



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

**Reference: Effectiveness of the Trade Practices Act 1974 in protecting small
business**

FRIDAY, 7 NOVEMBER 2003

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SENATE
ECONOMICS REFERENCES COMMITTEE

Friday, 7 November 2003

Members: Senator Stephens (*Chair*), Senator Brandis (*Deputy Chair*), Senators Buckland, Chapman, Ridgeway and Webber

Participating members: Senators Abetz, Barnett, Boswell, George Campbell, Carr, Cherry, Conroy, Coonan, Eggleston, Faulkner, Ferguson, Ferris, Forshaw, Harradine, Harris, Kirk, Knowles, Lees, Lightfoot, Ludwig, Mackay, Mason, McGauran, Murphy, Murray, Payne, Sherry, Stott Despoja, Tchen, Tierney and Watson

Senators in attendance: Senators Barnett, Boswell, Brandis, Buckland, Chapman, Murray, Stephens and Webber

Terms of reference for the inquiry:

To inquire into and report on:

1. Whether the Trade Practices Act 1974 adequately protects small businesses from anti-competitive or unfair conduct, with particular reference to:
 - (a) whether section 46 of the Act deals effectively with abuses of market power by big businesses, and, if not, the implications of the inadequacy of section 46 for small businesses, consumers and the competitive process;
 - (b) whether Part IVA of the Act deals effectively with unconscionable or unfair conduct in business transactions;
 - (c) whether Part IVB of the Act operates effectively to promote better standards of business conduct, and, if not, what further use could be made of Part IVB of the Act in raising standards of business conduct through industry codes of conduct;
 - (d) whether there are any other measures that can be implemented to assist small businesses in more effectively dealing with anti-competitive or unfair conduct; and
 - (e) whether there are approaches adopted in Organisation for Economic Co-operation and Development (OECD) economies for dealing with the protection of small business as a part of competition law which could usefully be incorporated into Australian Law.
2. That the committee make recommendations for legislative amendments to rectify any weaknesses in the Trade Practices Act identified by the committee's inquiry.

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Committee met at 8.34 a.m.

ANTICH, Mr Robert Alan, General Manager, Compliance Strategies Branch, Australian Competition and Consumer Commission

CASSIDY, Mr Brian David, Chief Executive Officer, Australian Competition and Consumer Commission

KING, Mr Sean Patrick, Deputy General Counsel, Australian Competition and Consumer Commission

MARTIN, Mr John, Commissioner, Australian Competition and Consumer Commission

RIDGWAY, Mr Nigel Cameron, Deputy General Manager, Compliance Strategies Branch, Australian Competition and Consumer Commission

SAMUEL, Mr Graeme Julian, Chairman, Australian Competition and Consumer Commission

SMITH, Mr David F., Executive General Manager, Compliance Division, Australian Competition and Consumer Commission

CHAIR—Today the committee will continue taking evidence on its inquiry into the effectiveness of the Trade Practices Act 1974 in protecting small business. The terms of reference for the inquiry direct the committee to examine whether the Trade Practices Act 1974 adequately protects small businesses from anticompetitive or unfair conduct, with particular reference to whether section 46 deals adequately with abuses of market power, whether part IVA deals effectively with unconscionable or unfair conduct, whether part IVB promotes better standards of business conduct, whether there are any other measures which could assist small businesses to deal with anticompetitive or unfair conduct and whether approaches to small business and competition law in other OECD economies could usefully be incorporated into Australian law. This is the fifth day of hearings on this matter.

Before we commence taking evidence, I advise all witnesses that, because the Senate has been recalled for a sitting at nine o'clock, we will have to take a short break at five to nine and then we can come back. I also want to reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. The committee prefers all evidence to be given in public, but under the Senate's resolutions witnesses have the right to request to be heard in private session. I welcome back the representatives of the Australian Competition and Consumer Commission. Mr Samuel, can we recap from where we left off last Friday? Do you have an additional opening statement to make in response to any of the discussions that we had last week?

Mr Samuel—I do not want to catch you unawares again, Madam Chair, but last time I thought it would be more productive if we moved straight to questions, so I am happy for you to do that again.

CHAIR—Okay—

Senator MURRAY—It sounds like you are.

CHAIR—I had something churning around in my head just then—be fair. One of the things you suggest in your submission is voluntary codes. Can you elaborate on how you think voluntary codes would be an effective response to strengthening section 46?

Mr Samuel—We should emphasise that voluntary codes are not intended to strengthen obligations under the Trade Practices Act. They never were. They are not intended to be a substitute for obligations under the Trade Practices Act; they never were and never can be, because the act is there and it will be enforced in the appropriate manner by the ACCC. Voluntary codes are primarily intended to deal with issues involving what I will call business-to-business disputes. These primarily concern big business and small business disputes and concern for the rise in particular industries where a code of conduct might set out a course of behaviour between large and small business operators within an industry and that deals with concerns that might otherwise be felt to be inappropriate to be dealt with by regulation. The commission has, for some time, been dealing with codes of conduct which range from purely voluntary codes through to mandatory codes which apply under part IVB of the act.

I will put aside the mandatory codes for the moment, which are almost the equivalent of regulation, and deal with voluntary codes. There are a number of step-up processes involved in voluntary codes. There are voluntary codes which I would describe as being relatively ineffective. They are codes which, if I can take an almost black-and-white example, indicate that a course of behaviour is to be pursued by the parties at their will, but they might explicitly state that there is no obligation on the part of the parties to comply with the codes, there are no enforcement regimes contained within the codes, there are no penalties for breaches of the codes. The commission's view is that they are rarely effective codes. They state at the commencement almost a cultural intent that they are there in name only but rarely have the spirit or culture of compliance attached to them. The commission has little interest in those codes and little interest in those that want to promote those codes.

If I can move up a level to what I call 'effective codes', effective codes are those that have been developed between members of an industry in a spirit of endeavouring to resolve concerns, to resolve issues of debate and concern within an industry, with a view to them being effective. They will almost invariably contain provisions for transparency, accountability, administration of the code by an effective administrative body within the context of the industry itself and compliance, and penalties for non-compliance. These might include suspension from participation in certain sectors of the industry and the benefits that might be involved by being participants, for example, in industry organisations.

What the ACCC have done very rarely in the past is to take effective codes and say, 'These codes can actually be stepped up to an even higher level of compliance and a higher level of behaviour. If they can be stepped up, then the commission would be prepared to endorse those codes as having a stamp of approval by the ACCC or a stamp of endorsement by the ACCC.' So we announced, just two or three months ago, a process whereby we would be prepared, in conjunction with industry groups, to look at codes that have already got to the level of effective, and we are now looking at a higher level of potential endorsement. As I have said on many occasions, endorsement will be hard to obtain and easy to lose. It involves a number of

principles which we have since issued by way of guidelines for discussion. Nigel, have we tabled a copy of those guidelines?

Mr Ridgway—If we haven't, I will make sure we bring one, if we can.

Mr Samuel—Thank you. They cover a whole range of issues. It is an attempt to see whether industries which have an underlying culture or spirit of compliance with the codes of conduct, with the behavioural standards that are contained within these codes, are prepared to engage with us to ensure that what we have is absolute transparency, absolute accountability and absolute enforcement procedures that are capable of being audited. If so, then we may be prepared to consider the endorsement of those codes. I should indicate that we would not be contemplating the endorsement of a code that has simply, on its face, satisfied our guidelines. One of the fundamental requirements is that there be a culture of compliance within the industry concerned, so one of the precursors to endorsement would be a period of at least 12 months during which the industry deals with what we regard as an effective code so that we can then determine whether or not it is appropriate for endorsement. The last thing that the commission would want to do is endorse a code that appears, on its face, to be effective where in terms of the industry itself there is not the culture of compliance.

CHAIR—How long ago did you put out these draft guidelines for discussion?

Mr Samuel—About three weeks ago they went out.

CHAIR—So it is early days in terms of getting any feedback?

Mr Samuel—Yes. I should say that, when we announced the initiative of endorsement, we received a number of approaches from industry groups that said they wanted to work with us in the context of working towards endorsement.

Mr Ridgway—We have had 12 industry groups approach the ACCC proposing to get support to go through the endorsement process.

Mr Samuel—Very often these are dealing with issues where governments would find it difficult, if not inappropriate, to bring about regulation. It is the sort of area where we are dealing with issues of concern that arise between small and big business. They are issues that change—they evolve over time—and government regulation can be somewhat inflexible in dealing with some of those issues. So we are looking at a position where industry itself can respond to changes that will occur in industry environments and is able to adapt its codes in terms of behavioural issues in a reasonably quick response to changing community expectations and changing industry expectations.

CHAIR—Coming to the issue of industry expectations, Mr Samuel, did you see the article entitled 'ACCC's epic plans fall flat' in the *Australian Financial Review* on 15 October this year?

Mr Samuel—Yes.

CHAIR—That article suggests that the ACCC's program so far has been fairly slow, and some business groups seem to think the standards are too tough. Would you like to respond to those criticisms?

Mr Samuel—I am always cautious about responding to criticisms of particular journalists in particular articles of particular newspapers because they very often do not represent what is truly happening. I will point to an interesting contrast to the by-line of that article. I think the day after I announced the proposed industry codes, the headline was something to the effect that 'Samuel was promoting a deregulated environment'—in other words, this was a process to enable big business to absolve itself from compliance with the Trade Practices Act. I then noticed in the second part of the episode, if you like, that suddenly these guidelines are so tough that business is baulking at the prospect of compliance. It shows that contradictions occur in some of the reporting of this matter.

If you examine that article I think you will find that the reported comments of reticence about adoption of our guidelines or pursuit of our guidelines came from one particular industry group—I think it was the Australian Retailers Association. I am not sure that that relates so much to the level of obligations imposed in the guidelines as to potentially a reticence on the part of that organisation to even contemplate a code of conduct in the first place. That may be misstating that particular organisation's aspirations and motive—but it does not really matter. What is important to note is that, very soon after we announced the initiative of endorsed codes of conduct, we received three or four approaches from organisations that said they wanted to be first cab off the rank. They are organisations that in general would demonstrate a culture of compliance, a culture of wanting to engage with us in developing proper ethical standards of behaviour, particularly on a business-to-business basis and sometimes on a business-to-consumer basis. That is a good starting point.

I am not aware of all the details of the 12 which Mr Ridgway has referred to, but we would be dealing with those primarily if we sensed on their past behaviour that there was a culture of compliance. Where organisations are perhaps not focusing on cultures of compliance or not focusing on wanting to develop those standards of behaviour, then frankly we will have little to do with them in developing any form of code of conduct.

CHAIR—The article also suggests that consumer groups think that the standards are too weak. Were consumer organisations consulted in the drafting of the code?

Mr Ridgway—The ACCC have a fairly regular consultation process through our Consumer Consultative Committee with a number of consumer organisations. We did discuss the guideline as we were developing it. We of course have circulated the guideline, which is in a draft form, to all of our Consumer Consultative Committee members, as well as to a large number of consumer organisations. The process at the moment is that the guideline in draft form currently on our web site is very much that—a draft guideline; and we are seeking comments. We have responded to and consulted with the individual who was quoted in the article, and that process is helping us to develop the guideline.

Mr Samuel—I would think it highly unlikely that the commission would respond to comments such as those you have referred to from business groups by seeking to water down our guidelines. These are benchmarks of behaviour and you do not, if I might say so, adjust

benchmarks of behaviour to meet industry concerns. What we are far more concerned about is community expectations and community concerns. So I would think it most unlikely that there would be any watering down of the guidelines. In terms of consumers groups, we also need to respect that certain standards of behaviour often cannot be achieved by any form of voluntary code of conduct. They ultimately require some form of regulation, because you are dealing with generally a small but ultimately quite damaging part of industry. They will be the mavericks in the industry that simply do not understand what proper behaviour and compliance with the law is about, and they ultimately have to be dealt with by regulation. Voluntary codes of conduct are simply anathema.

CHAIR—On the voluntary codes, the committee has been looking at a comparison of the enforcement powers of different organisations. Does the ACCC have the power to endorse voluntary codes?

Mr Samuel—In all the examinations, it has never been raised that we do not have the power. Remember that an endorsement is not a formal process. It is a process of saying that this code has been examined by the commission; it has been worked up with the commission, and the commission is satisfied that the code satisfies our guidelines in terms of both the content of the code and the culture of compliance. I should emphasise one thing: endorsement by the ACCC is not the same thing as authorisation. Authorisation is the formal power we have under the act, and that is a formal power that is there to deal with a specific issue of anticompetitive content of, for example, codes of conduct.

Where there are anticompetitive aspects of a code of conduct, they will need to go through a separate process of authorisation to satisfy the commission that the public benefits associated with the code exceed the anticompetitive detriments. Authorisation may well take place with a whole range of codes of conduct, including those that we regard as being ineffective codes for the purposes of this exercise. Endorsement is a separate exercise that involves our assessing whether the issues of codes of conduct—the issues of behavioural standards and of ethical standards—within the industry are such that meet certain requirements, meet community and business concerns and that there is a compliance culture within the industry.

Mr Cassidy—We have looked at some issues relating particularly to the disendorsement process—if I can call it that—such as natural justice and due process. We are satisfied that the processes outlined in our draft guidelines—that is, if we had endorsed a code, then found it was not being complied with and was not being properly enforced and therefore we wanted to disendorse it—would meet any of those sorts of concerns about due process and natural justice. Even though there is no formal head of power under the act for endorsing voluntary codes, we think we are—if I can put it this way—on fairly safe legal ground in terms of what we are proposing to do.

CHAIR—You have sought legal advice?

Mr Cassidy—It is internal legal advice. In the commission we are blessed with having ready sources of legal advice on hand.

CHAIR—Is it possible for the committee to get a copy of that advice?

Mr Cassidy—That is a good question. Was it written or did we do it orally?

Mr Ridgway—It is oral at this stage, I believe.

Mr Cassidy—If it would help, we could do something which canvasses what we think are the relevant issues relating to endorsing codes and what we are proposing to do to meet those issues.

CHAIR—Thank you, that would be very helpful. Mr Samuel, you made the comment about not necessarily responding to organisations commenting in the press about these issues, but some small business groups have been quite sceptical about the benefits of the proposal. A submission to the committee from the Fair Trading Coalition—which comprises 22 representative organisations and covers 300,000 small businesses—states:

Members of the FTC, in relation to voluntary codes (whether ‘endorsed’ or not by the ACCC), note there are always issues with enforcement, the imposition of sanctions against those who do not comply with the Code and the issue of ‘free riders’ and the possibility of industry participants choosing to ‘opt-in’ or ‘opt out’ depending upon their circumstances. The FTC believes that in ‘business’ to ‘business’ relationships voluntary codes will not be adequate to address standards of behaviour and that regulatory ‘underpinning’ of such codes is necessary.

We need to leave to attend a division in the Senate. Perhaps we can talk about this when the hearing resumes.

Mr Samuel—I am saved by the bell!

CHAIR—Saved by the bell, indeed! I apologise for this short suspension. We will be back as soon as we can be.

Proceedings suspended from 8.55 a.m. to 9.12 a.m.

CHAIR—Mr Samuel, I remind you that we were just talking about the Fair Trading Coalition’s concerns about the codes.

Mr Samuel—There are a couple of answers I gave earlier which I can perhaps give you a bit of elaboration on. Would that be of help?

CHAIR—That would be helpful—thank you.

Mr Samuel—Learned counsel to my right have actually drawn this to my attention. This is the issue of the power to endorse codes. Let me give you a technical reference first. It is in regulation 28A(2)(c). It says:

... the following acts done by the Commission are prescribed ...

