.

Senator FIELDING—Is there a need to address the issue of financial power?

Ms Edghill—Financial power in so far as it is an element of market power should definitely be a factor that is taken into account. A large range of factors should be taken into account. There has been a lot of criticism of the Boral decision, but I believe that the High Court got that right in saying that financial power is an element that either assists somebody in attaining market or, once market power is attained, is an element of that power. But then a whole range of other factors ought to be taken into account, like the countervailing power of customers, like the extent of competition in the market. The lack of definition of 'financial power' also makes it a difficult concept for people to grasp and to be sure of some degree of success if they commence proceedings.

Senator STEPHENS—We appreciate your very succinct submission and the discussion has been very fruitful. I want to follow up with some specifics. Basically, your submission says that there is no need to amend the Trade Practices Act as it currently stands. I understand that the government's amendments do not alleviate the onerous threshold test that was applied by the High Court in the Boral case and that, by not addressing that, it falls short of the position argued by the ACCC.

Ms Edghill—That is assuming that I am correct in understanding that you believe the onerous threshold test is the need to have a substantial degree of market power and what constitutes market power. I believe that the benefit of section 46—and I think it may have been the majority of judges who said it in Boral—is that it is flexible, that it does allow a whole spectrum of claims to be looked at. In the life of a competition lawyer, you do not see predatory pricing very often. You do not get it alleged very often and you do not look at a client and very often say, 'I think you're predatory pricing.' Section 46 manifests itself in so many other ways. It tends to manifest itself in examples of the big guy threatening somebody else: 'If you move into our market, we'll do whatever.' So, in terms of it being an onerous test, I very firmly believe it is the appropriate test. Just because people have not met the test does not mean that the test is not right—from a competition lawyer's perspective, I have to say.

Senator STEPHENS—I understand what you are saying there, but the High Court effectively defined a substantial degree of market power as the ability to raise prices without losing custom and then being able to recoup losses from below cost pricing, didn't it?

Ms Edghill—They said that recoupment was not a necessary element. There is a confusion there between what is market power and what is an element in relation to predatory pricing. What they said was that it is the ability, effectively, to act unconstrained by your competitors and your customers so you can put your price up and not have it matter. What occurred in the Boral case was a finding that they could not do that. Even though they had substantial market share—even though they had all of those things—their customers would not allow it. They were never going to be successful in knocking out all of their competitors. The recoupment issue is a bit like financial power in the sense of it being a factual matter that needs to be taken into account.

CHAIR—As opposed to a threshold?

Ms Edghill—Yes.

Senator STEPHENS—Would it be worthy for the committee to consider an amendment that clarified that recoupment did not need to be proven?

Ms Edghill—No, I do not. The risk there is that by putting in something positive, if you like, about recoupment you run the risk that the factual importance of it may be lost in the argument, because people will think that they do not have to prove recoupment or otherwise. The question of recoupment is definitely part of the factual matrix that needs to be looked at to see whether somebody has taken advantage of their market power.

Mr Maher—The difficultly with recoupment is that, depending on the market, recoupment may not occur for some substantial period into the future, so it is always difficult to prove. But having said that, the High Court is aware of the whole issue of recoupment. It is a factor they take into account in determining whether pricing was predatory at the time.

CHAIR—Just on that point, all you are saying is that there is a risk that if you codify that you will permanently or inappropriately realign the matters that need to be taken into account?

Ms Edghill—Potentially.

Mr Maher—The position probably is at the moment that the issue of recoupment and whether recoupment is plausible or likely to occur at some stage in the future is a factor that the court will consider in determining whether or not the pricing behaviour has been predatory. A statement which reflects the current stable law would be of assistance. Anything other than that might, as my colleague has said, cause too much emphasis to be placed on recoupment. It is a fact that the courts look at already.

Senator STEPHENS—I want to go through the sections of the bill that are being amended and draw some additional commentary. Schedule 3 of the bill amends part IV dealing with unconscionable conduct. At the Senate inquiry, the ACCC chair made a significant argument about the issue of a threshold. This bill amends the threshold from $3 million to $10 million. Mr Samuel argues that the threshold should not exist at all because unconscionable conduct is unconscionable conduct. What is your view on that matter?

Ms Edghill—I do not have a problem at all with the limit being raised. I have some sympathy for Graeme Samuel's views that it is the conduct that we should be focusing on, not necessarily the value. However, 51AC ended up in the act very much to protect small business—to provide something which defines a particular protection for small business. That is because it extended what was effectively the common law definition of unconscionable conduct. I have some sympathy for Graeme Samuel's views.

Senator STEPHENS—What will the effect be of raising the threshold from $3 million to $10 million?

Ms Edghill—It will probably give a little more certainty to small business. There is often a difficulty when you are advising clients—and there is some case law on this—on contracts which extend for a long period, and you are part way through and you have not yet got to the threshold, and on what the value of the contract might be. It is like Graham's point: when does the damage occur? It gives certainty, but I have no problem with a limit being removed.

Senator STEPHENS—Do you have any comments to make about the amendments in relation to unilateral variation of contracts?

Ms Edghill—No. I think that is a factor that is, in any event, taken into account frequently.

Senator STEPHENS—There are a couple of things that are not in the bill that the opposition believes could have been dealt with. One is the issue of cartel operations. We heard some evidence this morning about growing concentration of markets and creeping acquisitions. Do you have a view on that issue?

Ms Edghill—I am assuming you mean creeping acquisitions more in the context of section 50 and whether or not the ACCC should be able to review creeping acquisitions. My problem with creeping acquisitions is at what point does the creep become the concern and at what point, again, does that artificially stop people from obtaining efficiencies and economies of scale. I think section 50 deals with it adequately at the moment.

Senator STEPHENS—And in relation to cartel operations?

Ms Edghill—If you could let me know what was the more pressing concern there.

Senator STEPHENS—The Dawson committee report actually recommended the imposition of prison terms for individuals. That does not appear in the bill. Do you think that has merit?

Ms Edghill—That I think is very much a policy decision for government. Those criminal provisions exist overseas. I have not had any direct experience as to whether or not that is a more particular deterrent to cartel activity than otherwise. I do have some very recent experience in dealing with the difficulties that global cartel conduct gives rise to in the context of it being a criminal offence in some jurisdictions and not a criminal offence in others. Of course any introduction of a criminal offence really does mean that it raises the threshold. It has to be only, in my view, in circumstances where the conduct can be very easily established. For example, I would hate to see criminal offences for a breach of section 46, where so much of it is an economic analysis of conduct.

Senator STEPHENS—Can we go to the issue of the ACCC's enforcement powers. Section 155 of the act provides powers to the ACCC which are similar to those available to

ASIC, APRA, the ACS and the ATO. But the courts have currently ruled that these powers cease when the ACCC begin an action. The ACCC have argued quite consistently that the act should be strengthened for them to be able to retain the powers while seeking an injunction and for them to continue until the substantive case begins. Do you have a point of view on that?

Ms Edghill—Yes. I do not agree with the ACCC's views. Once they are on the path of litigation then they have all the processes that are available to any litigant. The purpose of section 155 is an investigative power. It gives the ACCC some very extensive investigative powers. It only requires a reasonable suspicion of a contravention. Those powers, for example, for any business which is served with a 155 notice, are quite intrusive, unlike a subpoena or the court process. If the ACCC get it wrong, there is no provision for you to get your costs back or anything like that. I had a recent example of somebody who was asked to attend and give evidence on a 155 matter which was a merger matter. That was a party that ran a small business in South Australia and had to make his way to Melbourne and give up a day of business. He does not get in any way recompensed for that. My feeling is that the powers, if anything, need some changes around what happens when the ACCC use them and do nothing with the material. Once they commence litigation, like every other litigant, they have the powers of discovery at their disposal.

Senator STEPHENS—Another recommendation of the majority report of the Senate inquiry was about extending the provisions of the Federal Magistrates Court. It was a recommendation of the ACCC but it is not included here. Do you have a view about that, given that the purpose of that recommendation was to reduce the costs and increase accessibility to the court system for small businesses?

Ms Edghill—To the extent that that would involve, for example, allowing section 46 cases to be heard, I cannot see that there is any benefit in it. I cannot see that it would reduce the costs. I cannot see that it would necessarily make it any quicker. It is the factual matrix of a section 46 case which always creates the difficulties, and that will not change whether it is the Federal Magistrates Court or the Federal Court.

Senator STEPHENS—What about section 83 cases where someone is bringing action for damages?

Ms Edghill—Where there has been a prima facie finding in another case? The actions for damages, for example, in a section 46 case, if it is a damages case rather than a penalty case, will probably be so complex that, again, I doubt whether it will have any real benefit at all.

Mr Maher—I was just musing that the Federal Magistrates Court may be an appropriate place to look at all the consumer protection provisions of the act and how the case is going—which may speed matters up.

Senator STEPHENS—You have expressed concern about the definition of 'relevant cost'. What about the definition of 'taking advantage'?

Ms Edghill—The definition of taking advantage is, again, not an easy one to come up with. I think it is different from 'relevant cost', though, because at least with cost we are talking about some factors that you could, if you wanted to, put some more definition around. Taking advantage will always differ depending on the situation. It is always a very difficult

thing in advising clients to understand what is really taking advantage of market power as opposed to something that could or would be done irrespective of any market power.