(c) developing industry codes of conduct to encourage compliance with the Act.

I would not rely too much on that. I think it is there just by way of an introduction. Let me perhaps indicate, though, that the process of endorsement of a code of conduct is not a legal process and it does not confer any legal status. It is much more of a behavioural process with

industries. If I might say so, I think the concept of endorsement is very much a reputational issue. Endorsement will give, we would hope, a level of reputation to an industry that its behavioural standards are very high. This endorsement, of course, will have exactly the opposite impact.

That then brings me, conveniently, to the issue you raised just before we broke. There will be industries where significant sectors are not interested in a code of conduct. They may not be interested for two reasons, which will actually be two entirely opposite reasons. One reason will be because one or more sectors of the industry simply do not want to engage in the sorts of standards of behaviour that are contemplated as part of the code of conduct. Therefore, they will resist a code on any basis. Naturally, they will also resist regulation.

Senator BUCKLAND—That would in the main be companies with the market share or the dominant player in the market, wouldn't it?

Mr Samuel—It may or may not be. I can give an example only in a public sense, because it was revealed on the *7.30 Report* only recently. You would be aware that we put out recently a discussion paper on some concerns that had arisen between sectors of the insurance industry and motor crash repairers. Motor crash repairers were advocating the development of a code of conduct between insurers and motor crash repairers that might resolve some of the differences in the industry. There were some quotes from me that appeared on the *7.30 Report*.

I was interested to note that the insurance industry were very resistant to any form of code of conduct. So they have indicated that they are not keen on developing issues within a code of conduct that might deal with the issues of concern between, say, the insurance industry and the motor crash repairers. They are the sorts of things that were the subject of that discussion paper and might be the subject of further discussion between the ACCC and the various industry groups. At the other end of the spectrum there will be industry groups that do not believe that any form of voluntary code of contact can achieve their objectives in terms of satisfying concerns and/or disputes that are occurring within the industry. They believe that the only way to do that is to impose statutory or regulatory obligations. So that is the other end of the spectrum.

For example, I think that your reference to the Fair Trading Coalition's resistance to codes of conduct reflects that end of the spectrum; that is, they believe that some of the concerns they have can only be dealt with by regulation. If I am not mistaken, that was a fairly early submission made by the Fair Trading Coalition. Since then they have had some discussions with us—or members of the FTC have had discussions with us—about what is intended by codes of conduct and they may be more receptive to the concept of the endorsement of codes of conduct than may have been reflected in their earlier submission. I have already mentioned the insurance industry and the motor crash repairers, but to give you a range of attitudes—and I am indebted to my colleagues at the back who during the break reminded me of these examples—I would like to talk about NARGA and the Tasmanian Independent Wholesalers. They have actually come out and supported the concept of the endorsement of codes of conduct so far as it may impact on their concerns in the retail grocery industry.

You would be aware that there has been a voluntary code of conduct for the retail grocery industry which is currently proceeding through a review. As part of that review we have put in a submission which has referred to our guidelines for the endorsement of codes of conduct. We

have encouraged the reviewer and the participants in that code to focus on lifting the standards of that code, and in particular some of the standards of transparency and compliance, so that it might become more effective and meet some of our guidelines in respect of endorsed codes of conduct.

Senator MURRAY—It seems to me that so far you have enunciated three potential market situations: firstly, no code at all where regulation is either not thought necessary or nobody has gotten their act together; secondly, an unendorsed code; and, thirdly, an endorsed code. You are not ruling out, I assume, a mandatory code regime where, in the opinion of the ACCC, it becomes essential for a particular industry?

Mr Samuel—No, in fact I think I started my comments by pointing out that I put aside mandatory codes only in the sense that they are almost the equivalent of regulations—so I put those into a similar basket. That would fall within your first category.

Senator MURRAY—But you are not ruling them out?

Mr Samuel—No, absolutely not. They are an essential part of the mechanism. If I might say so, it is the prospective of regulation that, very often, brings parties in an industry to a point where they say, ‘We’d rather have a co-regulatory environment.’ This is the process that we are contemplating in terms of both effective and endorsed codes of conduct.

Senator MURRAY—That is right, because to rule out the stick would be—

Mr Samuel—Oh no, you must have that.

Mr Cassidy—It is a bit like enforcement and compliance where enforcement is important for making compliance activities effective. Similarly, the possibility of mandatory codes and/or regulation is important for making the voluntary codes process work.

Mr Samuel—There may well also be, in the context of certain industries, corporate codes of conduct, which will not necessarily be industry wide so much as they will reflect a code of conduct by corporations within an industry. They also need to be kept as part of the total package. The only other comment I would make in this context, and it is appropriate just to mention this, is that I referred to the Australian Retailers Association before. Subsequent to that article which you referred to, we have had discussions with the ARA and I think the impression we gained—and it is appropriate for them to speak for themselves—is that they are more receptive to the concept of endorsed codes of conduct than perhaps may have been reflected by some of the comments quoted in that article.

CHAIR—Mr Samuel, I take you back to a response that you gave to Senator Murray about mandated codes. The franchising code is the only one that has been mandated since 1998. Is that an argument that part IVB is underutilised?

Mr Cassidy—I do not know whether I would say that it is underutilised. We tend to be a bit careful about mandatory codes under part IVB, because they do effectively become quasi-law, which we are then required to enforce under the act. That means that a code described under part IVB really needs to be carefully drafted if we are going to be able to enforce it, which basically

means that we could end up having to go to court to prove that there has been a breach of the code and to seek remedies. While, as the chairman said earlier, we certainly do not rule out mandatory codes, we are fairly careful about propositions saying, 'Here we are. Here is a code, and we ought to make this a mandatory code,' because what may be passable and acceptable as some sort of voluntary code within an industry really needs to be carefully looked at and reworked before you turn it into quasi-law. Our response would be probably not so much one of saying whether it is underutilised, but rather one of sounding a note of caution about the thought that might be abroad in some people's minds that you can just grab a code and prescribe it under part IVB, because that really only has effect if the codes are capable of being enforced in a judicial sense.

CHAIR—Going back to the comments you made about the *7.30 Report* program and the issue of the motor vehicle repair industry, I am interested to know how the ACCC would move forward with the insurance industry to strengthen that—but we have to go because the bells are ringing. I am very sorry about this.

Mr Samuel—Saved by the bell again. It is very well timed.

Proceedings suspended from 9.23 a.m. to 9.33 a.m.

CHAIR—Mr Samuel, we were talking about the insurance industry, and my question was whether the insurance industry was one of the industry groups that you had been in consultation with about the development of the guidelines.

Mr Samuel—Yes, it was. It has been part of the whole process of discussion, negotiation and attempted facilitation that we have been involved in with the insurance industry and the motor crash repair industry to try and resolve some fairly difficult issues that have arisen between those two industry groups. About three weeks ago, we issued a discussion paper on these issues. It was issued in September this year. It was a discussion on the relationship between the Australia motor body crash repair industry and the general insurance sector. It covered a range of issues that have arisen where the ACCC has become involved, particularly with allegations of anticompetitive and unconscionable conduct occurring. I will focus on the primary issue, which is the preferred repairer scheme that the insurance industry has established. It would maintain the scheme as designed, in terms of motor vehicle repairs, to ensure low cost, high quality and consistency of high quality. For those motor crash repairers who are participants in the scheme, that works very well. However, nonparticipants take a view that they are being excluded from a major part of the crash repair industry. Therefore, you can see the tension that results.

We have had lodged with us, over a period of time, complaints and allegations of anticompetitive and unconscionable conduct which, on our investigation, have not withstood the appropriate tests of investigation and so we have taken them no further. But clearly there are issues of dispute and issues of debate. This discussion paper was part of our facilitation process in an endeavour to see whether there was a way in which, with our assistance, the insurance industry groups and the motor crash repair groups might be brought closer together in terms of the business-to-business issues.

One of the suggestions there is a code of conduct. I think I mentioned to you that the insurance industry have not embraced the concept of a code of conduct with any enthusiasm. That is one

way of describing it. They would be at the end of the spectrum I described before where they believe that no further impositions ought to be created in terms of the way they work within the industry and on these business-to-business issues. You can imagine that the response of sections of the motor crash repair industry would be to say that, in the absence of any voluntary attitude on the part of the insurance industry to enter into a code of conduct, the appropriate course of action is something that is more mandatory in the form of regulation. Therefore they would be less enthusiastic about a voluntary code of conduct.

If we can help facilitate resolution of those issues then that may be an appropriate way to bring about co-regulation. If we cannot then it is a question for the industry groups themselves and/or for government to determine whether this is appropriate for regulation or whether it is a matter which, on proper analysis, does not merit regulation, because the ultimate purpose of regulation, in the context of the Trade Practices Act, is not to deal with protection of certain sectors of business from competition but to act in the interests of consumer welfare. What the ACCC fundamentally has to be concerned about is that consumer welfare is being enhanced or is not being in any way diminished or damaged by some of the issues that are raised in this industry.

CHAIR—Mr Samuel, are we able to have a copy of that discussion paper?

Mr Samuel—Yes, that is publicly available and we can provide you with that.

CHAIR—Thank you.

Senator BRANDIS—I have just one question. I want to pick up where we left off in Melbourne last Friday. Mr Cassidy, I think I was directing this question to you. I asked you to think about what the Law Council have to say in their submission, particularly on page 21, about recognising and incorporating into the act the concept of financial power. You were going to take that on notice. I do not know if your thoughts on that have matured to such a point that you now want to respond or whether you want to leave that and put something in writing. If you are prepared to, I would like to engage you on that now.

Mr Cassidy—We took it on notice and I would probably prefer to give you something in writing.

Senator BRANDIS—So you do not want to talk about it now.

Mr Cassidy—I would prefer not to.

Senator BRANDIS—That is fine.

Mr Cassidy—We do want to give you a considered response to that, which we are aiming to do next week.

Senator BUCKLAND—Yesterday in Senate estimates, Mr Cassidy, as reported to me—I was not there when this bit was spoken about—you discussed the impact of recent litigation costs on the ACCC budget and the fact that you ran an operating deficit of \$10 million last year. As

reported to me, you said that the Boral case had cost over \$3 million to run and you had not paid Boral's costs yet. Is that the case?

Mr Cassidy—That is right. Boral cost us just a shade over \$3 million—but let us say \$3 million. That is purely our own costs, and, given that we ultimately lost that case in the High Court, we are expecting that during the course of this financial year we will have to pay other party costs to Boral.

Senator BUCKLAND—Do you know what they will be?

Mr Cassidy—That is still being determined through the taxing process that goes on. They will inevitably be more than our costs. That is what we typically find, because, to be quite honest, we pay below market rates for counsel.

Senator BUCKLAND—Take that on board, Senator Brandis!

Mr Cassidy—It is probably a bone of contention for Senator Brandis from previous incarnations.

Senator MURRAY—So you're very cheap!

Mr Cassidy—I do not want to elaborate. It is not unusual in these sorts of cases.

Senator BRANDIS—It is almost pro bono, Mr Cassidy!

Mr Cassidy—We engage senior and junior counsel and we may be confronted on the other side by at least a couple of senior counsels and so it goes on. We have a matter at the moment, which I will not name, where the other side—if I can put it that way—has engaged or otherwise signed up five senior counsels against us. I do not know what the figure for their costs will be yet, but the whole of their costs will inevitably be more than ours and is probably going to be significantly more than ours, I suspect.

Senator MURRAY—So you are the victim of predatory behaviour!

Mr Cassidy—Just the victim of having lost that particular case, I think. The chairman has just reminded me that the other thing I should explain is that one of the reasons we are having financial problems is that, even if we are successful in the case and we would therefore recover part of our costs from the other party, with the way our funding works, those recovered costs go straight to consolidated revenue; we do not retain them.

Senator BUCKLAND—Following on from that, I was going to ask Mr Samuels something. Section 46 cases on the misuse of market powers, from my point of view, the layman's point of view—and I think I am right in my suggestion—are the hardest cases to run, given the complexity and the legal and economic issues involved. Are they particularly vulnerable to being affected by the current funding shortfall being suffered by the ACCC?

Mr Samuel—We—

Mr Cassidy—We are—and the chairman is obviously free to comment as well—having to think fairly carefully about new section 46 cases that we take on at the moment. They are inevitably very expensive. They are also very long cases, which is probably another issue in itself, and by the time we make our way through the court processes it takes us several years to obtain an outcome in section 46 cases, simply because of the complexity and the appeals and so forth. But we are having to think fairly carefully about new section 46 cases, both because of the state of the law and also because of our financial position at the moment.

Mr Samuel—With Mr Cassidy's permission—

Senator BUCKLAND—I am sure he will grant it to you.

Mr Samuel—You are absolutely right in your perception about the costs and the complexity of these cases. The time that it can take from the commencement of litigation through to the conclusion of a High Court appeal, for example, can be anything between five and seven years. One of the things that we need to examine in the context of our enforcement strategy is what the outcome is in terms of the Australian community and Australian consumers. So, in the context of that outcome focus and the focus on our financial constraints, I think we are having a long, hard look at section 46 cases to determine whether we are focusing on achieving that outcome in terms of consumer welfare, given the six or seven years that transpire.

I think it is fair to say that Boral has, in one sense, clarified the position for us in this context. We now have six judges of the High Court that have made, we think, fairly clear their views as to the interpretation of section 46. I am not sure that the commission will now see a lot of benefit in pursuing cases to try to prove what the High Court believes section 46 means, because we now know what it means, according to the Boral decision—at least in the context of substantial degree of power in a market. We have now formed some clear views about what the High Court said about that and also about the clarifications needed in the context of that and the 1986 intentions of parliament in respect of substantial degree of power in a market—and also in the context of taking advantage under section 46. What may have been one of the objectives in the past, which is to pursue cases to try to get a clarification as to meaning, I think is becoming such a long tunnel with a very dim light at the end of it. There is a real question mark over to whether we continue with that objective as one of our drivers.

Senator BUCKLAND—That raises real concerns for small business. Of course, the costs now become a real problem for small businesses gaining access to justice, if what you are saying is correct and if the interpretation of the Boral case is right, as I read it. I am not going to pit my legal skill against that of Senator Brandis—other skills maybe, but certainly not my legal skills. Given the high cost of running a section 46 case, do you think we have now arrived at the point that only the commission can run a case all the way to the High Court?

Mr Samuel—It would need to be a small business with extraordinarily deep pockets, which is generally a contradiction in terms; it is an oxymoron to suggest that could be done. It is also an oxymoron to put the ACCC in the same context as deep pockets. We have now got to the position where we are becoming more and more convinced that there are some issues as to the interpretation of section 46. Whatever we now do in pursuing these matters before the High Court is not going to change the outcome. Therefore, we are beginning to question, in terms of the shallowness of our pockets, the merits of pursuing these matters through to the ultimate end

point of a potential seven-year court battle. That is one of the reasons why we have put material before you, in our submission, which suggests that these matters would be best dealt with by parliamentary amendment.

Senator BRANDIS—I refer to Senator Buckland's point about small businesses not being able to afford to run section 46 cases—which is, by and large, right. Are you aware of any instances where a small business has relied on section 83—that is, the findings of fact—in proceedings initially brought by the ACCC, to piggyback on and avoid the cost of full-on litigation?

Mr Cassidy—No, I cannot readily think of any.

Senator BRANDIS—That is an unusual provision. I think that was part of one of the purposes of it, but it seems to have been a bit of a dead letter.

Mr Cassidy—As a more general comment relating not only to section 46, we would make the observation that private parties really do not take much advantage of that section. That applies in consumer protection issues as well, while we often seek findings of fact for that very reason.