Senator STEPHENS—Thank you very much for that candid advice. I appreciate it very much.

CHAIR—Going back to the 51AC thresholds—and I think they were introduced in 1998 or 1999—would it be fair to say, given the nature of the limitations, that they were designed for small business? They took out listed companies and also put that threshold in there. Is there a risk that if this cap was completely removed then it might, for want of a better word, broaden the focus of that initial intent so much as to make it no longer the intent?

Ms Edghill—That is very possible. The difficulty with unconscionable conduct though is never really about the monetary limit; it is about the behavioural aspects and proving that the conduct itself was unconscionable. Yes, I am ambivalent either way about whether the removal of the limits would change it or whether it would restrict or open up the operation in ways that were not intended.

Mr Maher—You may find a situation like the case of C7 where three or four very large corporations started using unconscionable conduct provisions a bit like you use section 52, which it was not intended for originally.

CHAIR—So that is why you would support the retention of the threshold, albeit increased?

Ms Edghill—Yes.

CHAIR—Thank you very much for your appearance here today.

Proceedings suspended from 12.45 pm to 1.47 pm

EDGHILL, Ms Kathryn, Partner, Addisons Lawyers

OSMOND, Mrs Margy, Chief Executive Officer, Australian National Retailers Association

CHAIR—Welcome. For the first time in three days I can with some confidence say that one of our witnesses has heard the opening statement. I think, Mrs Osmond, you might have been here as well.

Mrs Osmond—I was indeed.

CHAIR—I will dispense with those formalities, which I am very grateful for, and just ask whether you would like to make an opening statement.

Mrs Osmond—I would. Thank you very much for the opportunity to appear before you today on these very important matters. ANRA is a relatively new organisation. It was set up some 12 months or so ago to represent the large retailers here in Australia, which includes the large supermarkets but a very significant number of non-supermarket members as well. We think retail success depends upon providing what consumers want at a price they are prepared to pay, and that is best achieved through a truly competitive market. Consequently, ANRA supports the objective of the Trade Practices Act and looks to it to provide a clear framework that protects competition and consumers but not individual competitors. ANRA is concerned that the amendments suggested by Senator Fielding may dampen competition and in fact lead to increased prices.

The supermarket model in Australia has proven very popular and has been very successful since it was introduced, because of its ability to offer a very wide range of products in one place at low prices when people want them. As the chains have grown a little larger, it has enabled them to develop greater efficiencies and, through those economies of scale and investment, to continue to offer those lower prices. We have seen that with the two majors, and we are now seeing it with Metcash as well, a dominant wholesaler that is becoming an even larger player in the supermarket business. In Australia, as in other countries, the critical mass to deliver significant efficiencies is usually around 6 million people for each major chain. So the model has proven a popular segment of the retail mix, with millions of transactions every day. It has grown because it is popular with customers.

The size of the supermarket chains means they have also got a very wide family of small business suppliers and are major employers, with something over 300,000 Australians and their families being part of that family. The amendments proposed to the Trade Practices Act by the government and Senator Fielding are largely aimed at the fresh fruit and grocery marketplace, so I would like to clarify a couple of issues specifically in relation to that market. The first of those is the myth about market share. People like to use the figure for a combined market share between Coles and Woolworths as being something between 78 and 80 per cent. This figure is actually wrong. It has been variously calculated quite recently on the basis of company turnover, in a report recently commissioned by NARGA. The other figures that are quite often used are the AC Nielsen figures for scanned goods that go through a supermarket.

The first is an inappropriate calculation. Turnover is not an indicator of market share as far as we are concerned. The second only relates to those scanned products that go through supermarkets, so effectively it does not include in many instances fresh food lines and it does not include those stores that do not scan. Effectively the AC Nielsen data represents only about 50 per cent of food retail sales in Australia. When you examine them a little more accurately, those market share figures come down to Woolies, at about 29 per cent, and Coles, at about 23 per cent.

The second myth is the one that small business is suffering because large supermarkets offer low prices to and convenience for their shoppers. Where is the proof behind the emotional rhetoric? The food retail sector is an incredibly diverse one with something like 50 million transactions every week and something like 30,000 retail outlets. Approximately 97 per cent of the food retailers in Australia are in fact small businesses. There is also the same number of small food retailers per head of population here in Australia as there were 30 years ago. A recently released piece of research from—

CHAIR—Sorry, but what was that figure?

Mrs Osmond—Approximately 97 per cent of the food retailers in Australia are in fact small businesses. The number of food retailers per head of population is the same as it was 30 years ago.

CHAIR—Thank you.

Mrs Osmond—Recent research that came from NARGA, which represents those small and independent operators, says—in a report prepared by PricewaterhouseCoopers—that they are booming in the current climate economically and legislatively. We recently did a national survey asking shoppers whether they were happy with the mix of big and small. Seventy-three per cent of them said to us that, yes, they were very happy. Having said that, 50 per cent of them still buy their meat at the local butcher shop and something between 40 and 50 per cent of them are buying at their local greengrocer. So the bottom line is there is diversity and also there is opportunity—and people are using it.

Pricing at discounted levels is not predatory pricing, regardless of the size of the retailer or the level of the discounts. It is a very common practice across all retailing sectors. It benefits consumers and keeps their businesses competitive. If it were otherwise, all retail prices would eventually be set at the level of the least efficient operator in the market. If the amendments proposed were to be passed, discounting would virtually be abolished. There would be no more selling of cooked chooks last thing in the afternoon at a supermarket to clear them out. There would be no capacity to clear out perishables close to their use-by dates at lower prices for consumers.

Myth No. 3 is that consumers are being ripped off by the major supermarkets and that food prices have increased radically compared with those of OECD countries. As part of a survey we did not so very long ago, we looked at how much it actually cost you as a percentage of your weekly pay packet to buy a standard ABS basket of groceries. On the basis of that research we know it is in fact cheaper now to buy the same basket of groceries that your mother or your grandmother bought 10, 20 or 30 years ago in terms of that slice of the weekly pay packet. Additionally, the margins for the major chains are between 3c and 5c in the dollar.

That information is published in their annual reports. Those are not huge particularly when you consider the banking sector here in Australia. When comparing the price levels of consumer goods and services with those of other OECD countries, you note Australia ranks somewhere in the middle.

Finally, in our view section 46 of the TPA is not about protecting small businesses; it is about protecting vigorous competition. That should be a boon for all consumers. The act already contains a range of unconscionable conduct provisions that provide important protection for small business operators. ANRA and its members are concerned that the amendments proposed by Senator Fielding will detrimentally affect the entire retail sector, generating a high level of confusion and uncertainty that will reduce discounting and will ultimately push up prices. The most important person here is the shopper—the consumer, the ordinary citizen who has got to put food on the table. That is the person that we must be thinking about. The large retailers make no apology for their desire to offer lower prices. In a climate in which the latest CPI figures have shown the impact of increased food prices and the subsequent impact on interest rates, lower prices have to be a desirable outcome. That outcome is only certain with a strong competitive market and appropriate protection for the consumer and all businesses—in short, a maintenance of the status quo.

CHAIR—Thank you, Mrs Osmond. Ms Edghill, do you have anything to add?

Ms Edghill—No, I do not have anything further to add.

Senator STEPHENS—Thank you for that comprehensive opening statement, which adds to your submission, which in fact did not go quite as specifically to the amendments that we are considering today. I need a bit of help to understand those figures that you were quoting, please. First of all, you are critical of the PricewaterhouseCoopers report about the sector. I just need to understand what your figures consider and what their figures consider. You said to us that 96 per cent of food retailers in Australia are small businesses. Does that figure include individual stores—

Mrs Osmond—Yes.

Senator STEPHENS—like the hamburger joint down the road?

Mrs Osmond—It would include all food retailers. I think the interesting thing about the PricewaterhouseCoopers report is that—and I am not discrediting the PricewaterhouseCoopers report by any means—it makes quite clear that the small sector is thriving. There is an enormous amount of growth in the independent supermarkets and others. Metcash and IGA are doing extraordinarily well, as is Aldi. I suppose the question is: if they are doing well in that climate, why do we need to make amendments and changes?

Senator STEPHENS—You made the point that turnover is not an indicative measure. What do you consider to be the most indicative measure of market share?

Mrs Osmond—The ABS figures, which are what the 29 and 23 per cent figures are based on. I think probably the most commonly quoted is not in fact the turnover figure; it is the AC Nielsen ones that I mentioned in terms of scanned goods. We feel they are not a good judgement of what market share is because they do not include, in many cases, fresh fruit and

vegetables, meat and so forth; it is usually, in many cases, just dry product scanning, and many stores do not have scanning.

Senator STEPHENS—One of the submissions talks about your calculations as being a 'whole-of-stomach approach', which includes, as we have just established, takeaway food, other food retailing, liquor products, fuel and everything else that consumers eat across the economy to calculate the market share, rather than on the basis of supermarket consumption. If we were to include those activities that Coles and Woolies have, particularly outside the grocery retail sector to include the sales in petrol stations' convenience stores, which are growing, are you able to provide some information about what the share of the market would then go to?

Mrs Osmond—I am sorry, I cannot in relation to those, but I would be very happy to supply something to the committee in writing.

Senator STEPHENS—That would be useful. Going to the substance of the bill—

CHAIR—I am sorry to interrupt. In what sort of time frame would you be able to get that to us?

Mrs Osmond—The beginning of next week—Monday on Tuesday.

Senator STEPHENS—Great. Thank you.

CHAIR—Monday would be terrific.

Mrs Osmond—Monday it will be then.

Senator STEPHENS—Going to the substance of the bill, I understand that you are saying that there really should not be any amendments, in your view.

Mrs Osmond—I beg your pardon—I am sorry?

Senator STEPHENS—Are you saying that the Trade Practices Act does not need to be amended in your view?

Mrs Osmond—Our preferred option would be to see no amendments to the bill. We think it offers adequate protections. We think—

Senator CHAPMAN—To the bill or to the legislation?

Mrs Osmond—I beg your pardon. To the legislation.

Senator CHAPMAN—So you are opposing this bill?

Mrs Osmond—We are opposing Senator Fielding's bill, yes.

Senator CHAPMAN—You are not opposing the government's bill?

Senator STEPHENS—What about the trade practices amendments?

Mrs Osmond—We are saying that we do not feel there are any amendments necessary. There are aspects of the government's bill that we can live with, but there are aspects of Senator Fielding's bill which we think particularly will be a disadvantage for the whole retail sector, not just the companies that I represent, and that it will create a high level of confusion across the marketplace.

Senator STEPHENS—Would you have concerns that the predatory pricing amendments could lead to a reduction in specials and discounts, such as for the cooked chook and the almost-out-of date foods?

CHAIR—Is that the Fielding amendment or the government amendment?

Senator STEPHENS—I am not sure.

CHAIR—I think that might be in relation to the Fielding amendment, but I just wanted to clarify whether that is what you are referring to.

Senator STEPHENS—On page 18 of your submission you state that the government's bill is a 'legislative classification of existing courts' interpretation of the law'. Do you mean 'clarification' instead of 'classification'? Therefore, does that mean that you do not think the bill adds much to the law?

Mrs Osmond—It is 'clarification' and, yes, we do not think it adds much at this point.

Senator STEPHENS—Do you have any comment to make about the unconscionable conduct amendments other than what we have heard already?

Mrs Osmond—At this point in time, no, I have no comment on the unconscionable conduct provisions.

Senator STEPHENS—Do you have any comment to make about the impact of raising the threshold from $3 million to $10 million?

Mrs Osmond—Not at this point, no.

Senator FIELDING—I have some questions with regard to page 10. There are some figures there that I would like to go through. You claim that supermarkets operate on margins—earnings before interest and tax—of seven to eight per cent. Can you identify which supermarkets they are? My information is that the US Food Marketing Institute quotes figures of around two per cent and even Walmart, which sells a lot of non-food items, is only up around six per cent.

Mrs Osmond—Once again, I would have to come back to you with the detail on where those figures are sourced from, but they are standard figures that have been used on a number of occasions previously in terms of the USA.

Senator FIELDING—Do you know the US Food Marketing Institute figures at all or is it that you just do not have them?

Mrs Osmond—I am not familiar with the ones you are talking about. I would be very happy to have a look at them, but these are the standard figures that have been used by the industry here in Australia.

Senator FIELDING—It is pretty important, given some of the claims you are making. Again, I refer to the US Food Marketing Institute and the fact that it says that profit margins in grocery retailing in the US are around 1c in the dollar. Why are they around 5c in the dollar in Australia?

Mrs Osmond—I am not familiar with the figures you are talking about but it is quite important to remember that the American market is quite a different one. They have a large

number of chains in the US. They have an extraordinarily large market and, once again, those things will reflect themselves in a whole range of price outcomes. So without having those figures in front of me and an opportunity to go through them, I could not comment any further on them.

Senator FIELDING—In another area on page 10 you refer to price changes between 2002 and 2004, which is a very narrow time frame. Aren't these figures misleading in light of the broader trend, such as the fact that the price of bread has increased by 100 per cent, according to the ABS, since 1990 while the CPI has increased by 57 per cent? Isn't that why page 10 also focuses on a minutes worked analysis since 1978, taking advantage of the increase in people's income while ignoring the increase in food prices over that time?

Mrs Osmond—Effectively the 2002 and 2004 figures are merely meant to indicate that there are fluctuations in grocery prices, and there will always be fluctuations in grocery prices particularly in the fresh food line. You pick the example of bread. We have had a rather significant longstanding drought. The cost effect on grain is major and it flows through so many different prices within the supermarket environment. This is no attempt to mislead; it was simply an opportunity to give an indication of what prices may vary and how they vary. In terms of the minutes worked, that was quite specifically explained as being a proportion of the weekly pay packet. We looked at the number of minutes it took you to earn the standard ABS basket of groceries now as opposed to what it took you a number of years ago, and that is what that reflects.

Senator CHAPMAN—What is the percentage share of the grain in the cost of a loaf of bread?

Mrs Osmond—I could not answer that but, once again, it is something I would be happy to come back to you on.

Senator CHAPMAN—I do not think you can claim that the cost of grain as a result of the drought is a contributing factor in the increasing cost of bread.

Mrs Osmond—I think it is important, though, to understand that there is bread and there is bread. People like to compare the prices, but are we comparing a standard loaf with a standard loaf or are we comparing a home brand with Bornhoffen or something?

Senator CHAPMAN—But it is just ridiculous to attribute to the drought the increase in the cost of whatever bread you are talking about.

Mrs Osmond—I think it is quite fair to say that some increase in the price of bread must be directly attributable to weather conditions.

Senator CHAPMAN—Maybe 1c. It is just nonsense.

CHAIR—You said there are certain aspects of the government's bill that you do not like. Could you elaborate on that for me, please.

Ms Edghill—I think ANRA's concern, which is similar to the concern that I expressed in the evidence I have given to the committee before, is that attempting to specify what constitutes predatory pricing is probably more likely to lead to uncertainty and confusion. In that respect, as I understand it, ANRA's concern is probably with the definition of 'relevant cost'—leaving open what is relevant.

CHAIR—Are you able to make any comments in relation to the relative position of section 46—after these amendments, as opposed to before them?

Ms Edghill—Are you talking about the government amendments?

CHAIR—Yes.

Ms Edghill—From a legal perspective, there is very little change in the existing position other than to expressly clarify certain aspects which the courts have already held. The only major difference is the express reference to predatory pricing as a particular form of, if you like, the use or abuse of market power.

CHAIR—As a lawyer, would you view those as being substantial changes?

Ms Edghill—As a lawyer, I would not view them as being substantial; I would view them as being harmful. In some instances they do provide guidance to the courts, but I think the courts are already very mindful of and are doing their job very well in taking those factors into account. Lawyers are very good at arguing over what a particular word means. I suspect that the inclusion of the word 'relevant' will be the subject of a lot of judicial interpretation. My reading of the explanatory memorandum for the government's bill is that that is exactly what the government hopes and wants to occur. It seems to be a concern that you cannot pigeonhole fixed costs, variable costs, average variable costs and avoidable costs as being the single and only criterion by which to judge whether or not somebody has misused their power.

CHAIR—That is certainly not codifying existing judicial decisions, is it?

Ms Edghill—No, it is not.

Senator CHAPMAN—In your opening statement you made a comment to the effect that—and correct if I am wrong—the cost of a basket of groceries today in real terms is about the same as it was 100 years ago.

Mrs Osmond—No, that was in relation to our moments worked survey, which looked at what proportion of an average citizen's pay packet it would cost to buy the same basket of groceries as mum or grandma might have bought in the last 20 or 30 years. If you look at the time you have to work to earn the money to buy a standard basket of groceries, it takes less time now than it did 30 years ago.

CHAIR—If you start talking about the contents it would be—and pardon the pun—very much apples and pears, wouldn't it?

Mrs Osmond—No, it is comparing the same contents. It is an ABS standard, because the ABS figures follow through this period.

Senator CHAPMAN—Do you know how the components of that cost have changed as well, in terms of the raw materials, the manufactured component and the retailing?

Mrs Osmond—No, I could not give you that detail.

Senator CHAPMAN—I suspect that the raw material component has fallen by substantially more in real terms than the final cost of the goods.

Mrs Osmond—This basket is a mix of manufactured and fresh food.

Senator CHAPMAN—But they all start with raw materials.

Mrs Osmond—Yes, they all start with raw materials. But, effectively, we were seeking to illuminate that, when we talk about a massive increase in the cost of the weekly budget for groceries, when you look at it as a proportion of the weekly budget in terms of the pay packet that mum or dad or both bring home, it takes less now than it did before to achieve that basket.

Senator CHAPMAN—I understand that, but that may not necessarily mean that the retail component of that basket of goods has proportionally increased as against other components that go into that basket of goods.

Mrs Osmond—I am sorry if I am misunderstanding you. Are you suggesting that the profit margin for retailers is higher now than it was previously?

Senator CHAPMAN—The share of the price. The profit may well depend on other things. I am talking about the share of revenue.

Mrs Osmond—I see what you are getting at. I suppose counter to that would be the fact that the stores you shop in now are dramatically different from the ones you would have shopped in 20 or 30 years ago and the oncosts that relate to those stores are dramatically higher. People demand certain things when they shop in a supermarket now; it has to be clean, it has to be green, it has to be cool and it has to have the latest trolleys. All those overheads did not exist 20 or 30 years ago. I think that is the answer.