Senator BRANDIS—Why do you think that is? Is it simply because the culture is such that small businesses are not aware of it, or their legal advisers are not sufficiently alert to the potential shortcut it provides?

Mr Cassidy—I do not really know. It could still be a worry, even though we have established findings of fact, that they are going to find themselves in court for a period of time and that that is going to cost money. Small businesses, in particular, just cannot afford that sort of money. To be honest, I do not know. It is something which, in internal discussions, has been commented on more than once within the commission—that, in an across-the-board, that section is rarely utilised.

Senator BUCKLAND—In an estimates hearing yesterday, Mr Cassidy mentioned that, when the ACCC is successful in a case, the costs recovered from the other side are paid into consolidated revenue.

Mr Cassidy—That is right.

Senator BUCKLAND—Mr Samuel, given what you said earlier, do you think this practice could be looked at?

Mr Samuel—I would be at risk of my life if I said otherwise!

Mr Cassidy—I agree with the chairman. That would be my instinctive response to you as well, particularly as far as we are concerned, but there is a policy issue that governments would obviously need to think about. This is a practice that does not just apply to us; as far as I am aware, it is the practice for other regulators as well. It is the sort of thing that governments would need to think about if we were able to keep, say, the costs that are recovered when we are successful. We take cases that are more in the consumer protection area, which are public interest cases, for want of a better way of putting it, but we also deal with cases involving almost

shell companies—'fly by nights', as they are often called—and we realise that, even if we are successful, there is very little prospect of subsequently recovering costs. Indeed, sometimes we struggle to even obtain penalties that have been awarded by the court.

I think the public policy issue for governments, if an agency like the ACCC were able to retain costs, is that there could be a worry on the part of some that it would skew us away from pursuing the sorts of cases where we realise right at the outset that we would probably never be able to recover our costs. What the cases are really about is stopping the behaviour and stopping the particular entities undertaking that behaviour from operating. So, while I very much agree with the chairman's reaction that we would certainly like to be able to keep the costs that we are able to recover, I would have to flag that there is a public policy issue lurking around in that as well.

Mr Samuel—While recognising the public policy issue that Mr Cassidy has raised, it seems to me that the commission has two disciplines that ensure that it pursues issues that have public policy merit and that are focused on consumer welfare: one, its obligation under the act; and, two, the transparency of what it does and its accountability to the Australian public. If the commission were seen to be delinquent in pursuing matters under whatever financial policy regime existed, I would be very surprised to see those within the Australian community—whether they are in small business groups, in business groups generally or, more importantly, in consumer groups—being reluctant in coming forward to point out our delinquency of effort. I think that accountability ensures that we actually carry out our public responsibility, leaving aside our obligations. Coming from the private sector, I find it incongruous that we expend money on costs in a court case, win the case and then find that we do not actually get our costs back but that they have to go elsewhere.

Senator MURRAY—And you carry your losses.

Mr Samuel—Yes, we carry our losses.

Mr Cassidy—The other comment I would make is that when you look at section 46 cases, even if we kept the costs that we recovered, we could still have some serious funding issues simply because of the time lags involved. Most of our costs are incurred when a case first goes to court. The Safeway case, which is a section 46 case, amongst other sections, is a classic example where at first instance we ended up being in court for, I think, 93 sitting days. That involved an enormous cost in terms of counsel, expert witnesses and so forth. Much of our costs in these cases are incurred up-front and, of course, there may be subsequent appeals, which we now have in the Safeway case, for argument's sake. If we are ultimately successful, we could end up waiting for many years before we have our costs recovered.

Senator BUCKLAND—Could I just indicate that I did have other questions but that I have been summoned and I will have to leave it there.

Senator BRANDIS—I just want to tease out the point, though, that it has always been like that. It is obviously a problem, but it comes with the territory, doesn't it?

Mr Cassidy—This is true.

Senator BRANDIS—This is not a new and striking development.

Mr Samuel—No, I just happen to have the luxury of being new to the game; therefore, I can express my incredulity.

Mr Cassidy—The issue is that, for various reasons, at the moment we have a significant increase in our litigation costs. If you say that perhaps a solution to that is for us to be able to keep our costs that we recover when we are successful, I think the issue is that, because of the lags involved, we could still find ourselves at least with a temporal funding issue. Our litigation costs have increased significantly over the last couple of years, and it could be several years down the track before the flow back of our costs recovered would help ameliorate that.

Senator BRANDIS—The other reason I raised the point is that I think it would be bad for this committee to be diverted by what seems to me to be essentially a false issue. There have always been long, complicated and expensive proceedings and there always will be.

Mr Cassidy—That is true.

Mr Samuel—If it is appropriate, I want to cap off this issue by making it absolutely clear—and I have said so in a public sense on a *Business Sunday* program—that we will not be deterred from taking on issues that involve those on the other side who have deep pockets. We will not be deterred by the fact that they are deep pockets if serious issues of anticompetitive conduct or if serious issues of anticonsumer conduct are involved. Our mandate and our duty and responsibility to the Australian community is to deal with anticompetitive issues and consumer welfare issues.

The point I was trying to make before was that there will be issues, particularly in relation to section 46 cases, where the focus of our attention, which ought to be on protecting consumer interests and protecting the competitive environment in the interests of consumer welfare, is perhaps no longer relevant in the context of a seven-year time frame for a court case. I think we are coming to the conclusion that we now understand what the High Court's view is on issues relating to section 46, and we think the only way of dealing with it is by some clarification process through parliament rather than our attempting to run up against a brick wall in the context of the High Court and the court's interpretation of the section.

Senator MURRAY—We discussed that theme last week, and I raised it in the particular context of small business where, generally speaking, they have short-term tenancies of three to five years. The problem for small business in general in taking up actions under the Trade Practices Act—not just with regard to section 46, I am sure you would agree—is the risk and return relationship. Typically, small business wants to incur a risk and get the return within a manageable time frame, which is often within that financial year but certainly within two financial years. The risk and return factor for even a highly arguable case has such a long time frame, and I think that observation and understanding leads me to two beliefs: firstly, that you need as much certainty in the law as possible; and, secondly, that there need to be procedures for the commission to be able to end the matter outside of the courts in some manner. I will leave it at that.

As you know, I agree with your broad submissions. I want to cover one other area, the area of unconscionable conduct. There is a view that there should be no threshold. That view is predicated, as I understand it, on the perception that unconscionable conduct is self-evident when you have a greater commercial power set against a lesser commercial power. However, the consequence of having no threshold will be that lawyers will always raise the threshold question. At the commencement of litigation they will say: 'We argue that there is no disparity in power in this particular circumstance.' From there you might come full circle and say, 'It is better to have a threshold even if you don't need one.' My question to you is, firstly, do you think there should be a threshold? Secondly, if there is to be a threshold, do you think the present threshold needs to be adjusted in any material or significant manner?

Mr Samuel—Our submission indicates that we do not think the current threshold is appropriate and, indeed, that we think the concept of a threshold is in itself inappropriate. We think the current threshold is inappropriate because it is a sudden cut-off. Just below \$3 million is within the section, while just over \$3 million is outside the section, when in fact the context of the section is dealing with unconscionable conduct between larger businesses that are in a superior bargaining position compared to businesses that may be in a lesser bargaining position. We think that ought to be the threshold for the application of the section. In other words, it should deal in the vertical supply line or the vertical relationship where there is an existence of a superior bargaining position and an inferior bargaining position. That ought to be the entry point of the section.

Senator MURRAY—Might I test a proposition with you and see if you react favourably to it? I am of the view that one solution to this is to automatically say that anyone who falls within the ABS small business definition, where they have either 20 employees or below or 100 employees if they are a manufacturing business, and that anyone who falls below a certain monetary threshold—and that can be arbitrary; that can be established—is automatically captured. But that should not exclude somebody else from being captured if they meet the circumstances you outline. The merits of that, to me, would be that there would be no dispute for certain categories of business at all, because the legislation would say they automatically have access. At the same time, it would reflect the discretion that you think is intellectually and economically valid. How do you react to that different approach?

Mr Samuel—When you contemplate some threshold of automatic entry, be it the ABS definition of what a small business is or whatever, that only takes you the first step along the way. The real point of section 51AC and part IVA is to deal with behaviour between those that are in a superior position as against those that are in an inferior position. The fact that some parties, some businesses, might automatically come within the protection of the section will still require the threshold of superior and inferior and behavioural conduct—that is, unconscionable conduct—to be dealt with.

Senator MURRAY—That is why I am suggesting to you that both should apply.

Mr Samuel—I am not sure whether the initial threshold step of automatically bringing certain parties within the protection of the section achieves anything. It simply says, 'You're in the first door, but you've still got to go through the second door,' which is the door of proving unconscionable conduct, one of the factors of which is superior and inferior bargaining positions. If you take those that do not enter the first door, I am not sure that they are

disadvantaged by the fact that they have not gone through the first door relative to those who have gone through the first door, because in any event they have to go through the legal process of looking at the fundamental objective of the section, which is to deal with unconscionable conduct behaviour between those in a superior, as against those in an inferior, bargaining position.

I am not sure whether the provision of a threshold that you have identified—for example, ABS or a \$3 million or \$5 million threshold—takes those that fall within the threshold any further along the way, other than saying, ‘You are into the first door but you still have to get through the second door, and that is the important door and the only relevant door in the end when it gets to the court.’

Senator MURRAY—But the proposition I put to you, because it accepts yours but adds the existing regime and does not make them contradictory, would not retard the law. It would advance the law, wouldn’t it?

Mr Samuel—It certainly would not retard it. I am not sure at the moment about whether it advances the position. I am looking at a small business within the ABS definition and saying, ‘What advantage have they obtained by being automatically within the section?’ What advantage does someone obtain by being automatically within the section—by, for example, coming below a \$3 million threshold—when the next step is that they need to prove a breach of the section, which is the unconscionable conduct behaviour between those in a superior as against those in an inferior bargaining position? The concern we have is not so much with the current threshold allowing people in as with the current threshold excluding parties from protection under the section. We think that the object of the section ought to deal with behaviour between those that are in superior and inferior bargaining positions, irrespective of their size, through some arbitrary threshold of \$3 million or an ABS statistic or whatever might be the case.

Senator MURRAY—I accept that argument, but what I am arguing for is retaining existing automatic access. As you know from your experience in these matters, much of competition law is psychological—it is a sense of what is lawful and unlawful; a sense of what behaviour is required. It seems to me that having an ability to automatically access gives that category of small business some confidence that their needs are being looked after. I recognise the legal impediments—I have spent far too much on lawyers myself—but I do not think you should discount the psychological effect of it in your legal argument.

Mr Cassidy—I make the observation which we also made in our submission: if we are going to continue to have some sort of threshold, I think we need rather more clarity about it than we have at the moment. There are questions being asked in the courts about the \$3 million and exactly how it applies. If you had an ABS type definition—20 employees, for argument’s sake—you would probably need some decision around that as well. Obviously our first preference would be to remove the threshold, but our fall-back position is to say that, if we are going to continue to have a threshold, we probably need to try to get more precision around it than we have at the moment.

Senator MURRAY—I would have thought that the proposition that I am putting to you overcomes those difficulties—

Mr Cassidy—It does—

Senator MURRAY—because any business could access it, but there are businesses which automatically can access it—

Mr Cassidy—That is true.

Senator MURRAY—given that they still have the legal hurdles. And you would not be unsympathetic to that approach, would you, or do you want to think more about it?

Mr Samuel—We want to think more about it to see whether it enhances the position. I am not sure what automatic access does other than to say, ‘Well, I’ve got automatic access to now dealing with the fundamental requirement, which is to prove unconscionable conduct.’ I understand the psychological impact—

Senator MURRAY—In my view it is unashamedly psychological.

Mr Samuel—And I accept that.

Senator MURRAY—Could you think a little more about that and come back to us on it, because I am hopeful of persuading the committee to that view, but if you think it is hopeless then I have less likelihood of doing that.

Mr Samuel—We will get back to you on that.

CHAIR—Could I take you to one final issue—and thank you for your patience today with all the disruptions. The issue of price discrimination has been raised with us in some of the submissions—for example, it takes up a lot of the NARGA submission. Can you comment on section 49—the price discrimination provision—having been repealed from the act and whether or not you consider that section 46 adequately captures the whole anticompetitive price discrimination thing.

Mr Samuel—I am going to defer to Mr Cassidy on this because it predates my time in the commission, as I recall when the amendment took place.

Mr Cassidy—Section 49 was repealed as part of the national competition policy reforms back in the nineties. As I recall, the history was that there had been very few successful cases brought under section 49. There was a similar provision in US law which had the same history—there were fairly few successful cases brought under that statute in the US. I think the view at the time was that price discrimination should be seen more in the context of an abuse of market power rather than as something that was an offence or objectionable in its own right. Indeed, there are quite good economic reasons why you would have price discrimination occurring in terms of the quality of service that someone in offering—positioning in a retail store or whatever it might be.

Obviously, we have got issues about section 46 as it currently stands. Leaving those aside, I do not think that the commission feel uncomfortable having price discrimination dealt with within the section 46—abuse of market power. In terms of price discrimination and the cases of price discrimination that you would want to be focusing on with respect to their impact on competition

and consumer detriment, it is basically those that fall within the section 46 type framework that concern us. Someone misusing their market power in the process of price discrimination is what you should be focusing on and, as I say, we do not feel uncomfortable with that.

You then get into the fairly difficult issue of trying to unpick the problems with section 46—that is, is this being adequately dealt with in section 46? We would be fairly wary of having a separate stand-alone provision prohibiting price discrimination—or some forms of price discrimination—because, as I say, there are some instances of price discrimination that are quite economically justifiable and quite beneficial to the broader community.

Mr Samuel—I would add that there is a view that the former section 49 and price discrimination provisions—or those that prevent price discrimination—are an ill fit within part IV of the Trade Practices Act, because the fundamental foundation of part IV is to promote the process of competition in the interest of consumer welfare. There is a view that price discrimination is less related to that than it is to protecting certain competitors from the process of vigorous competition. There can be an impact from price discrimination provisions such as section 49 being anticonsumer. What they do is remove the ability of those in the supply line to provide discriminatory prices or different discounts. The result is that it will tend to raise prices rather than lower them for consumers; they can therefore operate in a potentially anticonsumer context. I think that is one of the reasons why section 49 was removed in the first place.

CHAIR—Thank you for your comments. There being no other questions, I thank you very much for your time. I again apologise for the disruptions.

Mr Samuel—We appreciated being saved by the bells!

[10.16 a.m.]

CASTLE, Ms Louise, Chair, Business Law Section, Trade Practices Committee, Law Council of Australia

REID, Mr William, Deputy Chairman, Trade Practices Committee, Law Council of Australia

WILLIAMS, Dr Philip Laurence, Member, Trade Practices Committee, Law Council of Australia

CHAIR—I now welcome the representatives of the Law Council of Australia. Before I ask you to make an opening statement, I advise you that Senate proceedings are getting a bit messy and we may have to be disrupted by bells. As Mr Samuel said, he has been saved by the bell several times this morning.

Ms Castle—Thank you, Chair and Senators, for the opportunity for the Law Council to be here this morning. The Trade Practices Committee of the Law Council are a representative body. Our membership includes academics, economists, lawyers in the public and private practice, and state competition regulators. Our meetings are regularly attended by the ACCC, the NCC and the Treasury.

I am a partner with the law firm Allens Arthur Robinson, and I am the Chair of the Trade Practices Committee of the Law Council. Bill is the Deputy Chairman of the Trade Practices Committee. He is also a partner with Blake Dawson Waldron and acted for Boral in the litigation in the Federal Court and in the High Court. Philip Williams is arguably Australia's most experienced trade practices economist. He is a principal of Frontier Economics, which is a firm of consulting economists. Until the beginning of this year, Philip was Professor of Economics at Melbourne Business School. He has appeared in three section 46 cases, most recently for the ACCC in the Safeway litigation.