CHAIR—I think it would be very difficult for this inquiry to start altering what is a fairly acceptable standard of measurement. I think that is probably way beyond what would be viewed as being reasonable for this inquiry. As there are no further questions, we thank you most sincerely.

Mrs Osmond—We thank the committee again for the opportunity to speak to the amendments.

[2.15 pm]

HOLDAWAY, Ms Hae-Kyong, Manager, Competition Policy Framework Unit, Competition and Consumer Policy Division, Department of the Treasury

ROGERS, Mr Scott, Senior Adviser, Competition Policy Framework Unit, Competition and Consumer Policy Division, Department of the Treasury

CHAIR—I welcome back the Treasury officials. Are there any matters that you wish to put to the committee prior to taking questions?

Ms Holdaway—Yes, if I may, thank you. We have been listening very carefully to the other evidence provided to the committee and have given due consideration to the submissions put forward. In that context, I think it is important to remember some recent history to do with consideration of section 46. As you all know, the Dawson review concluded that the competition provisions, including section 46, have in effect been serving the Australian people very well, that they has been very effective and that they continue to be so. But, at the time, as we all know, there were certain High Court cases underway. Since the Dawson review recommendations we have seen the results of those High Court cases, and I think it is without doubt that those decisions created uncertainty around the operation of section 46, which has led to this committee looking into the effectiveness of that provision. As a result of that, a number of recommendations were made.

What is before you in the bill is a very careful consideration of all those recommendations, including the view of the decisions of the High Court, and we believe that the amendments go a long way to making sure that we have a very effective section 46, which is really at the heart of the competition policy framework, to ensure that the Trade Practices Act continues to be effective in promoting competition which ultimately will lead to enhancement in the welfare of the Australian people. I wanted to start with those comments to highlight that we are here to ensure the absolute effectiveness of section 46. Thank you for the opportunity.

CHAIR—Thank you. Mr Rogers, do you have anything further to add?

Mr Rogers—I have no comments.

Senator BERNARDI—Is it fair to say that section 46 is designed to ensure the health of the competitive process rather than to specifically target whether an individual competitor will survive in a given market?

Ms Holdaway—That is correct.

Senator BERNARDI—That is the intention of that part of the legislation?

Ms Holdaway—As stated in section 2 of the Trade Practices Act, the whole intention of the act is to enhance the welfare of Australians by promoting competition and, as you said, protecting the competitive process rather than a particular competitor in a market.

Senator BERNARDI—Ms Holdaway, we have heard substantial evidence today, and certainly it is in one of these submissions, that simply says that section 46 does not work at all and that, in fact, these changes proposed by the government will not cause it to work. How do you respond to that?

Ms Holdaway—I think we have also heard views that it is working just fine, which is also in some of the submissions. Really, section 46 is focused on ensuring that there is no misuse of market powers. There have been a number of court cases that looked at the operation of section 46. I think that, by and large, the structure of section 46 is still valid and that what was required was further clarification. I think the bill is providing that clarification; it is ensuring that it improves the effectiveness of section 46. It is difficult to accept the conclusion that section 46 does not work at all.

Senator BERNARDI—You mentioned the court cases that have arisen over this section of the act. How do you respond to the claims that we should be codifying the High Court's decisions?

Mr Rogers—There have been a number of decisions on 46. What this committee's report provided was the opportunity for the government and interested stakeholders to take a look at how it is operating and decide which of those pronouncements to incorporate into the law. The government's response to the Senate committee's recommendations adopts those recommendations that on the one hand balance the interests of all the competitors in the market and on the other hand take account of relevant concerns that were raised in the course of the inquiry.

Senator BERNARDI—You have to take account of all competitors in the market. We also have to be mindful of the impact on consumers, don't we?

Ms Holdaway—Absolutely.

Senator BERNARDI—We have heard evidence that an increase in regulation in this area could in fact increase prices to consumers. Do you have any comment to make on those sorts of claims?

Ms Holdaway—I think they are valid comments and claims. Certainly it is a very fine balance that we have to strike here. What we are talking about is ensuring that no anticompetitive behaviours take place. There may be quite legitimate behaviours out there of which ultimately the benefits go to the consumers. What we certainly do not want to do is create an environment where we have a chilling effect on what is very robust and healthy competition. We accept the validity of that claim and we have taken that into account in coming up with the clarifications and enhancements through this bill.

Senator BERNARDI—So you believe this bill will balance the protection of business and align the interests of consumers to the long-term benefit of our economy?

Mr Rogers—That is certainly the government's view.

Senator BERNARDI—I have nothing further to ask immediately, but I may have in a moment.

Senator STEPHENS—This morning I started to ask you some questions and then we got distracted. I appreciate the fact that you had the opportunity to listen to several witnesses who are pretty underwhelmed by this piece of legislation and do not really believe that it is actually going to deliver any more benefits. They argued that the Trade Practices Act as it stands is robust and that these amendments could in fact have the effect of muddying the

waters a little and creating confusion about some definitional issues. You have not actually responded to those concerns, and I wonder if you have something to say.

Ms Holdaway—We can certainly pick up on some of those definitional issues that some of the previous witnesses highlighted. Obviously from our perspective these amendments do make a difference. They do help to clarify without limiting the factors that the courts can actually take into account when considering what constitutes a substantial level of market power. In that regard, we heard some of the witnesses talk about the definition of relevant cost and how perhaps that may lead to uncertainty and confusion. I think Senator Chapman highlighted this previously. It is with the proviso that the court may wish to take that into account.

'Relevant cost' was specifically chosen because the other options for how the cost could be described are unnecessarily limiting. We have heard of 'variable cost' as another option—and I think we have already heard a number of problems associated with that—as well as what was described as 'avoidable cost'. I think it is fair to say that the way courts have used 'avoidable cost' may even be quite different from perhaps what was described in the Pharmacy Guild's submission. So in choosing another definition there are a number of issues which really do not lead to any more certainty. But by using the term 'relevant cost', what we have done—and I think the chair has highlight this—is not to codify the court's decision but to allow that flexibility while providing certain levels of certainty about what we mean by predatory pricing, which is that it is below relevant cost.

Senator STEPHENS—What about the definition of 'taking advantage'?

Ms Holdaway—I think we have heard from many witnesses that that is a very difficult term to define. But having said that, it was the government's view that there was not enough ambiguity about the term 'taking advantage'. A lot of the confusion and uncertainties that were created by the court's decision were around the definition of 'substantial level of market power', while there was a reasonable level of understanding of what 'taking advantage' entails.

Senator STEPHENS—You mentioned the robust nature of the Dawson inquiry and the fact that the report took a fairly minimalist view and did not recommend many legislative changes. But it did make one significant recommendation, and that was about the imposition of prison terms for individuals found to have been engaged in serious cartel conduct. The government accepted that recommendation in 2005, but we still have not seen anything. Why is it not in this bill?

Ms Holdaway—Certainly, as you said, the government has already made a public announcement that it accepts the recommendations of the Dawson review. The timing of the introduction is a matter for the government.

Senator STEPHENS—One of the submissions—and I have not noted down which one it was—mentioned the issue of unconscionable conduct and made the suggestion that unconscionable conduct be extended to cover unconscionable terms of contract rather than just procedural unconscionability in negotiating contracts. Do you have a view on that?

Mr Rogers—I think I understand what you are talking about. I think the view there was that it should be extended into almost an unfair contracts provisions type regime. That is a

significant departure from the way that 51AC is drafted at the moment. There was certainly no suggestion in the recommendations of the committee that that be the way provisions be drafted. The unfair contracts terms regime is quite different. It is about prescribing how people enter into contracts and what contract terms are allowed. Section 51AC does not take that approach. As a result, the government's bill does not pick up on that concept.

Senator STEPHENS—Do you have a comment about the suggestion in the Fair Trading Coalition's submission that section 51AC be amended to prescribe conduct?

Mr Rogers—I do. Again, that is a significant departure from the way that 51AC is drafted. At the moment it is very much that the prohibition is against unconscionable conduct; it is not directed at particular types or examples of conduct. The factors listed in the section are things for the court to take into account. We are looking at the unconscionability of certain conduct so, again, it is quite a departure from the way that that provision is drafted. I think a lot of stakeholders would have a significant view on it.

Senator FIELDING—There is a lot of talk today about the issue of price, or the relevant price. There seems to be a bit of confusion about it. How should it be interpreted?

Ms Holdaway—Relevant price or cost?

Senator FIELDING—Cost.

Ms Holdaway—There is an explanation in the explanatory memoranda which basically allows for factually gathering that information, whether that be by the ACCC or, if the case goes before the court, by the court. The relevant cost may in actual fact include variable cost and in some cases may even include part of the fixed cost, so it is on an average total cost. So what the relevant cost to the organisation may constitute will really depend on a case-by-case basis.

Mr Rogers—Picking up from what Ms Holdaway said there, it is important to remember that section 46 does apply throughout Australia regardless of industry or market or type of company. While it may be possible to craft industry specific definitions for a lot of these concerns, when you are dealing with something like section 46 and in fact with the Trade Practices Act generally—which is an act of general application—by putting in specific definitions you run the risk of potentially allowing anticompetitive conduct that may not be captured by those definitions.

Senator FIELDING—So you are basically saying that the courts or the ACCC will be able to interpret that in the right way?

Mr Rogers—Yes.

Senator FIELDING—Some others may argue that that may be confusing and create chaos throughout Australia. But I hear what you are saying. Some of the submissions say that there were no problems with the Trade Practices Act and that it is working fine. Is that true?

Ms Holdaway—It is probably not fair for us to comment on that as such. But, as I said in my mini opening statement, it is true that there was a certain level of uncertainty created by the High Court decisions. The content of the bill is aimed at ensuring that the operation of section 46 is as effective as possible.

Senator FIELDING—I assume that that would be a balanced perspective that you would have, so I cannot see how we can take submissions that claim that there is no need for a change as credible or even balanced if that is the conclusion that they are drawing.

Mr Rogers—The government accepted that there was scope to clarify the operation of section 46 and that is what the government's bill is directed at.

CHAIR—I am not going to go through some of the evidence that talked about whether section 46 is still operating as it should be, because in the main the view—apart from Professor Zumbo's—is that that section is operating as it was intended as a matter of principle. I will turn to some of the practice issues. What has been put to us today by some witnesses is that the matters included in the government's amendments are already matters that may be considered as material by the court. Is it indeed clear that the courts are giving appropriate consideration to the matters raised in the amendments? If not, is that the reason why these amendments have been brought in?

Mr Rogers—It is right to say that a lot of the things that are in the bill have found expression in court judgements. What the bill does is provide a degree of clarity in light of those judgements over a number of years in relation to a number of factors. Putting it on the face of the legislation provides a clear signal to the economy and to markets across Australia about how section 46 is to operate.

CHAIR—So in effect—and I will be careful how I put this—is this indicating that the courts must include these matters as matters that they may take into consideration; if that makes sense? Do you see where I am coming from? You are nodding, Ms Holdaway, so I think I will take your answer!

Ms Holdaway—I think it is probably fair to conclude—the way you have, Chair—that they must take into consideration these factors that they may take into consideration for the particular case that they are considering.

CHAIR—And that is not the situation at the moment? Is that indeed why this is a change to section 46 and its interpretation as it stands at the moment?

Ms Holdaway—Yes.

CHAIR—The secretary has quite rightly said that Hansard cannot pick up nods, but I deferred to you anyway and indicated that you were nodding, so I do not think Hansard has missed anything in the interpretation. But the point is well noted.

Mr Rogers—I think it is also worth noting perhaps that, because of the wording that is used in the bill, it does not limit the general prohibition that is in subsection (1). That still stands.

CHAIR—Yes. As there are no further questions, Ms Holdaway and Mr Rogers, thank you for arriving here at nine, staying and hearing that evidence and giving the committee some feedback. I appreciate it. Thank you very much.

Proceedings suspended from 2.37 pm to 2.45 pm

LEGG, Mr Chris, General Manager, Financial System Division, Department of the Treasury

MOORE, Dr Andre, Manager, Superannuation and Insurance Prudential Policy Unit, Financial System Division, Department of the Treasury

CHAIR—We turn now to the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill. I welcome Treasury officials. Would you like to give the committee an overview of this bill and then we will take questions afterward.

Mr Legg—I appreciate the opportunity to speak to the committee on the bill, which, as I think you would probably appreciate, implements measures to streamline and simplify prudential regulation. The core of the bill is a series of measures to give effect to the government's response to the report entitled *Rethinking regulation: report of the taskforce on reducing regulatory burdens on business*—otherwise known as the Banks task force report. There are also some measures included which, although not formally part of that report and the government response, are nonetheless in keeping with and aligned with the spirit of the government's response and its intention to streamline regulatory burdens on business. I should emphasise that the government accepted all of the recommendations in that report relating to prudential regulation, and those which require legislation are being implemented through this bill.

There are a number of elements to the bill. It includes measures to streamline breach reporting arrangements, to provide enhanced protection for whistleblowers, to encourage information flows to APRA and also to harmonise those arrangements between prudential bills and, as far as possible, to bring them into alignment with similar arrangements in the Corporations Act. It provides additional flexibility through exemption powers, enforceable undertakings and discretion available to APRA under its prudential standards. It implements simpler processes for appointing actuaries and auditors, and facilitates enhanced cooperation with professional bodies. It seeks to simplify the Life Insurance Act and the SI(S) Act. It also implements the government's response to the review of part 23 of the Superannuation Industry (Supervision) Act 1993.

I should emphasise that we have had extensive consultation on the proposals. This includes an industry roundtable which discussed an exposure draft of the amendments. In the development of the bill the government has paid particular attention to ensuring that, wherever appropriate, the requirements for entities operating under the prudential acts are harmonised with the Corporations Act. I think you would appreciate that differences in the objectives of prudential regulation and consumer protection do mean that in some areas there are different regulatory approaches adopted. An example there relates to the arrangements for whistleblowers. We modelled that on existing provisions in the Corporations Act but we have, nonetheless, adapted it to better suit prudential regulatory principles. I am aware that there have been some concerns raised in relation to the differences between the amendments to the prudential acts and the regulatory approach found in the Corporations Act. I am also aware that submissions to the committee have suggested some further amendments—for example, to

the Corporations Act in relation to breach reporting under the act. We are certainly open to considering those further amendments.

CHAIR—Sorry to interrupt, that is the ABA's submission, is it?

Mr Legg—I believe that is the case. The government is involved in a continuing process of regulatory reform and red tape reduction, so in that spirit we are always interested in these suggestions. I guess that, at this point, we would want time to give them full consideration to ensure that the impacts of new proposals, including for the integrity of the regulatory framework, are properly considered, so we would not be considering picking them up in this particular legislation.

CHAIR—I take it that you are saying that you are prepared to have ongoing consultation with them as I think they would question this submission. Is that correct?

Mr Legg—Absolutely. We have obviously, as consistent with the government's approach generally in the financial sector, attached a particular priority to ensuring that the framework is a principles based framework, as I think you are aware. There are significant benefits in the flexibility that provides for entities to tailor their internal processes to suit their circumstances so long as the desired outcomes are achieved. It avoids the costs of overly prescriptive legislative approaches which do not allow for the different size of entities, circumstances in the industries in which they operate, differences in their internal structures et cetera. But we are conscious that this always raises an issue of concern about the degree of certainty in compliance requirements. Those sorts of issues have again been raised in this case. For instance, with regard to when the clocks might start ticking for breach reporting, our approach, consistent with the Government's approach, is basically to deal with that tension, to manage that tension through focusing on principles based legislation but supporting that with guidance on the issues. The subsequent guidance will be the source of the solution to those concerns.

Senator STEPHENS—You have addressed one of the concerns raised in the submissions by IFSA about when the clock starts ticking. Am I to understand from your response that you intend to provide guidelines once the legislation is enacted?

Dr Moore—Yes, that is the case. The breach reporting requirements are quite closely modelled on the Corporations Act and ASIC already has guidance out, which is designed to assist entities to comply with that framework. It is envisaged that both regulators would work together on providing consistent guidance across both the corporations and the prudential regimes that is appropriate to assist entities to comply with their obligations.

Senator STEPHENS—IFSA also argues that in relation to the whistleblower protection the proposed two tests create serious unintended consequences and recommends that the provisions be aligned with the Corporations Act, that 'they should be objective, should relate only to significant and materially damaging conduct and should relate only to a potential breach of the legislation in which it appears'. Do you have any comment on those recommendations?

Dr Moore—The whistleblower protections that are to be introduced by the bill are very closely modelled on the Corporations Act. There are a couple of places where they do depart and that is, as Mr Legg pointed out in his introductory comments, a consequence of different

objectives of prudential regulation. The first principle that we have sought to apply through these provisions is to make it as easy as possible for potential whistleblowers to convey information either to the regulator or to senior managers and to have a reasonable level of confidence that they will be covered by the whistleblower provisions. To that extent, the standard that is required to invoke the protection is that the discloser makes the disclosure in good faith. I understand from the submission that they are recommending or suggesting a more objective test. Given that the information which flows to the regulator, particularly the prudential regulator, is of crucial importance, we would want to ensure that people had confidence that they can disclose information, if they have any sense or suggestion that it may assist the regulator, and not be worried about whether they are covered by the protection.

Mr Legg—I think the key point here is that the prudential regulator, unlike a market conduct regulator, needs to identify problems fairly early. They are not just identifying issues that might lead to a breach of the law but addressing problems in the way that risk management operations operate within a regulated entity—problems which may just be concerns about management practices. The prudential regulator needs to be able to identify those issues and have information brought to it fairly early in the process. The thinking behind the difference here is to facilitate that difference in the underlying process of prudential regulation relative to market conduct regulation.

Senator STEPHENS—I have a couple of other matters. In their submission, the Australian Bankers Association make the point, notwithstanding that you had said you were happy to continue consultations, that policies on depositor protection and policyholder protection are still being resolved. Since they made their submission and now, I wonder whether there has been any progress on that issue?

Mr Legg—I cannot say much more than that. I think it is in the public domain that the government have been considering policyholder protection and an early access scheme for depositors to get funds that they would otherwise get eventually under depositor preference. It is not deposit insurance. The Council of Financial Regulators has made recommendations to government. The government are considering those issues. I am not in a position to say any more than that in terms of the timetable. They certainly have not yet reached the point of making any decisions, although the Treasurer has publicly indicated that he is sympathetic to the proposals, subject to being able to manage moral hazard issues and compliance costs.