With that bit of disclosure aside, we would like to confirm that the purpose of part IV and section 46 of the act is to protect competition, which maximises economic efficiency for the benefit of all Australians. Vigorous competition is desirable because it delivers economically efficient outcomes, even though it is bound to damage some competitors. The Trade Practices Committee believe that no amendments need to be made to the Trade Practices Act and that any concerns being raised in relation to the treatment of small business in various sectors can best be addressed through greater use of industry codes. In that way it will not undermine the economic principles underlining part IV—specifically the preservation of competition rather than competitors. In that sense, we welcome the announcement by the ACCC in relation to voluntary endorsed codes, which were discussed earlier this morning.

The Trade Practices Committee are very concerned that the current state of the law is not being accurately represented in this inquiry. For example, we believe that the impact of the High Court's decision in Boral is being exaggerated. First, we do not agree that there is any ambiguity in Australian case law about when a firm will have a substantial degree of market power. We

believe the High Court has articulated and continues to articulate a clear list of factors that need to be considered in deciding this issue.

Secondly, it is being suggested that the 1986 amendments to section 46, which were designed to achieve a shift from dominance to a substantial degree of market power, have not been effective. We do not think that the High Court has raised the threshold to dominance. The High Court did not have to decide whether two or more firms can have market power. The Boral decision leaves this issue open. In fact, a majority of the Federal Court in the Safeway case found that Safeway had a substantial degree of market power with only 16 per cent of the relevant market, which is evidence that more than one corporation can have a substantial degree of power in a market. Further, the High Court will have the opportunity in the short term in any appeal from the Safeway decision to further clarify this issue.

Some have also argued that, as a result of the Boral case, section 46 does not work to catch predatory pricing by firms with a substantial degree of market power. We disagree strongly with this proposition. Boral was not simply a predatory pricing case. The price war was started by another firm before the new entrant entered. In fact, the evidence showed that Boral was keen to raise its prices. It wanted to put its prices up but was unable to do so because of the power of its customers, who were able to drive the prices down. What the Boral decision does do is confirm that conduct engaged in by a firm at a time when it does not have a substantial degree of market power is outside section 46, as was always intended by parliament.

The current position in section 46 which limits predatory pricing to firms that have a substantial degree of market power is consistent with the position in the United States and Europe, where the thresholds respectively are monopolisation and dominance. In fact, the threshold in Australia of a substantial degree of market power is already lower than in the US and Europe. In our submission we discuss below-cost pricing prohibitions in other overseas countries in some detail. Generally, such prohibitions have been introduced in response to industry specific issues, usually in the retail sector and the airline industry. To the extent that those same concerns exist in Australia, our committee recommends that they be addressed through the use of industry codes. More importantly, however, we would like to draw your attention to the fact that several of those countries have experienced difficulty in implementing a general below-cost pricing prohibition. In some cases, those laws are now being repealed.

In the course of preparing our submission we had very vigorous discussions about several possible approaches to introducing a general predatory pricing provision. However, we concluded that all approaches risk capturing conduct which is procompetitive and introducing a degree of uncertainty into the law with the consequence that there may be an impact on the ongoing competitiveness of Australian business. Again, we set out in detail in our submission the various approaches that we canvassed.

I am very concerned that the Law Council are being represented in this inquiry as supporting the introduction of financial power into section 46. The High Court has held that financial strength is not of itself market power. I would like to stress that the Law Council have not proposed such an amendment. We are strongly opposed to such a proposal as it would constrain the aggressive practices of new entrants, start-ups, entrepreneurs and innovators battling for market share—aggressive practices which have been encouraged and acceptable up until now due to the obvious consumer benefit they bring. Such a change—that is, introducing financial

power into section 46—would, for example, catch the conduct of Virgin as it seeks to establish itself against Qantas.

What the Law Council did propose on page 21 of its submission was a very limited approach for dealing with predatory pricing by firms who do not have market power. This was proposed only if the Senate committee believes it is necessary to have a general prohibition on predatory pricing for firms without market power, notwithstanding our principal objection to that position and the difficulties experienced overseas. I would also like to place on record, however, that a number of members of the Trade Practices Committee are very concerned about the ramifications of such an approach, its potential to stifle aggressive pricing behaviour and the general negative effects of introducing new elements to the terms of section 46, which will diminish the value of cases already decided.

There has been much discussion in this inquiry about introducing into section 46 a list of things the court should take into account in order to clarify the operation of section 46. Our first response to this is that no clarification is required. The guidance has been given by the High Court from the cases. As a general response, the Law Council urge the Senate to be wary about introducing language to clarify the law or to make it clear what the principles underlining the law are. Australia's antitrust jurisprudence is comparatively young and developing. As we have heard, it takes several years for cases to emerge, and we are now in the position that there are at least three more opportunities for the High Court to provide guidance on the current draft of section 46 in the short term. Further, if words are introduced into the section, courts will always give meaning to the words, and it will be assumed by them that the words were inserted to achieve a change, otherwise there would be no point in inserting the words at all.

We wish to respond to some of the points made in the ACCC's submission. The ACCC's submission gives the appearance of seeking to clarify section 46, but in truth they are seeking to introduce two very significant extensions to the law which we are strongly opposed to. The first change is referred to on page 21 of the ACCC's submission, and that is the reference to extending the concept of taking advantage by introducing the words 'in relation to'. The words 'in relation to' have been interpreted very broadly by the courts, and that is acknowledged on page 38 of the ACCC's submission. The consequence of such a change would remove the filter in section 46 which requires a link between the conduct and the market power.

The second issue is the recommendation that it would not be necessary to prove the expectation or likely ability of recoupment in predatory pricing cases, and this is referred to on pages 21 and 22 of the ACCC's submission. As I mentioned, Australia already has almost the lowest monopolisation threshold in the world. To go further and remove the reference to an element of recoupment would mean that large Australian companies could no longer engage in aggressive pricing strategies, and such pricing strategies are clearly to the benefit of consumers. Expectation of recoupment is wholly consistent with the threshold of substantial market power and is the critical factor which distinguishes between legitimate low pricing, whether above or below any particular measure of cost, and predatory pricing.

Finally, the Trade Practices Committee believe that section 51AC provides robust and extensive coverage against unconscionable conduct, and the short history of litigation under section 51AC indicates that the courts are interpreting unconscionability as broader than the concept of unconscionability at general law and as commensurate with unfairness. We note that

the ACCC currently has 10 cases under 51AC, and we believe it would be premature to amend the section at this early stage in its development. As we indicated in our submission, we would support a Senate committee recommendation that the funding program given to the ACCC when section 51AC was first enacted be reintroduced in order to provide additional funds for such prosecution. As we have heard this morning from the ACCC, I imagine those funds would be gratefully received. We do not object to the inclusion of the unfettered unilateral variation clause in the list of factors in section 51AC(4) as proposed by the ACCC in its submission. We agree with the ACCC that the \$3 million threshold is arbitrary, but we consider that it would be curious to remove the threshold completely when the purpose of the provision is to be a small business provision. We thank the Senate committee for the opportunity to be here today and we are happy to answer any questions.

CHAIR—Thank you very much. Do others want to make any additional comments?

Mr Reid—No, thank you.

Dr Williams—No, thank you.

CHAIR—The committee noted your call for the ACCC to release guidelines as to when it is likely to consider that a company has substantial market power. In the light of Boral, do you think the ACCC guidelines are likely to set the threshold for substantial market power somewhat lower than the courts would?

Ms Castle—To put in context why we recommended that the ACCC publish guidelines, we do not believe as a committee that there is any ambiguity about the factors which the courts take into account. In fact, we have prepared a list to give you today and we are happy to talk about that. However, we recognise that in the course of this debate many people are arguing that those factors are unclear. The reason we have recommended that the ACCC publish guidelines is to try and bring to those people who perhaps do not read the cases a greater understanding of what the factors are. We would not expect the ACCC guidelines to do anything other than reflect the current state of the law, nor would we expect those guidelines to have any legal status. It would purely be an information document designed to inform people more about what the state of the law is.

Senator BRANDIS—Who is the author of the Law Council's submission?

Ms Castle—I coordinated the submission, but it was prepared by all the members of the committee in consultation.

Senator BRANDIS—All the members of the committee?

Ms Castle—They do not all draft it, but it is done in consultation with all members of the committee.

Senator BRANDIS—That is why I asked who the author was.

Ms Castle—There were different authors for different parts. I had overall editorial responsibility.

Senator BRANDIS—I understand that. Who was the author of section 3.5, on pages 19 to 24, regarding the treatment of financial power?

Ms Castle—I suppose I am the author of that in consultation with some members of the committee.

Senator BRANDIS—Who are the members of the committee with whom you were in consultation?

Dr Williams—Certainly she consulted with me about this cost business.

Senator BRANDIS—Were there others?

Ms Castle—Yes. There is quite a long list. I would have to get my email and check the names. However, the initial draft of this went through about 15 members of the committee and, once we had finalised a proposal, it was circulated to the whole membership of the committee, which as you know numbers about 90.

Senator BRANDIS—You are aware, aren't you, that not all members of the trade practices committee agree with the submission?

Ms Castle—I am well aware of that.

Senator BRANDIS—I am a member of the trade practices committee—I might be nonfinancial now, but I used to be—and I do not agree with it.

Ms Castle—That is right.

Senator BRANDIS—There are many other members—some of whom have spoken to you—who do not agree with it. I do not want to intrude too much or embarrass you about the politics of the Law Council, but there is a variety of points of view within the trade practices committee, as you would surely acknowledge.

CHAIR—Ms Castle actually made that point in her opening remarks.

Senator BRANDIS—I am sorry; I was delayed.

Ms Castle—In my opening statement I actually said that I wished to place on record that a number of members are very concerned about the ramifications of this approach. I had majority approval.

Senator BRANDIS—I am sure you did. But the trade practices committee includes a variety of points of view and approaches.

Ms Castle—Yes.

Senator BRANDIS—You are telling us that you have distilled what you think is the approach of the majority in putting down the submission. Is that right?

Ms Castle—What I can tell you is that, with the exception of this section on financial power, this submission has the unanimous support of the trade practices committee. In relation to all other matters about whether the act needs to be changed and whether ‘substantial degree of market power’ is clear, the submission has unanimous support. This is the only issue on which there was any division within the committee.

Senator BRANDIS—I want to explore this, because it is an interesting question. Can I explore it with you, Dr Williams? The submission says:

The only reform that the Trade Practices Committee believes could be introduced to deal with predatory pricing would be—

and then some possible statutory language is set out. What is your thinking about this? Do you favour this? Where are you on the spectrum from being absolutely opposed to it to thinking it is kind of a second order alternative to thinking it is a good idea? Where are you?

Dr Williams—As you and the members of the committee are undoubtedly aware, there have been very few predatory pricing cases. Most of the section 46 cases have either been refusal to deal or vertical squeeze. It is often hard to distinguish between those two categories. My feeling is we do not yet know quite what the law is on predatory pricing.

Senator BRANDIS—That seems to be a little inconsistent with what Ms Castle said—that section 46 seems pretty clear.

Dr Williams—I think certain things about section 46 are very clear.

Senator BRANDIS—I am sure that is right, but predatory pricing is not one of them.

Dr Williams—As you are undoubtedly aware, predatory pricing is not mentioned in section 46.

Senator BRANDIS—Nor is vertical price squeezing or refusal to deal. We are talking about glossing comments on the broad conceptual language of the section.

Dr Williams—All we can say from Boral is that predatory pricing cases probably do require some notion of recoupment, and that is probably about all we can get from Boral apart from a reiteration that the principles that the High Court enunciated in *Queensland Wire* and *Melway* apply. In a way, Boral is not a very interesting case. I teach trade practices at the Melbourne Law School, and we decided not to include Boral in the reading list because we thought it did not add very much to *Queensland Wire*. But I guess on the predatory pricing episode—

Senator BRANDIS—It is the first time that the High Court has been seized with predatory pricing under section 46, isn't it?

Dr Williams—It is. But all they found necessary to make their decision was basically to reiterate the principles in *Queensland Wire* and *Melway* and to rap the full Federal Court over the knuckles for not having read their earlier decisions.

Senator BRANDIS—There have been a lot of conflicting points of view and vested interests displayed before us in this committee, but one of the hard pieces of evidence that we have received, which I think has to influence our thinking, is the statement by the ACCC that, having regard to the Boral decision, they are discontinuing a number of section 46 proceedings. It is their judgment on advice that, as a result of Boral, section 46 cases will be more difficult to successfully pursue than has hitherto been thought to be the case. They may be wrong about that, but they are the principal litigant under this act. If as the result of a decision of the High Court they say, ‘We think these cases are now harder to run, therefore we have abandoned several,’ that sounds to me like the best evidence we can get that, in a practical sense, Boral has changed the law, because in the mind of the principal litigator it has changed the law. What do you say about that?

Dr Williams—The ACCC’s remark has to be understood in the context of the history of its litigation under section 46 since 1974. Until about five or six years ago, the ACCC was being roundly criticised for not bringing any proceedings under the rule of reason type sections of part IV or, in particular, under section 46. Indeed, Maureen Brunt wrote a famous article on private litigation under the Trade Practices Act in which she was also critical of the ACCC, basically for not bringing proceedings. So until five years ago the ACCC was certainly not the principal litigant under section 46. I think it is fair to say that the ACCC was stung by this criticism and decided to initiate two, and subsequently three, section 46 cases just to give them a go. They knew they were hard to prove, but they thought they would give it a go. They initiated Boral and Safeway, and subsequently added Rural Press. It was certainly being discussed within the ACCC that this was going to be a sort of make or break effort with them on section 46. They knew it was hard and they knew it was expensive, but they decided to give it a go in response to all this criticism.

When the first two decisions came out and they appeared, at least in the first instance, to lose on Safeway and Boral, there was much dejection and upset within the ACCC, and I think it is fair to say that the people who had opposed issuing proceedings under section 46 at all felt that their opinion had been justified. Since then we have obviously found out that it is a bit more complicated than that and, at least so far, they are succeeding to some extent in Safeway and Rural Press, and they got pretty close to it in Boral—not when it got to the High Court, but prior to that it looked as though things were in their favour. Their subsequent dropping of some cases under section 46 might well reflect a slight move back to the position that they had prior to initiating these cases, which were very much test cases within the mind of the ACCC, rather than a change of the law.

Senator BRANDIS—Except that is not what they told us.

Mr Reid—Perhaps I can express a view on that.

Senator BRANDIS—No. I am asking Dr Williams. I am sure other senators will come in at the end, but I want to pursue this dialogue for the moment. Dr Williams, you told us earlier that predatory pricing is uncertain. That is a post-Boral remark, so presumably I am not verballing

you or putting words in your mouth if I take it that you are telling us that, notwithstanding Boral, predatory pricing in this country is still uncertain.

Dr Williams—Yes. I do not think you can give many general rules. There are two separate issues, aren't there? One is with regard to the law, and I do not think there are any general rules apart from: we know the three legs of the section have to be satisfied. I think the only gloss that we can read from Boral is that there needs to be some evidence that recoupment would be possible in the future. That is perhaps about all we can read from it.

Senator BRANDIS—It seems to me that part of the problem with a section like section 46 is that it is—to use an expression I have used with other witnesses—a high concept provision. It incorporates a lot of high concept economic language, but it does not have any descriptors in it. It does not describe the particular species of conduct that it is concerned to prohibit, so we have to have this sort of argument at one remove by talking about vertical price squeezes, refusal to supply, constructive refusal to supply, predatory pricing or what have you, none of which are defined terms. But we understand that those are the kinds of conduct at which section 46 is directed, don't we? Do you agree?

Dr Williams—Yes, but this problem is always true throughout the world in what we might call rule of reason provisions. The per se provisions have to be very precise, they have to precisely identify the conduct that is prohibited and it is just a matter of finding out or proving to the court whether or not that conduct has been undertaken. The language is naturally very clear. In any competition type provision where conduct is not just proscribed but, rather, subject to some sort of competition or monopoly test, then the language has necessarily to be rather vague.

Senator BRANDIS—Of course, I am not saying that the section is necessarily flawed for that reason. It must be very generic language. But in applying that very generic language to particular cases we need to have guidelines. We have spoken about guidelines before, and when Mr Corbett from Woolworths gave evidence to the committee—I do not know whether you have read the transcript of his evidence—we had a discussion about the utility of guidelines. I wonder, and I would be interested in all of your views about this, what is wrong with the idea of doing it in section 46, or somewhat expanding upon what section 46(3) says as the test for determining market power. I know the analogy is somewhat limited, but—much as section 50(3) adumbrates a number of criteria or factors that might have regard to determining whether there will be a substantial lessening of competition from an anticompetitive merger—I do not see the logic of saying, 'We need guidelines but, whatever you do, don't put them into the act.' Can I invite you each to speak about that?

Ms Castle—Our primary position is that we do not need guidelines to clarify the factors. Our committee would say the factors are clear.

Senator BRANDIS—But Dr Williams, who obviously speaks with a different voice, has just told us that what predatory pricing is just is not clear.

Ms Castle—No, I do not think he did say that.

Dr Williams—No, I think we are talking about two separate things. One is the factors that the courts would take into account when assessing market power, and the other is the factors in

finding out whether predatory pricing constitutes a taking of advantage. I think they are quite separate.

Senator BRANDIS—Okay, but I do not think anybody is ever going to win an argument in this by asserting the proposition that section 46 is clear. Nobody believes that; you might believe that, Ms Castle, but you would be one of very few people in the Commonwealth who believes that the meaning of section 46 is perfectly clear.

Ms Castle—It depends on which aspect of 46 you are talking about.

Senator BRANDIS—Of course it does. Because of the very nature of an economic regulation like this, as Dr Williams has just been saying, I agree with you. It is never going to be perfectly clear and that suggests to me that for a statutory provision like this, more than most statutory provisions, there is a strong case to be made—not in a straitjacketed or dogmatic way but in a very flexible way—for some statutory guidance as to what the factors are to which the court may have regard in determining whether market power exists or whether market power has been taken advantage of. To a degree that is already done in section 46(3), but I am wondering whether or not a greater degree of specificity by reference to economic factors that is found in the existing section 46(3) will be useful. That is what I am inviting your comments on.

Mr Reid—The view I have on that issue is that, if you were starting with a blank sheet of paper, you would be well advised to take up your suggestion in relation to expanding upon 46(3) in the current context—

Senator BRANDIS—But along the lines I have just proposed.

Mr Reid—quite—along the lines of subsection (3) of section 50.

Senator BRANDIS—I should not have cut you off before, Mr Reid.

Mr Reid—But the concern we have, and which Ms Castle referred to in her opening remarks, is that in the current context of the High Court having considered that particular subsection and its import in construing subsection (1) of 46 and there being now 15 years of jurisprudence on that issue from Queensland Wire Industries—and, as Dr Williams says, the issue of where market power rises is reasonably settled having had that issue confirmed by the Boral High Court decision—to introduce new words into subsection (3) of section 46 would, in our view, be likely to encourage the courts to think that those words have been introduced for some purpose beyond clarification and that they may go further than the remarks already made by the High Court.

Senator BRANDIS—That depends on what the words are and it may depend on what is in the second reading speech.

Mr Reid—I think that is correct, but we are concerned that the High Court has already set out a comprehensive list of the factors to be taken into account. Indeed, we have prepared a distillation of those factors from the High Court's decisions. But to go further in the legislation itself in relation to those issues may be overly prescriptive or may encourage the courts to relook at the issue when it is now reasonably settled.

Senator BRANDIS—I think your point is well made. Other senators may have different views, but I do not think that section 46 should be overly prescriptive. I agree with you.

Mr Reid—Indeed.

Senator BRANDIS—But, conversely, I also think, given the highly generic character of the language, it should not be insufficiently prescriptive either. The question arises: is it insufficiently prescriptive at the moment? I am inclined to think that it is but, having offered that tentative view, I take on board entirely your caution that, were we to alter the statutory language to give it a little bit more structure, we should not be overly prescriptive. Sorry, go on.

Mr Reid—I have made my principal point.

Ms Castle—With your permission, can I table the list of factors which we have prepared?

CHAIR—Certainly, I think that would be very useful.

Ms Castle—We just felt, having read the transcript, that it might be something useful.

Dr Williams—Can I say one thing about lists. I suspect that not much harm would be done by putting in a list of factors like this because basically this is what the law says anyway, so putting them in a statute I think probably would not hurt much. My only slight reservation is this: I see the list in section 50(3) that sometimes biases the ways cases are pleaded. There is a problem in litigation in part IV and that is—if I may say so with respect to my colleagues—that a lot of lawyers adopt a rather straitjacket approach to thinking about the economic issues in part IV. Giving them lists and writing more words tends to bias them more in favour of that. An economist advising—whether you are advising the ACCC or private parties—often has to fight against these straitjacket views. Whether the views come from court decisions or from words in the statute, there can be a bit of a problem. I can give you an example.

Senator BRANDIS—We know, Dr Williams, that the economist's mind and the lawyer's mind work quite differently. What you have to face—and I think I have said this to you privately over the years—is that, at the end of the day, it is the lawyer's mind that is going to win this because it is the judgments written by judges in courts, who are lawyers thinking like lawyers, albeit influenced by economists such as you, that are going to lay down the law, to use the vernacular.

Dr Williams—Of course, I acknowledge that.

Senator MURRAY—I beg to differ: the politician's mind is going to enforce this—you can be sure of that.

Mr Reid—An example of what Dr Williams is speaking of arose in the Boral case through its history, and it may be worth while just drawing that out, in relation to the thinking on barriers to entry, which are a required element to a finding of market power. Prior to the publication of the full court's decision in the Boral case, the legal fraternity adjudicating on section 46 would have had very strong regard to structural barriers to entry, such as sunk costs and access to raw materials, in arriving at conclusions on that issue.

The full court's decision picked up submissions from the ACCC in relation to the strategic barriers to entry—reputational issues, conduct of companies in terms of signalling responses and so on—and drew them out as barriers to entry. The High Court has dealt with them and said that they are a variety of barrier to entry and they are to be referred to in any adjudication on these issues. A list drawn up three years ago would have had regard simply to structural barriers to entry, and the economic learning in relation to strategic barriers to entry would have been missing from that list completely. That is, perhaps, an example of a development over time which might be constrained in its entry into the law by a list of this nature and where the advantage of the generic language—which I think was the expression you used—for section 46 comes to the fore in admitting those new influences from our economic colleagues.

Senator BRANDIS—But isn't that just a rather elaborate way of saying that statutory language inevitably gets glossed?

Mr Reid—And is inevitably the rock to which the lawyers refer in dealing with the case and, being a rock, may not necessarily admit other influences which are perhaps properly—

Senator BRANDIS—I think the problem is that a lot of people think that section 46 at the moment is not so much a rock but a swamp. It does not have enough structure.

Mr Reid—I can see that that is a view that some people might have.

Senator BRANDIS—Madam Chair, I hope you do not mind me conducting this seminar!

CHAIR—No, that is all right.

Senator MURRAY—Madam Chair, I am getting a little impatient with it, frankly, because it is a debate more than questions. The chair last night was excellent in insisting that questions be properly framed and put together; yet today's discourse is a contradiction of that insistence that I saw last night.

Senator BRANDIS—I must say that I find it very helpful, so can I use my time to pursue this?

Senator MURRAY—Except that I am making a deliberate point of order.

CHAIR—Yes, I acknowledge your point of order.

Senator MURRAY—I am acquainted with the views of Senator Brandis and I think very highly of them, but I am very keen to hear more from the other side.

Ms Castle—Perhaps I can answer the question that I think you posed to us, which was: what is the harm of including in the section a list of factors?

Senator BRANDIS—Yes.

Ms Castle—We have spent a bit of time saying that, ultimately, if what you did was put into the act a list of factors taken from the cases—similar to what we have done—it would be very

difficult for us to oppose such a thing. When we say, ‘This list is already clear,’ all we are questioning is the need for it and the utility of it. Secondly, we are cautioning you about the list because it gives rise to the problem that, if you are not on the list, you have to fight and prove your way on. That is the point that Philip and Bill were making. I am not sure that any more really needs to be said on this particular issue, although we could talk a bit more about the clarity of predatory pricing if you felt you wanted to talk about that as a separate issue.

Senator BRANDIS—I heard what Dr Williams had to say about that, and I agree with him. Under the constraint of what Senator Murray just said—although I would like to go on with this—let me move to a different topic. I want to come back to the question of financial power and whether the act should acknowledge that as a discrete category. I understand that the primary position of the Law Council’s submission is to counsel against doing that, but you have, as it were, a secondary position that says, ‘You could do that,’ and ‘could’ is the word that has been adopted in fact in the submission: ‘The reform could be made.’ I will be honest with you: I have an open mind about this and I am intrigued by it. Dr Williams, perhaps you could approach this question as an economist: if this committee were of a mind to recommend the incorporation of a category of financial power, in your own words what do you see as the advantages and the perils of doing that?

Dr Williams—I think there are some advantages or one advantage anyway, and it is this: economics models predatory pricing—and I am quite aware that the courts say that that is different from what happens in section 46—as basically an investment; that is, you invest now and forgo profits, or you make a loss now in order to make the market less competitive so that you can reap the higher profit rewards of your investment later on. A couple of models in economics along these lines make financial power quite important. For financial power, in one sense, you have to have access to the funds to finance your investment, because you are investing in the predatory episode in order to reap the extra profits in the monopoly episode.

Clearly, you have to have access to funds and there are a few models in which this is made explicit. In most models it is not because a lot of economists and a lot of economics operate on the proposition that, if you have a profitable investment, you can always fund it. We know that is not always true and so some of these models of predatory pricing do make explicit the difficulty of funding the predatory episode. There is something in having access to funds if you are going to have a period of predation—that is true.

Senator BRANDIS—At that point, I want to clarify something. Would you say that, if a firm engaged in a predatory pricing strategy in a market by cross-subsidising from either its overall financial resources or from profits earned in a different market, that was an exercise in market power in the first market or an exercise of financial power not caught by the current section 46 in the first market?

Dr Williams—No. Providing cross-subsidies are defined correctly—there is a technical economics definition about cross-subsidies—what you mean by a service being cross-subsidised or activities in a market being cross-subsidised in economics is that you are not covering your avoidable costs, which is a similar notion to the notion of the trial judge in Boral. Providing you define it that way, then the economics says you can only sustain cross-subsidies because you have market power. So economics teaches that cross-subsidies in that sense, providing you define them appropriately, are needed and you do need market power for them. So if you then

had one of the prescribed purposes, it is very likely that you would be found to infringe section 46, providing the case were argued properly and whatever.

Senator BRANDIS—All right, can you give me an example where pricing behaviour might be regarded as an exercise of financial power without it being an exercise of market power?

Mr Reid—I can give you an example. The example which is slightly flippant is Bill Gates investing in a series of 7-Eleven stores in Australia. That is a market which has no barriers, or very limited barriers, to entry. There is no prospect of market power in the sense that the minute Bill Gates puts the price of a chocolate bar up in the 7-Eleven store customers will go elsewhere to purchase that chocolate bar or there will be new stores emerging to sell that chocolate bar to customers. In that regard, the financial power behind that initiative is of no importance in assessing the market power of the resulting business.

Senator BRANDIS—What about the context?

Mr Reid—Going from 7-Eleven stores into a monopolised market?

Senator BRANDIS—No. What about Bill Gates putting the price of chocolate bars down in 7-Eleven stores using his wealth from his Microsoft business? Is that financial power or market power?

Ms Castle—Using his financial resources—it is the same thing.

Mr Reid—Quite. I am sorry, I was cutting to the second monopoly context that Philip was talking of. Assuming that he had driven businesses away from that market by a predatory scheme, such as the one that you refer to, you then move to the monopoly context where he endeavours to recover that investment—as Philip has referred to. In that period, he will be met by chocolate bars re-emerging on the shelves of petrol stations and all sorts of other possibilities—which borders on the ridiculous to go into. In that sense, I do not think the financial power bears any fruit in pursuing that scheme in that particular type of market. The position would be quite different if you had a market in which there were barriers to entry and Gates had undertaken a predatory scheme of the one you contemplate, and was able to do so by virtue of financial investment that he could find and is then able to recoup that financial investment secure from competitive response by the barriers to entry in the market at that time. In that sense, I think the High Court has it right, with respect, that financial power is an explanatory element of market power, or may be, but is not a sufficient condition for market power.

Senator BRANDIS—Quite. But I suppose the other approach to this—and it is a question of defining the limits of categories, I know—is to say that financial power can act as an indicator or as an ingredient of market power, but it can also have an independent significance so that there is such a thing as financial power which may exist independently of being an ingredient of market power. Do you accept the proposition that I have just expressed?

Dr Williams—That there can be those two relationships? I was just going to point to a third one.

Senator BRANDIS—But you accept there can be those two?

Dr Williams—Yes.

Senator BRANDIS—What is the third?

Dr Williams—The third is that you may have market power but no financial power. The ACCC is currently opposing the acquisition of Loy Yang power station, which is owned by a company which is currently almost bankrupt. Why? Because they paid far too much for the power station. The ACCC is convinced that it has a lot of market power but it clearly has no financial power at all. That leads to the danger of proscribing the use of financial power. In the last 10 years in Australia, and indeed in England, there have been a large number of acquisitions of what were previously publicly owned public utilities like electricity generation companies. A lot of people paid far too much for these, took in a lot of debt and are in very weak financial positions. I would not like to see, say, the demise of Loy Yang lead to litigation under the Trade Practices Act merely because they were in a weak financial position because they borrowed too much money. There are very real dangers of concentrating on financial power independently of market power.

Senator BRANDIS—In the case that you have just posited, why would that be a danger? If there were a category of financial power recognised in the act, in the case you have just posited it would not apply because there would not be financial power.

Dr Williams—If somebody then subsequently made a takeover bid of Loy Yang or somebody was pricing low and priced Loy Yang out of the market, you would not want Loy Yang to be able to bring proceedings against somebody else because they were in a weak financial position and somebody else, who had been a more prudent investor and had paid a lower price, was in a stronger position.

Ms Castle—That is really our concern about the incorporation of financial power. The problem about proscribing financial power is that it has the potential to stifle innovation and investment. The only context in which we thought it could possibly be relevant is in the context of predatory pricing, which is the genesis of our submission, and even then we know it has controversy attached to it.

Senator BRANDIS—I agree with that limitation.

Ms Castle—There could be no concept of financial power having any role to play in either the question of whether you had a substantial degree of market power or any other place in section 46 outside of predatory pricing.

Senator BRANDIS—I agree. That seems to me to crystallise the problem, but we do still have this great degree of uncertainty—I believe, and I believe Dr Williams agrees with me—about what predatory pricing is. We know that section 46 is meant to attack that type of behaviour. We also know that that type of behaviour may, although not necessarily must, be driven by financial power which I would say is something that may, although not necessarily must, exist independently of market power. If each of those propositions is true, this committee has to deal with whether we can properly attack predatory pricing or ensure that section 46 is

properly equipped to attack predatory pricing without going some way towards plan B, as it were—the statutory language you suggest would be appropriate to deal with financial power.