Senator STEPHENS—Finally, submission No. 3, from Chartered Secretaries, Australia, expresses concern that the failure to expressly include company secretaries in the relevant classes of persons is, in their words, odd, given their position within a company and the government's role, which may make them likely recipients for disclosure. Do you have a comment on that?

Dr Moore—The provisions in the bill ascribe responsibilities to those who have prudential functions in the entity. So in terms of disclosures by, say, whistleblowers, disclosures may be made to directors or senior managers of the entity. This is because the prudential acts ascribe prudential responsibilities of those people. Those acts do not ascribe specific responsibilities to company secretaries. However, it is possible, depending on the entity, that a company secretary might have a role which would mean they are included, certainly as a senior

manager or as a responsible officer, and in those situations a whistleblowing disclosure could be made to that person.

Senator STEPHENS—Thank you.

Senator BERNARDI—I would like to go back to whistleblower protection. There is general acknowledgement that it is a step forward, certainly from the Bankers Association. IFSA have said that the two tests which apply to the disclosure introduce subjectivity into the prudential acts. Specifically, the two tests are:

- The information concerns misconduct ... and
- the discloser merely "considers that the information may assist [the person to whom disclosure is made] to perform the person's functions ...

It then goes on to talk about these unintended consequences, which Senator Stephens talked about. What is your response to the subjectivity allegations of those tests?

Dr Moore—I have already responded to that issue. Basically, it is intentional to apply a subjective list in the good faith test so that whistleblowers can be in no doubt that if they are making a disclosure that is not malicious they will be covered by the whistleblower protection. It is designed to encourage information flows to regulators and senior managers about issues that might relate to the prudential safety and conduct of the entity.

Mr Legg—It comes back to that basic point of the different nature of the prudential regulation and how prudential regulators operate compared with market conduct regulators, who are more inclined to set standards and then enforce them by punishing or taking action against those that fail to meet them. A prudential regulator really needs to have a relationship with the entity where it understands problems long before they come to a head. It is at the coalface in the emergence of potential problems.

Senator BERNARDI—You said that these amendments are closely aligned with the Corporations Act but they cannot be as prescriptive as the Corporations Act because of that reason. Is that right?

Mr Legg—That is right. There is the basic difference between the nature of prudential regulation and the nature of market conduct, which means that you cannot have them exactly identical.

Senator BERNARDI—On another matter, the Bankers Association have raised some questions with regard to APRA's power to make discretionary decisions, and notwithstanding exactly what you have just said. They were seeking that APRA should be required to disclose on a quarterly basis through a public medium the interpretations for any discretionary decisions for that period, including an explanation of the grounds for its prudential decisions when that discretionary power has been exercised. What is your response to that?

Dr Moore—That is really a matter for APRA to consider. We have forwarded the submissions to APRA so it can consider relevant elements. One comment I would make about that is that there may be limits to what APRA can disclose in certain circumstances given that APRA is bound by its secrecy provisions under section 56 of the APRA Act.

Senator BERNARDI—That would make it very difficult for us to include it into the bill for a disclosure.

Dr Moore—It may limit the extent to which APRA can release information about the specific decisions it has made about exercising discretion.

Mr Legg—APRA needs to work with its regulated entities to solve problems early and be in a sort of problem prevention role rather than a standard enforcement role. APRA needs a spirit of cooperative involvement with boards and senior management, where boards and senior management have the ultimate responsibility for the prudential management of the company.

Senator BERNARDI—In their submission ABA mentioned the harmonisation of prudential acts with corporations acts, and you have answered my next question to some extent. Where possible, is it Treasury's intention to continue to support the harmonisation of these acts?

Mr Legg—As a matter of principle, if further issues are raised with us which point to solutions which would harmonise them, we would certainly consider them quite sympathetically.

CHAIR—This bill implements the outcome of the regulation task force report—is that right?

Mr Legg—Yes, and other measures which are consistent with the spirit of that.

CHAIR—Were all those recommendations accepted?

Mr Legg—All the recommendations in the report relating to prudential regulation were accepted.

CHAIR—And there has been an industry roundtable discussion on the draft bill—is that right?

Mr Legg—That is correct.

CHAIR—Is there anything further you wish to add in relation to the Australian Bankers Association submission?

Dr Moore—On any particular aspect? I have nothing more to add.

CHAIR—Anything over and above what has already been raised?

Mr Legg—Nothing from me; nothing that I would wish to say in general terms about the submission.

Dr Moore—Or from me, Chair.

CHAIR—They have raised some concerns, and I will take at face value the comments you made about some ongoing discussions with them in relation to that matter. The committee has no more questions. Mr Legg and Dr Moore, thank you very much for assisting the committee this afternoon. I made an assumption that you had received the standard introductory procedural commentary in relation to your attendance at these hearings—your evidence in camera and objecting to answering a question et cetera. I will take it that you had that

information; I do not think we have got ourselves into any trouble in that regard. Thank you again for your attendance.

Mr Legg—Our pleasure.

Proceedings suspended from 3.07 pm to 3.17 pm

CICCHINI, Mr Raphael, Manager Small Business and Trusts, Business Tax Division, Department of the Treasury

GRAZIANI, Mr Robert, Adviser, International Tax Unit, International Tax and Treaties Division, Department of the Treasury

MALLORY, Mr Alan, Manager, Benefits Unit, Personal and Retirement Income Division, Department of the Treasury

Evidence was taken via teleconference—

CHAIR—I welcome officers from the Treasury in relation to the Tax Laws Amendment (2007 Measures No. 4) Bill 2007 and related bills. Have you given evidence to a committee before?

Mr Graziani—No.

Mr Cicchini—I have.

CHAIR—Would you happen to have briefed Mr Graziani in relation to the introductory procedural matters?

Mr Graziani—I have had some briefing from some of my superiors.

CHAIR—In relation to answering questions, taking objections and questions on opinions of policy et cetera?

Mr Graziani—Broadly, yes. I think my colleagues can probably hold me in good stead if I cannot answer certain things.

CHAIR—Unfortunately the obligations are on me, as opposed to you. I take it that you are both aware of those matters. Would you like to make an opening statement first and then we will move to questions.

Mr Graziani—The key objectives of the new foreign income tax offset rules were to remove the quarantining of foreign losses from domestic income, and the associated ability to quarantine domestic prior year losses from assessable foreign income, to remove the need to quarantine foreign losses and excess foreign tax into classes of foreign income, and to streamline the remaining foreign tax credit rules and their requirements, rewriting them into the Income Tax Assessment Act 1997. They were the key objectives.

CHAIR—Nothing further to add?

Mr Graziani—No.

Senator STEPHENS—We have not received very many submissions on this issue, but those we have received have expressed their concerns about the way in which the amendments create inconsistencies. Have you had a chance to read the submissions?

Mr Graziani—I have. We understand that there is only one submission that pertains to schedule 1, the new foreign income tax offset rules, and that is from the Australian Bankers Association.

CHAIR—That is correct.

Senator STEPHENS—Yes, that is right. They make some commentary about their concerns with those inconsistencies. In particular, they suggest that the transitional provisions need to be amended and that there needs to be clarification in drafting the foreign tax offset limit to ensure there is consistency. They also commented on the way in which the anti-avoidance provisions have been drafted. They have some concerns that that might put Australian lenders at a commercial disadvantage. Do you have any response to those concerns?

Mr Graziani—There are five issues, effectively, that the ABA submission raises. The first three pertain to the OBU regime, the fourth one pertains to the treatment of debt deductions in relation to the new foreign tax offset cap, and the last one pertains to the anti-avoidance rules. Going from last back to first, the anti-avoidance rule is basically a rewriting of the current rule, section 6AB(5A). Treasury's view is that the scope of the rule has not been materially affected, in which case the example of concern raised by the ABA here would be a concern under the current rules as well. That is our view on that matter.

Senator CHAPMAN—We have received a submission from Pitcher Partners advisers about the amendments relating to family trusts in which they assert that the issues which were raised by the Institute of Chartered Accountants and which I also raised, which resulted in this legislation, have only partially been addressed. They raised about 15 or 16 points. I assume you have considered those. I wonder what your response is to those issues raised by Pitcher Partners.

Mr Cicchini—I will be dealing with the family trust election measure in chapter 8 of the bill. This piece of legislation is basically intended to amend the family trust loss regime to provide more flexibility to family trusts. It does this by allowing family trust elections and interposed entity elections to be revoked or varied in more circumstances than is currently available under the law. It also broadens the scope for who can be members of the family in terms of the definition. It exempts certain other people from being subject to family trust distribution tax when they receive a benefit if they are no longer within the family group. It is designed to provide more flexibility.

The submission from Pitcher Partners has been considered. The background to this measure is that the government made an announcement in the 2006-07 budget to do certain things. Earlier this year, Treasury undertook consultation on the details of how that would be implemented. Pitcher Partners were involved in that process. Pitcher Partners were also involved in the process of consultation on the draft legislation. The draft legislation that was consulted on reflected the decisions of the government in terms of what it would or would not allow.