Ms Castle—Can I make a couple of observations about the question of the clarity of predatory pricing. We are still waiting for the High Court to have the opportunity to talk about how section 46 relates to a pure predatory pricing situation. It has not had the opportunity to do that. The indications from both the Federal Court and the High Court are that section 46 will deal with predatory pricing. They have made clear suggestions, I think, that recoupment will be a necessary element. There has been some quite strong language from Justice McHugh and others about not wanting to be limited to a particular costs measure. In fact, the High Court and several judges are saying, ‘We actually like the flexibility that we are given in section 46, not to have to—

Senator BRANDIS—Judges always say that, because they can make up the law as they go along!

Ms Castle—But what they are saying is that we do not have to be wedded to an avoidable cost methodology which has proven difficult in the US.

Senator BRANDIS—Sure. I think you are saying what Mr Reid said before—and it is good counsel—which is that we should avoid being too prescriptive.

Ms Castle—We would say two things. Firstly, you do not need to do anything to section 46 to make sure that it catches predatory pricing. We believe that there is enough indication from the High Court to show that, when faced with an entity with financial power that engages in below-cost pricing with intent and with the expectation of recoupment, they will find that that comes within section 46. We do not believe there would be a justification for the committee to jump in and try to proscribe predatory pricing in section 46. All the dangers that would attend on that are reflected in our submission, in terms of having to draft cost measures and so on. You would automatically be limiting the flexibility of the Australian courts to deal with that.

Senator BRANDIS—I do not think anybody is saying that there should be an explicit, proscriptive prohibition. But, given that we agree that one of the vices towards which section 46 is directed is predatory pricing, there is the more modest question of whether a little more structure should be given to section 46 to give guidance as to what the court might have regard to. I guess that then raises the almost philosophical question of whether those criteria or descriptors are best found in the judgments or in the statute.

Senator MURRAY—Ms Castle, I want to start by examining the legal and economic underpinning of both your statement and your submission. To do so, I want to go back in history a bit. When was the Law Council formed? I presume it goes back many decades.

Dr Williams—I have no idea.

Ms Castle—I do not know about the Law Council, but the Trade Practices Committee of the Law Council—

Senator MURRAY—No, please answer the question.

Ms Castle—As for the Law Council itself, I will have to take that on notice.

Senator MURRAY—All right. I presume it predates the introduction of the Trade Practices Act.

Ms Castle—Yes, it does.

Senator MURRAY—Do you know whether the Law Council opposed the introduction of the Trade Practices Act?

Ms Castle—No, I do not know. Dr Williams, from the Leura workshop, I think it seems unlikely.

Dr Williams—I can say this, and I do not know whether it is helpful. The Law Council's Trade Practices Committee operates via an annual conference. With due respect to everybody in this room, I think it is fair to say that perhaps the two key members of the conference are Professor Baxt and Professor Brunt, who very much welcomed the new legislation in 1974. They wrote an article welcoming it, which took up the whole of the first volume of the *Australian Business Law Review*. Professor Brunt, who has been enormously influential, I think, on lawyers and on the development of the law in this area, was very critical that earlier pieces of legislation were not nearly strong enough, and that was the reason why she welcomed the 1974 act.

Senator MURRAY—If it did not involve expensive or extensive historiography, I would be keen to know whether the Law Council originally opposed the introduction of the Trade Practices Act. When I listen to you and read your submission, I get the impression that your legal and economic philosophy would have inclined the Law Council, if it held those same views, to oppose the Trade Practices Act. That is why I asked the question. My next question is: do you know if the Law Council oppose the introduction of section 51AC?

Ms Castle—No. We did not oppose the introduction of it, but we did have some discussions about the drafting of it. The way the Law Council usually operates is not to say whether the law is or is not needed—and we are doing the same thing at the moment with whether criminal sanctions should be introduced—but, if it is going to be introduced, to make suggestions about its drafting.

Senator MURRAY—Given your legal and economic philosophy as I hear it and as I read it between the lines, why do you not advocate repealing section 46? Why do you think section 46 needs to stay in the statute?

Dr Williams—Would you like me to answer?

Senator MURRAY—Any of you.

Dr Williams—I have always, ever since *Queensland Wire*, thought section 46 was a fine section and very well drafted. Although certain other members of the Law Council do not agree with me, I have always thought that the meaning of those words was perfectly clear since *Queensland Wire*. Indeed, I wrote a paper immediately after the High Court decision in *Queensland Wire*, jointly authored with Frances Hanks, in which we tried to explain what had

happened and why it was good economics and good law. I think it is a good section and I have always thought it was clear.

As I said in response to Senator Brandis, any provision that deals with competition and monopoly and that requires the courts to investigate and make decisions about degrees of competition and monopoly is going to be somewhat imprecise—that is, you will not be able to say, looking at a piece of conduct in any unambiguous way, whether that conduct infringes such a section or such a provision or not. That is true of pro competition and antimonopoly provisions, apart from what we call these per se prohibitions, apart from particular conduct which is proscribed. The proscriptions that we have in our statute, like price-fixing and resale price maintenance, are common per se prohibitions in jurisdictions throughout the world. It is these monopoly and competition prohibitions that are difficult.

Senator MURRAY—What about you, Ms Castle? Why wouldn't you want to repeal section 46, or would you want to repeal section 46?

Ms Castle—No, I would not want to repeal section 46.

Senator MURRAY—Why?

Ms Castle—Because it represents an important safeguard in balancing the conduct in which firms can engage and outcomes for consumers. I view the whole of part IV as trying to achieve the appropriate balance between the way firms behave and maximising consumer welfare. What it would do if you removed it is enable firms to take advantage of something which other people do not have, namely a substantial degree of market power, as opposed to using innovation and legitimate competitive activity to advance their cause. So I think it would be clearly to the detriment of consumers.

Senator MURRAY—Once you accept the proposition that you should restrain competition, which is what section 46 does, the question is the extent to which that restraint go—

Ms Castle—The balance.

Senator MURRAY—and I therefore find some of your propositions a little difficult to put into context. My question really is to the economist amongst you, although I am sure you are all adept enough to answer it. It is true, isn't it, Dr Williams, that economic theory posits that the eventual result of free competition and an unregulated market is the inclination towards monopoly?

Dr Williams—No. I would say two things: first of all, section 46—

Senator MURRAY—No, do not go to section 46; let us stay with the theory. The restraint that is apparent in any competition law in the world is a restraint on the monopolisation process, and that derives from economic theory which says that the inevitable exercise of laissez-faire competition will encourage the monopolistic concept.

Dr Williams—No, that was a theory of Marx. Marx wrote about that in volume III of *Das Kapital*, but very few other economists would ever have supported such a proposition. What we

mean by competition is free entry—that is, the ability of firms that are efficient to make money, to have a go. If you have competition, you will tend to have markets where you do get a lot of free entry; you do not get static markets that become more and more monopolised.

Senator MURRAY—If that is so, why do you need a trade practices act? If you maintain that the process of competition will not result in automatic monopolisation, why would you need it?

Dr Williams—There are basically two ways you can make money. You can make money by being efficient and doing good things and coming up with good products and pricing well or you can make money by monopolising—by preventing the process of competition from working. The aim of section 46—and indeed of the other sections in part IV—is to make sure that people make money, to the extent that the law can affect anything, by doing the efficiency things and not by doing the monopoly things, not by stitching things up. So the aim of all those provisions is to make sure people can only make money one way and cannot make money by the other. One way is good, one way is in the interests of consumers—the efficiency type things—but the other way is bad; the monopoly, stitching-things-up-way is contrary to the interests of consumers.

Senator BRANDIS—If I may clarify an answer very quickly, Senator Murray put to you, Ms Castle, before that ‘the purpose or the effect of section 46 is to restrain competition’. Do you accept that proposition or do you say that the purpose of section 46 is to facilitate competition?

Ms Castle—I agree with what you have just said. We say that the purpose of section 46 is to encourage vigorous and efficient competition. We said that in our opening statement and in our submission. We say if the price of vigorous and efficient competition is an economic shakeout and the exit of competitors that is in the best interests of consumers.

Senator BRANDIS—But not all aggressive conduct in the market is competitive.

Ms Castle—No, and what section 46 does is try to identify that class of conduct—and it necessarily needs to be small because otherwise you are going to stifle all competition—which we say is not facilitating competition and is some kind of aggressive or anticompetitive conduct.

Mr Reid—May I say, in an elaboration of Dr Williams’ remarks, that there are of course sectors of the economy which lend themselves more naturally to monopolistic practice, such as natural monopoly infrastructures and other industries with high ‘sunk’ costs. They are sectors of the economy which require some regulation of the form of section 46, in my view.

Senator MURRAY—I accept all of that. I have heard you state your CVs and it is quite apparent from your answers that you three people before us are of the highest calibre in your fields. But so I can understand the full range of your experience and understanding, have any of you three been in business for yourselves and run your own businesses? I know that being in law is a business so I am not implying that it is not a business; it is no longer a profession, in my view. I want to know whether any of you three have risked your own money running small businesses, medium businesses or large businesses and whether you have experienced competition in the direct sense. Believe you me, I understand that lawyers compete very strongly, so do not let me imply that you are not business people.

Ms Castle—So your question is: have we done any business other than law or economics business?

Senator MURRAY—That is right.

Ms Castle—I have not run any other type of business. I have been an employee.

Mr Reid—Speaking for myself, I have been involved in a family business that my father ran in furniture retailing. That is my experience, I would say.

Dr Williams—We established our current business about six years ago. On day one we hired 12 people. We hired them from another business that had collapsed, a business which I had nothing to do. I had to mortgage my house, much to my wife's distress, in order to meet the working capital requirements for the new business but, despite the activities of lawyers and litigation, we have actually done quite well and we have now paid off the mortgage.

Senator MURRAY—I asked you the question not to be smart but because we actually have in this room the person who referred to it. I asked a person who had been in business—and never in law or economics or accounting I might say—for, I think he said, 48 years or something, what he thought of market behaviour and what his experience was of the behaviour of market participants. I asked him if they would do anything possible, as a generalisation, that they could get away with to make money, to advance their business and achieve market power. I am paraphrasing the discourse between us but his answer was yes. In both economic theory and business practice, the inclination is to maximise power and earnings. I simply ask you the question: if you accept that, do you accept therefore that that essential commonsense understanding of the world is what informs a restrictive process as evidenced in the Trade Practices Act because it restrains and restricts predatory behaviour and behaviour which is regarded as socially and economically unacceptable?

Dr Williams—I think that is exactly right. I worked for 14 years at the Melbourne Business School and in my last year I was the academic dean of the Business School. In the field of business strategy, that is exactly what is taught—that is, the way to make money is either to compete on costs, what we would call efficiencies, or to try to stitch things up and make the market more monopolised in some way to give yourself monopoly power. The literature of business strategy is about trying to gain monopoly power and strategies to gain monopoly power. This is what business schools around the world teach. What the law does and what economic policy suggests is that there has to be some restraints on the use of monopoly power as a way of making money.

Senator MURRAY—Exactly. This is where I am going to with this line of questioning. This committee is particularly well served, if I may so, by having Senator Brandis on it because he brings to it known expertise and understanding in this field.

Senator BRANDIS—I do not think everybody would say that.

Senator MURRAY—I am not everybody—

Senator BRANDIS—You are very generous.

Senator MURRAY—and I say what I wish to say. One of the things Senator Brandis has been exploring, a view I share and a view put to us, although I do not think it has been presented in this form, is this: the arguments against the change to section 46 have been enunciated by you that doing so may result in a more restrictive, more proscriptive regime which is contrary to the intent of the act. In fact, the argument of those arguing for change and of the parliamentarians supportive of change is that it is the courts which have made the statute narrower, too proscriptive and too restrictive. If you want to return to the intent of parliament you, in fact, are forced to add words to restore the intent which has been narrowed by the courts. I put to you the question as to whether you recognise that that is a problem in the community, which is why I made the interjection I did earlier when I said it was not just the legal and economic minds that play here it is the politicians' mind. What I mean by that is the politician reflects a community view—obviously a concerned community not the community at large. That view I have crystallised in that way. It is the courts which have narrowed and made it too restrictive and prescriptive and it is the parliament which wants to go back to its original intention. How do you react to that proposition?

Mr Reid—I have a view on this, having read the explanatory memorandum to the 1986 amendments which introduced the current form of section 46 on many occasions but not recently. I will qualify my response in not recalling the terms of it exactly. If you work through it, the current status of the legal position as enunciated by the High Court, most recently with the Boral case but in previous cases particularly Queensland Wire, is to my way of thinking largely in line with what has been set out in that explanatory memorandum as the ambitions of that provision. That is principally that the threshold is now considerably lower than control of the market as was required previously and that there may be two or more—and this is expressly referred to in the explanatory memorandum or the second reading speech, I do not recall which but certainly in one of them—corporations holding market power in the one market.

That is an issue that has been left open by the High Court and accepted by the Federal Court in the Safeway decision. The findings of market power are to be drawn from the whole of the circumstances of the context in which the corporation participates and in which it has engaged in the impugned conduct. Those three basic principles go a long way, in addition to the lists that we have provided to you of indicia of market power which are set out in the High Court's judgments, if not all of the way—I simply do not recall the terms of the explanatory memorandum exactly—towards addressing the ambitions set out in that document. To that end, we are making progress towards those ambitions. We are concerned about fiddling with that progress in a way that may hamper further progress or divert it from its current cause.

Ms Castle—We understand the political context in which these remarks and this debate is taking place. We understand and recognise that you put to us that there is a community and therefore a parliamentary wish to ensure that section 46 is doing what it is supposed to have been doing from the 1986 amendments. Our position in this debate is to bring some facts to the table to say, 'Here is the evidence which shows that the 1986 amendments are being effective. Here is the evidence which shows that the people making claims that it is not working are exaggerating the position.' So we understand your position, but our position is that we do not accept that you are forced to add words to section 46 to achieve the original intention of the 1986 amendments.

Senator MURRAY—The advantages of the Senate process, of which I am a great fan, is that we have contesting views from informed people. Being a politician, I always look for those

views to support mine. The last little bracket I want to put to you is this: it has been a theme of mine that the time frame in which business operates on the risk and return basis is much shorter than the legal time frame for propositions to be tested and put through courts. A legislator knows that most statute in fact stands on its own. Most statute is not tested at jurisprudence, and therefore the interpretation of most statute comes in a form of either market knowledge or an advice to people as to what practitioners such as yourselves think of it. What do you say to the view that changing the wording of section 46 will provide certainty to those who use it until such time as it is again tested in the courts, which I would suggest to you would probably be three or four years away, and that that in itself will restore or could restore—not will restore, because you might have a different view—the balance that those advocating change are seeking?

Ms Castle—In a way, I feel we have addressed this question a couple of times already this morning. I think, because we are legal practitioners and economists that read the cases and it is our job as the Law Council to understand what the courts are saying this section means, we do not come to this saying there is a lack of certainty. We are saying the certainty is there if you look for it. We appreciate that within the community—

Senator MURRAY—By the way, I agree with you. I think there is certainty, and it is the certainty that worries me because it is too narrow.

Ms Castle—That is where we have to disagree. We have put our position that we do not think it is too narrow.

Senator MURRAY—And I respect that.

Ms Castle—The issue is: what is the mechanism for publicising to the community what we say the courts have said this section means? What you are proposing is that we should publicise it through legislation, and we would say that that is a very drastic way of influencing public knowledge about the state of the law.

Senator BRANDIS—Why? It is extraordinary to say that publicising the law through legislation is a drastic way of informing the public what the law is.

Ms Castle—Not really. We would say that the legislation already speaks for itself, and what I think you are suggesting is that you would have additional legislation, a list of factors, to try to explain what section 46 means.

Senator BRANDIS—Are you saying to us that it is wrong in principle for an act of parliament to be transparent in explaining itself rather than requiring access through a priesthood of lawyers who have access to the law reports to explain what it means?

Ms Castle—No, Senator.

Senator BRANDIS—I have been part of that priesthood so I know exactly what it is like.

Ms Castle—No, I am not saying that. I think we are going back to whether we are starting with the blank sheet of paper, which was Bill's point, or whether now we need to make it transparent. I do not think my remarks should be taken at large.

Senator MURRAY—That is all I have; I think that is a lovely note to end on.

CHAIR—I think it is. Thank you very much for your submission and for your evidence today. It has certainly been very helpful in clarifying some of the arguments that we will have within the committee in reporting.

Ms Castle—We have a couple of matters to come back to you on about the original history of the Law Council position, and we will do that.

Senator MURRAY—Just inform us as to the underpinnings.

Ms Castle—Yes, no problem.

[11.37 a.m.]

McKENZIE, Mr Alan John, Director and National Spokesman, National Association of Retail Grocers of Australia

ZUMBO, Professor Frank, Consultant, National Association of Retail Grocers of Australia

CHAIR—I welcome representatives from the National Association of Retail Grocers of Australia. I invite you to make an opening statement and then we will go to some questions.

Mr McKenzie—We have a brief opening statement. Thank you for the opportunity to appear before you today. We have provided the committee with a submission detailing our recommendations on the committee's terms of reference, and we have put in a supplementary submission this week which puts before the committee our research and analysis of the legislative history and parliamentary intention behind section 46. In these submissions we have sought to emphasise the importance of giving effect to the parliamentary intention behind section 46 and section 51AC in particular. All we ask is that, where the parliamentary intention has been undermined, as in the case of section 46, or runs the risk of being undermined, as in the case of section 51AC, this committee recommend legislative changes that restore or clarify the parliamentary intention.

We do not come before this committee seeking protection from competition or any legislative amendments that tilt the playing field in favour of small business. We believe the key concerns that small business have with the competition law provisions of the Trade Practices Act revolve around the extremely narrow view of the concept of 'substantial degree of market power', as used in section 46. Unless that threshold issue is defined in keeping with the intention behind that concept when introduced as part of the 1986 amendments to section 46, that section's application will be limited to monopolies or near monopolies.

Equally problematic is the High Court's present interpretation of the second key concept in section 46 of 'take advantage'. The High Court's narrow view of 'take advantage' means to us that, if a corporation with a substantial degree of market power could have engaged in the same conduct in the absence of market power, then that corporation would not be taking advantage of its market power according to the High Court and for the purposes of section 46. This is a particularly onerous test, which would even mean that below-cost pricing and refusals to deal would not be covered under section 46 because they could be engaged in even in the absence of market power.

Unless the concepts of 'substantial degree of market power' and 'take advantage' are defined in accordance with the parliamentary intention behind them, section 46 would only apply—if at all—to a handful of Australian companies, where those companies were monopolies or near monopolies. NARGA believes that the best and most immediate way to deal with abuses of market power, whatever form they may take, is to restore the parliamentary intention behind the key concepts in section 46. This could be done by inserting clear statutory definitions of those concepts. That section 46 was intended to apply to oligopolies cannot be doubted, and we ask

that ‘substantial degree of market power’ be defined to cover large and powerful oligopolies, as was originally intended.

For section 51AC, we note that the parliamentary intention was to give the word ‘unconscionable’ in that context a broader meaning than the equitable doctrine. In this regard we simply make the observation that, if the word ‘unconscionable’ was defined in the legislation by reference to its dictionary meaning, this would be in keeping with the parliamentary intention. NARGA further proposes that creeping acquisitions be dealt with in a manner that balances the interests of promoting competition in the retail grocery industry and other industries and the interests of those retailers seeking to exit the industry. NARGA offers a range of proposals seeking such a balance. We have also raised other matters in our submission which we hope will be of assistance to the committee, and we remain available to assist the committee in any way that we can. We would now be pleased to respond to your questions.

CHAIR—Thank you very much, Mr McKenzie. Do you want to add anything, Professor Zumbo?

Prof. Zumbo—No, thank you.

CHAIR—I know that you have paid very close attention to this inquiry and in fact have attended the hearings, so you have had the benefit of hearing the evidence of most of our witnesses to date, including this morning’s discussion.

Mr McKenzie—Yes.

CHAIR—Could I ask you quite directly about NARGA’s organisation and representation. In your submission you list the members of NARGA, but Metcash does not appear on the list. Is Metcash a member of NARGA?

Mr McKenzie—No, Metcash is not a member of NARGA, but Metcash supports NARGA, as does the other major wholesaler in Western Australia, Foodland. They provide financial and other support to NARGA. But the actual members of NARGA are all organisations that we are involved with; they are the ones listed in the submission.

CHAIR—So you would refute any claim that NARGA is merely a front for Metcash?

Mr McKenzie—Of course. We make no secret of the fact that NARGA is supported by the independent sector as a whole in terms of funding and other resources—and that means supported by both wholesalers and retailers. Our submissions are circulated within our membership and we take advice from our members on the issues that they wish raised. There is a lot of knowledge within the retail sector about these issues. We have made a lot of media comment, including in industry magazines and so on, about these issues, so everybody would understand what NARGA is trying to achieve, which is basically a competitive outcome for the retail grocery sector in which independent retailers can be a vigorous force in competing with the major retailers. As I say, we make no secret of the fact that Metcash supports NARGA.

CHAIR—Can we go to the contents of your submission. I appreciate that it was a substantial submission. I want to take up from this morning’s discussion about voluntary codes. I know you

heard what Mr Samuel had to say about the ACCC's position in relation to voluntary codes, and I know that you are aware that other evidence to the committee has been that people are fairly sceptical about the proposal to endorse voluntary codes, but your organisation is supportive of that process. Can you tell us why the proposal can benefit small businesses?

Mr McKenzie—The code that we are involved in is the retail grocery code, which after three years is now undergoing a review by an outside consultant. The code has been a voluntary code and there will be some who have some mixed views about how well the code has worked at the stage. Certainly from our point of view there is not a lot in it for independent grocers. There has been some involvement with the Ombudsman in raising some issues within NARGA's membership. As you can see from our submission, we believe that there would be value in the code if it promoted the principles of transparency and disclosure in relation to the prices, terms and conditions that are available within the retail grocery sector from suppliers as a means of promoting more vigorous competition. It was our view that, as part of the review of the code, the question of endorsement should be canvassed, because we think endorsement would improve the standards and operation of the code. The ACCC was involved in the early days of the code and has remained involved, but not very much in a formal sense. Our feeling would be that there would be an improvement in the standards that would apply if the ACCC was willing to go down the endorsement track. We certainly have suggested that to the outside consultant who is reviewing the code, and it would appear to be a logical next step up from what is currently a voluntary code. If the code is to have value for all participants in the industry, we think that the endorsement process could add something to that, and for that reason we support it. I am not quite familiar at this stage with the ACCC's endorsement guidelines—we have not really had a chance to get into that at this stage—but we support the broad principles.

Prof. Zumbo—Following on from that answer, the value of the ACCC's endorsement, and the guidelines that come with it, is to provide a benchmark or some process by which voluntary codes can be judged. You heard Mr Graeme Samuel this morning mention that there is a variety of codes, in the sense that there are voluntary codes that may not have much substance, ranging all the way up to the mandatory codes. In relation to the voluntary code side of the debate, there are no generally accepted benchmarks by which those codes are judged. What may happen is that an industry may get together at one point and say, 'We don't want regulation. Let's look at this issue closely; let's have a voluntary code,' so they put a document together. That code may address all the issues that need to be addressed; it may not. Some voluntary codes are very light on; some are very detailed. The point is that there is no mechanism at this point to say this voluntary code meets these generally accepted benchmarks. We see the ACCC's involvement as an independent observer experienced in these matters through their dealings on codes and making an assessment of the relevant code to see whether it meets certain standards. If it meets those certain standards, then it has made the grade. The commission has signed off in the sense that it feels it adds something of value to the industry. Where the code is not endorsed, then there will be very serious questions about why the code has not been endorsed—that is, does the code deal with real issues or is it simply a light-hearted attempt to deal with very serious issues? We see it as a way of bringing some objective measure to the value of voluntary codes.

CHAIR—That is very helpful. I want to move on to the issue of price discrimination, which took up a large part of your submission. You advocate the principle of like terms for like customers. When asked about price discrimination at Senate estimates earlier this year, in his evidence Professor Fels said:

The commission and I have always felt that section 49 did not work well and would be better dropped. It conceivably tended to even discourage genuine price competition.

Then he went on to say:

We have never been tremendously keen on putting explicit price discrimination clauses into section 46. There are circumstances where anticompetitive price discrimination would be unlawful under section 46. It would be a much narrower range of cases than might have been picked up under section 49.

On the basis of the issue about competition that you argue for very strongly, how does your proposal address concerns about the impact on competition of specific price discrimination provisions?

Prof. Zumbo—I am happy to make some opening remarks. Firstly, to put the debate—which was raised this morning with the ACCC—in the context of section 49 and section 46, we certainly do not advocate a return to section 49. The main, if not the only, reason why section 49 was repealed was that it could catch procompetitive price discrimination. More importantly, anticompetitive price discrimination could be adequately caught under section 46. The promise that was made at that point of the repeal was: ‘We’ll repeal section 49 because we believe section 46 does the job in terms of anticompetitive price discrimination.’

Unfortunately, the reality is that there are doubts as to whether section 46 will do that work in terms of anticompetitive price discrimination. We have taken the view in our submission that the threshold test in section 46 is set at such a high level that you do not even get to the level of talking about conduct. But we support use of section 46 that reflects the parliamentary intention to deal with anticompetitive price discrimination.

There has to be a distinction between procompetitive and anticompetitive price discrimination. We are only concerned with dealing with anticompetitive price discrimination. We believe that section 46, interpreted in accordance with its parliamentary intention when it was amended in 1986, would deal with anticompetitive price discrimination. But that is with the big proviso that section 46 must be interpreted in the way originally intended under those 1986 amendments. We do not believe it is, and therefore we do not get to the level of discussing the actual conduct.

In relation to our proposals on anticompetitive price discrimination we have two fundamental concerns. One is that often there is a lack of transparency in supply relationships, particularly where you have large suppliers and smaller customers or where you have suppliers facing market power by other customers. In that context, there is often a lack of transparency as to the prices that each of those customers is able to get. But it is not about one customer knowing what another customer’s prices are. In this context it is a question of knowing exactly where you stand with the supplier.

Customer A goes to supplier 1 and says, ‘I want to buy stuff from you.’ Supplier 1 says, ‘Okay. This is the list price. Anything more, come back and we’ll have a chat about it.’ That is not talking about the benchmarks by which customer A can get certain discounts. Particularly in the retail grocery industry, it is not about the list price; it is about all the rebates and trading terms.

CHAIR—But in your submission you actually capture that whole argument. I will quote from your submission:

... if a supplier is selling to a competitor at a cost price lower than the cost price offered to NARGA members, NARGA members are entitled to the same cost price where they make comparable purchases.

How do you define the use of that word ‘entitlement’?

Prof. Zumbo—We look at in terms of equivalent transactions. If you buy the semitrailer load, you get the same price whether you are customer A or customer B. If you provide comparable services to other customers you should be entitled to the same trading terms as those other customers. It is about setting benchmarks such that if I perform in a particular way—if I reach certain benchmarks, if I sell the same sorts of products or if I grow my sales by a particular percentage—I will be entitled to a further rebate and to know what that rebate is. There is certainly a lack of transparency in knowing what the actual hurdles to overcome are in particular instances. We define ‘like’ as equivalent transactions. We are not talking about a small person being entitled to the same price simply because they are smaller.

Mr McKenzie—We are not advocating that all customers be treated the same. Obviously there would be reference to volumes, there would be reference to the services that the customer provides the supplier and there would be an element of negotiating skills. What we are saying is that if you accept the principle that comparable customers should get comparable treatment—not the same necessarily, but comparable—it provides you with a benchmark to assess whether price differences are related more to natural competition developments or whether there are possible abuses of market power involved which might explain those differences. That is the concern. You set a standard by which you can assess in some objective way whether or not there is behaviour going on behind the scenes that is influencing the availability of prices in an anticompetitive manner. It is similar to the Canadian law, which focuses very much on making the prices available to a competitor of like standard. If you do not do that then you run the risk of breaching the law.

CHAIR—Sure. You heard the Law Council this morning talking about this whole issue in terms of procompetitive behaviour as opposed to anticompetitive behaviour.

Mr McKenzie—It is important to understand that what we are talking about here is improving transparency and disclosure in markets that are highly concentrated, and the substantial market power resides in the hands of the parties involved. If we are going to promote competition, then the more transparency, the greater the available information. That does not mean to say that every competitor, even knowing what the available price is, will get that price, because that competitor will have to satisfy the supplier that he can meet the requirements set by the supplier. Those of us in the grocery industry understand the complexity of business plans that are developed between customers. If you do not know what the endgame is, you are really fishing in the dark. Unless bits of paper fall off the backs of trucks, which happens from time to time—

CHAIR—Delivery trucks.

Mr McKenzie—we are in the dark about whether or not there is anticompetitive conduct going on. If we go back to the parliamentary intention, one of the kinds of conduct that was

identified in the explanatory memorandum was inducing price discrimination. The parliament at that time had intended that inducing price discrimination would be covered by section 46. One thinks that in most cases the suppliers who are discriminating are not necessarily doing so willingly but rather unwillingly under duress from major customers.

CHAIR—You also had the benefit of hearing Senator Murray’s discussion with the Law Council this morning, where he asked about whether any of them had actually owned and operated or been involved in small business. I wonder if you have any comments to make about the difficulty of capturing the experience of business in legislation in the ways that Senator Murray was trying to elaborate on this morning. Is it the practicalities? Is this a case of the intent of the legislation and the legislators—us—trying to reflect what is good public policy contradicting business practice?

Prof. Zumbo—There is no attempt to contradict business practice. Concerned elements of the community will believe they have an idea of what predatory pricing is if they are on the receiving end of predatory pricing, on the receiving end of anticompetitive price discrimination or on the receiving end of a refusal to deal. It is obviously important that that expectation coincides with what the law is, the law reflecting the public policy. If the community out there believes that there are species of anticompetitive conduct that need to be prohibited, those species of anticompetitive conduct should effectively be prohibited. If the law is inadequate to deal with those species of anticompetitive conduct, and the community and the legislature reflecting that community do not deal with it, there is a real issue—there is a gap between what the community believes has been outlawed, what parliament is saying is outlawed and how the courts interpret what has been outlawed.

There is a gap there if the community believe that predatory pricing is intended to be prohibited and is anticompetitive in such a form that it should be prohibited, the parliament has taken that on board through amendments to legislation saying that that species of anticompetitive conduct should be prohibited and then the High Court comes along and says, ‘Well, we look at one element of this provision—section 46—the element being substantial degree of market power,’ and that is defined in such a narrow way that not many organisations are caught, and, more importantly, we do not even get down to an assessment of the conduct. There is an element of the community, if not a widespread element of the community, who believe that there is a gap between what the legislation promised and the reality. For 17 years people believed they had effective protection against predatory pricing—for example, in relation to the Boral case. One day they wake up and they find out that, no, there is not that effective prohibition against predatory pricing because we do not even get to look at the conduct because of that threshold issue. So, if there is a gap between what the legislation is trying to do and what the community expects of that legislation, that obviously is an issue to be dealt with.