A couple of issues that were raised in Pitcher Partners' submission—which is comprehensive but I note that it attached a submission from the Institute of Chartered Accountants—have been previously considered by the government. In fact, many of these issues have been considered by the government but it has not adopted all of them. I will take you through some of the key ones. There is a suggestion that, once a trust has incurred losses and there is no requirement for the family trust election to be in place, they should be able to revoke it. One needs to appreciate that the family trust election regime is a concessional

regime. It allows you to access losses that you would not normally be able to access because you do not meet the normal rules for carrying forward and deducting tax losses.

It is a concessional regime. By opting into it, it allows you to utilise the losses and keep them within the family group, but there is also a penalty if you distribute outside the family group. So these are tax losses and benefits that you would not normally be able to utilise but for being able to elect into the regime. Of course, once you elect into the regime, you are subject to its rules and therefore need to consider whether or not it is necessarily appropriate for you to do that. If you had a regime where you could just fill in a form, obtain your tax benefits and then say, 'I've got my tax benefits and I would like to get out now,' then arguably there would not be much point to such a regime. The rules are designed to say that once you are in, you are in. There are certain ways to revoke elections in special circumstances, and this piece of legislation identifies those particular circumstances.

Senator CHAPMAN—What stage are you at with finalising the response to the related issue that I raised, which was to remove as a capital gains tax event the amendment of a trust deed to remove the vesting date?

Mr Cicchini—It is not part of this bill—

Senator CHAPMAN—No, it is not.

Mr Cicchini—so I cannot comment on that. We do not have the capital gains tax people here. It is not a part of this bill.

CHAIR—You would have seen the commentary from AFMA in relation to schedule 3.

Mr Cicchini—Yes, investment in instalment warrants. We have someone here from the superannuation area. I will put him on. It is Mr Mallory.

CHAIR—Mr Mallory, AFMA have thanked you for your consultation process. They say they believe the provisions in the bill will maintain the high level of regulatory protection afforded superannuation fund investors in instalment warrants. They did recommend an amendment to exclude an instalment trust. What views did Treasury have on that?

Mr Mallory—I think we need to look at the background for the amendments that we actually have in the bill. What gave rise to the amendments was the government's decision to allow longstanding industry practice to continue following a conclusion by the Commissioner of Taxation and APRA that instalment warrants constituted borrowing. So these amendments that we have in the bill at the moment are specifically directed at facilitating the continued investment by superannuation funds, particularly small self-managed super funds, in instalment warrants.

The issue raised by AFMA is in respect of instalments where there is no borrowing involved, so it is somewhat outside the scope of the provisions of the bill. We actually have not formulated a view on this issue yet. I think we would need to ascertain a bit more as to what the scope of that particular market is. It appears to be a very narrow market. But, as I said, the scope of the bill is specifically to deal with the issue about instalment warrants and the borrowing that is involved with them. The issue raised by AFMA is similar to instalment receipts where there is no borrowing involved.

CHAIR—Thank you for that. Thank you very much, gentlemen, for your assistance to the committee. You are now excused.

[3.37 pm]

KLJAKOVIC, Ms Marian, Manager, Market Integrity Unit, Department of Treasury

LEGG, Mr Chris, General Manager, Financial System Division, Department of Treasury

LYON, Mr Christopher Graeme, Senior Adviser, Department of the Treasury

RUECKERT, Ms Michelle, Policy Analyst, Insurance Access and Pricing Unit, Markets Group, Department of the Treasury

Evidence was taken via teleconference—

CHAIR—Welcome. We are addressing the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007 and the Corporations (National Guarantee Fund Levies) Amendment Bill 2007. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken, and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

I remind senators that the Senate has resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. Any claim that it would be contrary to the public interest to answer a question must be made by a minister and should be accompanied by a statement setting out the basis for the claim.

Would someone like to give the committee an overview of the bill before I ask my colleagues whether they have any questions?

Mr Legg—I will make introductory comments and then we will be very happy to answer any questions you may have.

CHAIR—Thank you.

Mr Legg—I suspect that members know that the regulation of discretionary mutual funds and direct offshore foreign insurers arose out of a recommendation and comments in the 2003 HIH Royal Commission report. In response to that, in 2004 the government commissioned a review of DMFs and DOFIs, and in 2005 Treasury released a discussion paper looking at how to implement the outcome of that review. We had further consultation with interested

stakeholders, including all the stakeholders who provided submissions to this inquiry, and the government announced its approach to regulating DMFs and DOFIs on 3 May 2007. This bill seeks to implement that announced approach. My comments from here on will focus solely on direct offshore foreign insurers because I do not think any issues have been raised in submissions about DMFs.

In essence, the approach being adopted is seeking to protect Australian consumers and businesses from poorly capitalised DOFIs based in regimes where there may be minimal prudential regulation, but to do that in a way so that, at the same time, it creates a level playing field in the Australian general insurance market, encouraging competition and the development of innovative new insurance products to meet the needs of Australians. The government recognises in this that there will be insurance risks that cannot be appropriately placed with insurers authorised by APRA, and that is why the Minister for Revenue and Assistant Treasurer noted in his announcement that there will be limited exemptions for these insurance risks. The five public submissions received by the inquiry mostly focused on the issue of these exemptions, which is why I say that for the rest of this we will just focus on that. Treasury has been consulting very actively with interested stakeholders—including the stakeholders who have provided submissions—with an eye to developing a discussion paper which would seek stakeholder input into how the mechanism for granting an exemption will operate. Our plan is to release that discussion paper in August, and we will be encouraging all interested stakeholders to respond to the paper.

It is obvious from a look at the submissions that there is an issue of balance to be struck in this exercise. We are trying to ensure the continuing availability and affordability of insurance for Australian consumers and businesses while not crafting an exemption that is so broad that it undermines the government's announced approach to regulating DOFIs and the intention of that in the first place. We are also trying to seek an exemption mechanism that is practical and takes into consideration how the Australian insurance industry operates. The exemption needs to minimise the costs to Australian insurers in obtaining an exemption and it also needs to minimise the costs to government in administering an exemption. We are looking for a mechanism which will be flexible to operate effectively through the insurance market cycle, which tends to move from being fairly hard at times, when it is hard to get cover, to a softer market, as in current circumstances, when cover is relatively easily accessible at a reasonable cost.

Our intention is to consult further with interested stakeholders once we have had an opportunity to consider their responses to our discussion paper, which we are aiming to get out, as I said, next month. The timetable would be to then release an exposure draft of the insurance regulation, setting out the exemption later this year or early next year, subject to the agreement of the government, so that we can finalise the exemption early next year and give people sufficient time to apply for such an exemption, if it is required, before the proposed commencement of the new regulatory regime on 1 July 2008. That is all I wanted to say in terms of introductory comments. We are very happy to try to answer any questions you have.

Senator BERNARDI—On the DOFIs, the direct offshore foreign insurers, you said that the intention of this bill was to ensure that there is a level playing field in Australia. By that, I

presume that you want to ensure that we have an effective and open insurance market as well, whereby those that want insurance can actually get it. Is that correct?

Mr Legg—That is right.

Senator BERNARDI—How do you respond to claims by some submitters, such as the Association of Consulting Engineers Australia, who raise concerns about their ability to obtain adequate levels of professional indemnity insurance?

Mr Lyon—We have been talking closely with the Association of Consulting Engineers Australia. We recognise their predicament. They experienced difficulties obtaining insurance in the wake of the HIH collapse, and they have worked very hard to insure that they have appropriate insurance arrangements in place themselves. Our response to their concerns about their continuing ability to obtain insurance that meets their needs is that we would be willing to work with them to develop arrangements that would allow certainly the larger of the engineering firms to continue to access insurance from foreign insurers if they are unable to obtain appropriate forms of insurance within the Australian market. So we recognise their needs and we have been talking to them and endeavouring to work with them to explore how arrangements might be established that could allow the bulk of the membership of the larger consulting engineering firms to continue to obtain adequate amounts of insurance on the assumption that smaller engineering firms would be able to obtain insurance in Australia. However, if there were special risks that needed to be covered because of the unique nature of the engineering business they conducted, those special risks may, in their own right, be something which would qualify for an exemption, and we would propose to allow that to go offshore. Furthermore, one fundamental element with this regime is to encourage foreign insurers who have been providing insurance into the Australian market to come into the market. We have had some early indications that there are some foreign insurers who are willing to come in.

Senator BERNARDI—Have the insurers who have indicated that they are interested in coming in raised any concerns about additional compliance costs or red tape to their business that may result in an increase in insurance premiums for Australian insurers?

Mr Lyon—The insurers I am thinking of are large, reputable insurers who have a presence in many jurisdictions. Their decisions to enter the Australian market are, of course, commercial decisions that are decisions for them to make. The additional cost to them of entering the Australian market is not insubstantial in nominal terms but, as a proportion of their overall business, it would not be necessarily very large, and if it allowed them to continue to supply insurance to clients who they valued in the Australian market, they may well choose to do that.

Senator BERNARDI—So Treasury does not anticipate that there is going to be any meaningful decrease in competition or additional costs to those people seeking insurance in Australia?

Mr Legg—The intent of the bill is to ensure that differences in regulation do not inhibit competition, or give one particular source of insurance an advantaged position because they are not regulated. At the same time, as I said earlier, we are very focused on the need to ensure that the crafting of the exemption ensures the ability of groups like consulting engineers or

other professional groups to be able to get cover offshore if it is not available here and also the right incentive for domestic insurers and others who want to be regulated here to develop the ability to provide cover if they see a commercial incentive to do so. So we are trying to get that balance right. The balance will hinge on the design of the exemption, which is what we have indicated to stakeholders we want to consult very closely with them on.

Senator BERNARDI—Which I applaud you on. I think the exemption is a very important part of the insurance market going forward. Is it the intention of the exemption provisions that if one of the national bodies—not only of engineers, but also, for example, the National Insurance Brokers Association, or one of their members—raised the inability to obtain insurance in the Australian market for a specific instance then it could accommodate that?

Mr Lyon—One of the challenges that we face when we are talking to industry about how the exemption arrangements might be structured is to ensure, as Mr Legg noted earlier, that we have exemption arrangements that meet the needs of how the insurance industry works but minimise compliance costs and the like. We imagine that there might be arrangements that will be enduring, and that might, through regulation, persist and allow people who need the insurance from foreign insurers to go off and get that without having to go to any regulator or administrator. However, in some unique cases it may be necessary for there to be a regulator that has a discretion that can provide an exemption from the arrangements at very short notice, and that is an arrangement that we will be consulting on and that we do recognise might be needed.

However, one of the challenges that the Treasury—and, indeed, all the stakeholders in these discussions—has faced over many years is that, whilst there is a lot of anecdotal discussion about the needs of Australian insureds to obtain insurance from foreign insurers, when people are asked for firm examples, there is limited information being brought forward. As a result of that, one of the things we have built into this regime is that, assuming an exemption is put into place, when insurance is purchased from foreign insurers we will be endeavouring to gather data on that insurance so that we can make transparent, to both the domestic industry and to insurers overseas, what insurance is going offshore, so that over time we can refine the balance and ensure that balance continues to serve the needs of the Australian community.

Senator BERNARDI—Whilst this bill is designed to protect the integrity of the Australian market, is a by-product that it would limit the abuse of offshore captive insurance companies by corporations trying to claim tax deductibility for premiums that, really, there is no meaningful re-insurance provision for?

Mr Lyon—The driving motivation behind the legislation is a prudential one—that is, to protect Australian policyholders and purchasers of insurance. Tax treatment has not been an element that has driven the formation of this.

Senator BERNARDI—But it may be a by-product of it.

Mr Lyon—One of the challenges that we are facing in terms of developing this regime is the question of how we treat captive insurers—corporate captive insurers, in particular—who might be based in a range of jurisdictions around the world such as Singapore, Bermuda or New Zealand. From our perspective, we are not being driven by the tax treatment of those

insurers. I would like to clarify, Senator, whether your concern is about the business tax that the companies that own those captives must pay in relation to those insurers or whether you are more concerned about the stamp duty and fire service levy issues that have been raised by some of the submitters to your committee?

Senator BERNARDI—It was a personal inquiry. It was more about the integrity of the taxation implications of it.

Mr Lyon—There is no doubt that, to the extent that we can have more robust prudential regulation and a clearer definition and defining line between those insurers who must be authorised and regulated in the Australian market and those who do not need to do that, we can have greater clarity in terms of the tax consequences that flow from that.

Senator BERNARDI—Thank you very much.

Senator STEPHENS—I want to go back to the genesis of this bill. I understand that it comes, in part, from a regulatory gap identified in the International Monetary Fund's Financial Sector Assessment Program for Australia in 2006. Has it solely been driven by domestic circumstances, or has there been any kind of request or interest in Australia resolving this from other countries?

Mr Legg—The origin of this issue goes back to the HIH royal commission. It is certainly true that the IMF noted this issue in their financial sector assessment. We felt that, in terms of our compliance with international standards, they may have been overstating the significance of this issue from that point of view. So we were not being driven by international standards in doing this; we were doing this because we felt that the issues raised in the royal commission and, subsequently, in the Potts report were valid interests in terms of the integrity of the domestic market.

Senator STEPHENS—Thank you for that. I was interested in Senator Bernardi's question about the tax implications of the measure, and that prompted me to think about whether or not this would constitute parts of any bilateral or multilateral agreements or treaties with other countries.

Mr Lyon—Australia is part of the World Trade Organisation and has free trade agreements with a number of jurisdictions. A number of those free trade agreements and our World Trade Organisation obligations cover financial services, and the regulation that the government is proposing here, the changes to legislation, to the best of our understanding, at this time, are compliant with all those obligations. Those international agreements allow jurisdictions to make appropriate laws to ensure appropriate prudential regulation of financial services providers in their jurisdictions.

Senator STEPHENS—What would be the proportion or the value of the sector that is affected by DOFIs and DMFs?

Mr Lyon—That is a very difficult question to answer and is one that has been disputed throughout public debate on this question. The Potts review, which was released in May 2004, estimated that direct offshore foreign insurance consisted of 2.5 per cent of the premium value of the general insurance market in Australia.

CHAIR—And DMFs?

Mr Lyon—DMFs consisted of something of the order of 0.5 per cent of the general insurance market.

Mr Legg—As my colleague said, these figures have been disputed. There have also been claims made that since that time those numbers have grown. With regard to discretionary mutual funds, this is the reason that the main thrust of the response is to gather data—more data—which shows just how significant this issue is. Similarly, on the DOFIs we will, as my colleague said, be collecting data here as well. The outcome of this will be that not only will we in the DOFI area improve the integrity of prudential regulation but also there will be more information down the track to give a sense of how significant this issue is.

Senator STEPHENS—You mentioned that consulting engineers were perhaps one group that would be covered by the exemption for risks that cannot be adequately insured domestically and be placed with insurers not authorised in Australia. What other kinds of activities would be exempt?

Mr Lyon—It is a matter for the government as to how any exemption arrangement is established. From the Treasury's point of view, we think it is preferable to have an exemption that is not group specific, if we can possibly avoid it. However, there is a range of groups who do benefit from foreign insurers in one way or another. Some of the ones that I can think of are: a foreign insurer providing insurance to the Real Estate Institute of New South Wales; some of the law societies in Australia obtaining insurance from foreign insurers; some sporting groups that have obtained insurance from foreign insurers; and, for example, the four major accounting firms all use insurance arrangements that are based offshore.

Senator STEPHENS—Does this in part reflect the global nature of these economic activities?

Mr Lyon—It certainly does when you consider that the larger advisory firms—for example, when you are contemplating lawyers or accountants or other professional groups—usually have an international network and will often meet their insurance needs through specialised insurance arrangements. The other group that might benefit from some kind of an exemption and continuing access to foreign insurers is some of our large multinational businesses—for example, BHP Billiton has a domestic insurer that meets its needs in Australia, but it also obtains insurance from the world market. Companies such as the Foster's Group have insurers based in foreign jurisdictions that provide insurance cover into Australia.

Senator STEPHENS—Schedule 2 of the bill includes a strict liability offence for breaches of the new section 985D. What are the penalties around that?

Mr Lyon—The penalty is 50 penalty units. One penalty unit is $110, so $5,500 if the maximum fine were applied. It is proposed that the offence be inserted into chapter 7 of the Corporations Act. The Australian Securities and Investments Commission would be the regulator that would investigate and enforce the offence. It would have all of its usual suite of powers to ensure compliance. For example, it could seek an injunction from a court to stop continuing contravening conduct.

Senator STEPHENS—Do you have any comment to make about the Corporations (National Guarantee Fund Levies) Amendment Bill?

Ms Kljakovic—Very briefly, this bill imposes a cap on levies that are payable in any financial year to the National Guarantee Fund. That fund has existed for 20 years. It has always been adequate to meet demands from ASX investors, so there never has been a levy. However, participants do have a potential unlimited liability to levies and the bill aims to cap that potential liability. Each year that would be equal to the minimum amount that must be kept in the fund. That minimum amount is set under the Corporations Act and currently it stands at $76 million. So it is considered that a cap set at that level per year would not unduly restrict the ability to levy.

CHAIR—In relation to that matter, I notice that the ASX submission states:

ASX believes that the imposition of a cap on the levies payable by exchanges and their participants in any one year offers the potential to allow the National Guarantee Fund (NGF) to attract a wider range of, well-capitalised, institutions to consider direct participation in ASX markets and associated clearing facilities.

Its view was that a theoretical unlimited levying power restricted some activity. Would you agree with that comment?

Ms Kljakovic—That is perhaps slightly speculative. I am afraid that we do not have a firm view as to whether or not it would have that effect.

Mr Legg—As I understand it, one of the issues is that Australian banks currently participate as subsidiaries. Because of the uncapped nature of their involvement, APRA will not let them participate in the scheme directly but will allow them to set up a subsidiary who then participates in the scheme. Putting a cap in place removes those sorts of nuisance distortions.

CHAIR—I will rephrase my question. Do I take it that you can see no reason why that commentary would not have the sort of outcome they anticipate?

Ms Kljakovic—That is correct.

CHAIR—Thank you very much for your attendance and for assisting the committee by being available earlier than was originally planned. You are excused. That now completes our inquiry in relation to these bills. I thank all senators who have attended today, particularly Senator Stephens and Senator Bernardi, who have been here for the duration. I thank Hansard and the secretariat. I particularly thank Dr Richard Grant and Dr Andrew Gaczol for their assistance. The committee has had a very significant program this week, for which a significant amount of preparation was undertaken. An enormous amount of work has been put into this inquiry, and I thank you both most sincerely for that.

Committee adjourned at 4.08 pm