CHAIR—Your submission also goes to the issue of your suggesting a divestiture remedy for repeated misuse of market power.

Prof. Zumbo—Yes.

CHAIR—Just clarifying that, are you saying that this should be only available where a firm is twice found guilty of misusing market power, or would it be available for a single case?

Prof. Zumbo—We have not put a number on it. We refer to repeated breaches, and we see it as very much a last resort.

Mr McKenzie—Repeated intentional breaches. It is where there is a series of reprehensible—

Senator BRANDIS—They are always intentional. It is purposeless if they are not.

Prof. Zumbo—Yes, but the word ‘repeated’ is the key—that is, you have penalties of \$2 million per breach and you may have criminal penalties. If, after all those penalties have been applied, this organisation continues to do that repeatedly, then you have no recourse left. You can keep imposing penalties and you may put people in jail, but if the culture of the organisation is embedded in being anticompetitive then as a last resort you order divestiture.

Mr McKenzie—And it would only be available to the ACCC to pursue.

CHAIR—One other issue that has not been discussed this morning, but perhaps you have some comments to make on it, is that of collective bargaining. Other small business groups have supported the notification procedure for collective bargaining that was recommended by Dawson. What is your view?

Mr McKenzie—I will start and then I will let Frank come in. Right from the outset we have said that we support effective collective bargaining. We have concerns about what the proposal that is currently on the table will deliver other than a purely procedural change in terms of timing and cost. I believe that the ACCC said in their evidence only last week that they do not believe that the change, or the proposal as it currently stands, will deliver anything more than a procedural advantage to small business. They indicated that it would be unlikely that the scope of the arrangements that would be given immunity under the Trade Practices Act would be widened. So, in effect, apart from the timing and cost benefits of the proposal, there would not be anything necessarily more in it than what there is under the current authorisation procedures.

So it is clear that some small business groups are of the view that, unless there are collective boycotts available as part of the proposal, they are not going to get much benefit. There is an expectation, I think, that there will be something by way of collective boycotts. But if those collective boycotts are widespread within the proposal that is coming forward, the commission has indicated that it will take a very firm view, as it does indeed with authorisation proposals. So, while we have supported the principle of collective bargaining and effective collective bargaining procedures, we question what this proposal will deliver beyond a procedural change, as far as we understand it at this point in time. I understand there is work going on developing a proposal.

But there are other issues as well. There is a \$3 million threshold involved. We have questioned why that is necessary given that there is no threshold involved in the authorisation procedure. There is also an issue of that only being available to firms that are dealing with a company with a substantial degree of market power. What does that mean post-Boral? There is a whole raft of issues that have to be clarified by the government in terms of its proposal.

We have said that we support effective collective bargaining and, in fact, the independent grocery sector is set up for collective bargaining. We collectivise volume at the wholesale level

in terms of our dealings with suppliers—individually, those retailers would have no ability to command best prices, but through their wholesaler they can buy at the best possible prices from suppliers—and then there is the collectivisation of volume at the banner group level for the negotiation of promotional and marketing activities. So the retail grocery industry has been set up for many years—since its inception—as an effective collective bargaining operation. Despite all of that, we still cannot buy at the very best price. So collective bargaining is not a panacea for all the woes of small business either. Even the most effective collective bargaining can still be undermined by anticompetitive conduct. That is why we need a strong section 46.

Senator MURRAY—You say the panacea is transparency? That is what you are saying.

Mr McKenzie—Yes.

Prof. Zumbo—It goes a very long way towards that. Following on from Mr McKenzie's comments, collective bargaining is only one side of the equation. Sure, let us have effective bargaining and let us make sure that all the details of the proposal are well known. We would all know that collective bargaining has been allowed since the inception of the act and that it has been able to be authorised since the inception of the act. The proposal before the government now is to streamline the process in terms of costs and what have you. That is one side of the equation for effective collective bargaining. But there is the other side of the equation—that is, the firm with whom those small businesses are collectively bargaining. If that large organisation is able to abuse its market power and not be caught by the Trade Practices Act, that is an issue that needs to be addressed. It is fine to have the ability to collective bargain, but if on the other side the larger player is unconstrained in its ability to engage in anticompetitive conduct then that is a serious issue that would undermine effective collective bargaining.

CHAIR—I have one final question. In your original submission, you made the suggestion that the Australian Competition Tribunal hear section 46 cases and that the Federal Magistrates Court hear unconscionable conduct cases. You have heard the evidence from witnesses that they did not think that was manageable, that it brought in another jurisdictional process and the possibility of other interpretations and that it complicated things. I wonder if your position on that has changed.

Prof. Zumbo—No. We stick by our original position, and we do so for a number of reasons. Firstly, we need to say why we drew a distinction as to the Competition Tribunal for competition issues and the Federal Magistrates Court, or FMC, for unconscionable conduct cases. Taking the somewhat easier proposition of the Federal Magistrates Court first: that court has been established as a lower cost forum to the Federal Court and has a greater emphasis on alternative dispute resolution. One of the key philosophies of the Federal Magistrates Court is that there is no assumption that all matters will be adjudicated or will go to a final hearing; rather, there is a greater emphasis on alternative dispute resolution. We suggest that court in relation to unconscionable conduct and breaches of the mandatory franchising code on the basis that in many cases you have a situation where you have a small franchisee and only a slightly bigger franchisor, and the cost of going to the Federal Court to deal with these technical issues for a resolution issue may be very expensive.

In many cases—although I would not say all cases—there is a genuine misunderstanding or a genuine breakdown of communication between a franchisor and a franchisee, or a landlord and a

tenant, and the emphasis on alternative dispute resolution may bring the parties together. We are comforted by the evidence in the franchising context where the Office of the Mediation Adviser has been set up and mediation has become a very successful tool for dealing with franchising disputes. I was fortunate enough to serve on the federal government's Franchising Policy Council and was privy to some statistics on matters going to the Office of the Mediation Adviser; 70 per cent of disputes were being resolved.

If you extrapolate that out into a federal magistrates context, where there is an emphasis on alternative dispute resolution such as mediation, we are comforted that there would be a low-cost and user-friendly forum where these players can get together at a minimal cost. In many cases it may not be a technical issue about what 'unconscionable' means that is causing the problem but, rather, a communication breakdown between the parties. That facilitates that, and often you will not see endless appeals in those cases, because the parties are often close in terms of bargaining power or, if they are not, the issues are best dealt with in that forum anyway. These are ongoing relationships. These are contractual relationships where the parties have an interest in continuing their good relations. We believe that that is a great, low-cost forum to deal with these issues expeditiously.

In terms of competition, however, you are dealing with issues between competitors. You are not dealing with contractual relationships in many cases but, rather, with competition issues and distinctions between procompetitive and anticompetitive conduct. We believe that the Competition Tribunal, subject to issues of resourcing and support for the tribunal, could provide a very quick forum for making an assessment as to whether the conduct is procompetitive or anticompetitive. That body is a specialist body, an expert body, a quasi-judicial body. These matters could be dealt with before the tribunal fairly quickly, with a quick resolution of the issues. We have heard evidence of how long these cases take, the endless appeals and what have you. We have also heard suggestions about the takeovers panel being an effective forum, where these issues are quickly dealt with. We would see the Competition Tribunal as a readily accessible mechanism for these issues to be dealt with by a specialist tribunal in those circumstances.

Senator BRANDIS—Professor Zumbo, are you a member of the Trade Practices Committee of the Law Council?

Prof. Zumbo—I am.

Senator BRANDIS—I take it that you do not agree with their submission.

Prof. Zumbo—Given my work for the National Association of Retail Grocers, I have abstained from deliberations that have taken place in relation to the Law Council submission.

Senator BRANDIS—I was not asking you whether you participated in drafting it—I assume you did not—but may I take it that you do not agree with it?

Prof. Zumbo—No, I do not agree with it.

Senator BRANDIS—Was I barking up the wrong tree before or am I right in thinking that there is a variety of views—we only heard one this morning—among the members of the Trade Practices Committee of the Law Council of Australia?

Prof. Zumbo—Absolutely. There are different views in the Trade Practices Committee. There are attempts to reach a consensus, I have to say, and sometimes that consensus is not forthcoming. In that case, it is simply taken on the basis of a majority view—maybe a big majority, maybe a slim majority. But in those cases where there is not a consensus, there is certainly a vigorous debate and alternative views presented before the Trade Practices Committee of the Law Council.

Senator BRANDIS—I know you go into this in your submission, but let us get it down in *Hansard*. In your opinion, did the Boral case narrow or confine the operation of section 46?

Prof. Zumbo—Quite clearly, yes, it did confine the operation of section 46.

Senator BRANDIS—So you disagree with the majority of the Law Council but you agree with, for example, Professor Allan Fels?

Prof. Zumbo—Yes; and, may I add, Mr Graeme Samuel and the ACCC at the moment.

Senator BRANDIS—I want to give you a hypothetical case that I have suggested to a couple of witnesses and I invite you to comment on it, particularly in view of the approach the court took to resolving the facts in Boral. This is purely hypothetical; it is not derived from the facts of any case at all. Let us say you had two firms in a market to supply a given good or service—for argument's sake, bus services between Cooma and Canberra—and they are competitive; there is no suggestion of section 45 conduct. Let us say that they are both large firms that operate in a diversified number of markets across Australia. Let us say that the market price for the provision of that service was \$150 per unit and that the avoidable cost to the firms of providing the service was \$110 per unit so that the profit that each of those two established firms earned on the provision of the service was \$40 per unit. Let us say that a new, small, lean, mean, hungry competitor—not diversified; not operating in other markets—comes into that market and it can provide the service for \$120 per unit, at a cost to it of \$100 per unit. Unlike the existing two firms, it is prepared to take a profit of \$20 per unit, not \$40 per unit, and it establishes the new competitive market price at \$120 per unit.

The two big firms can still make a profit by meeting that price. Their cost per unit is \$110, so they would still be making a profit; it is just that they would be making a profit per unit of \$10 and not \$40. But suppose, independently of each other, they say to themselves, 'At a \$10 profit we are not getting sufficient return on our capital. Let's drive the lean, mean, hungry, new competitor with the lower cost structure out of the market'—so there is a section 46 purpose. Suppose that in providing that service they then reduce their price below the \$100 per unit, which is the small competitor's cost price and also an additional \$10 below their own cost price, and get sued by the ACCC under section 46. Suppose they then say, 'Hang on a moment. Whether or not our purpose was to eliminate the small competitor from the market, the fact is that we were responding to the competitive pressure that the new competitor was exerting upon us in dragging the market price down; therefore, our conduct cannot constitute taking advantage

of market power.’ After our having had the Boral case, do you think they would get away with that?

Prof. Zumbo—We would say yes.

Senator BRANDIS—Do you think they would have gotten away with that prior to the Boral case, as you then understood the law?

Prof. Zumbo—No.

Senator BARNETT—Thank you for your submission and your supplementary submission, which are thorough and comprehensive. How important in fixing the problem is the issue of ‘like terms for like customers’? Also, would implementation of the parliamentary intent, as it was originally when the legislation was introduced, have impacted on addressing your concerns with ‘like terms for like customers’?

Mr McKenzie—Frank is the legal expert. Going to the issue’s importance, it is a very significant issue in our industry. Trading terms and buying prices are fundamental to our ability to compete in the marketplace. The ability of our major wholesalers to get the best possible price from suppliers which they can then pass down to their independent customers is critical to our ability to offer vigorous competition in the marketplace in the best interests of consumers. If we are being discriminated against in that regard, it is an issue of fundamental competition. As I indicated earlier, I believe that in many cases the supplier does it not necessarily willingly but purely because of the pressure they come under from the major players continually driving prices down. We feel that we end up cross-subsidising or subsidising those prices. So it is a critical issue because it is fundamental to the ability to compete in the market place. If you can be undercut while your competitor maintains a satisfactory profit level, it makes any predatory conduct over and above that even more punishing.

In our view, our ability to get the most competitive prices from suppliers is critical to our ability to compete in the marketplace and offer vigorous competition. It probably is a bigger issue for us than below-cost pricing, if you wanted to rate the two, because it is the one we see every day and it is fundamental to our ability to compete. If our independent retailers are unable to compete and earn an acceptable margin, they have to cut their margins. Ultimately that means they are unable to reinvest back into their businesses, which ultimately means that their offer to the consumer suffers and the position then deteriorates even further. It is a fundamental issue and we believe that it ought to be addressed. It could be addressed if the problems evident in section 46—the critical threshold issues of ‘substantial abuse of market power’ and ‘take advantage’—were addressed. We could then get into the conduct and see whether it was anticompetitive or just down to other factors—normal competitive factors. But we will never know unless we have an effective section 46.

Prof. Zumbo—We are mindful of there being a clear distinction between procompetitive and anticompetitive conduct. We would not want to propose anything that would capture procompetitive conduct. We need clarity as to where we stand, particularly in the retail grocery industry. That is why we talk about transparency. That is not about promoting any particular procompetitive or anticompetitive position but is, rather, about knowing where everyone stands. Then, knowing where everyone stands vis-a-vis customer A and supplier 1, as I said before, we

are not interested in knowing of everyone else's trading terms. We are concerned to know that, when we are dealing with a particular supplier, we are clear as to what our trading terms are in that instance and, having had transparency, that there is an effective section 46 where examples of anticompetitive price discrimination are revealed through ACCC investigations or other investigations.

Senator BARNETT—You have used the word 'comparable' a number of times. Can you flesh that out for us? It is obviously hard to define and is a difficult area.

Mr McKenzie—You cannot be precise. Obviously, there are reasons for differences in prices. The differences can be subtle and may relate to the negotiating skills of the parties involved. There could be differences in volume or in the services provided by the different parties. Customers are considered comparable, for example, if they are at the same buying point in the distribution chain. It is there that the impact of the discrimination will be felt. That is where the goods are acquired from the suppliers and then go into the distribution centres. They operate service retail networks—in the chain case the stores are their own; in the independent case they are third-party stores. If customers are considered to be comparable, the prices at which they can buy from suppliers should also be comparable.

Prof. Zumbo—We have made an attempt to define 'comparable customers' by reference to equivalent transactions; that is, a set of goods in a particular situation—a thousand or 10,000 units or whatever. We also have other requirements such as equivalent transactions in relation to competitors—because, if one competitor has that problem, it becomes anticompetitive. Then we have said that there are minimum requirements of a supplier or main player. A supplier might say, 'In these transactions we will give you this particular price on the basis that you perform in a particular way.'

Senator BARNETT—I am trying to work out how important this is. You have said that it is obviously very important. I am trying to find out how systemic the problem of intimidation of suppliers is in your industry. On page 27 of your submission, you state:

At worst, suppliers are coerced or intimidated by the large and powerful corporation into giving the entity a price advantage or a commitment not to offer discounts to the entity's rivals.

Can you tell us how systemic this type of pressure is in Australia's retail grocery industry?

Mr McKenzie—We believe that it is systemic. But suppliers will tell you things privately that they will never say publicly. That is the problem; it is all underground. You will notice that there are no suppliers attending these hearings. We had exactly the same problem back in the retail inquiry. Other than Proctor and Gamble, no suppliers attended voluntarily; from memory, all the others had to be summonsed to a special hearing to have questions put to them. So the reality is that no supplier can afford to be out of favour with the major players. As I say, we get told things privately that will never be said publicly. I know that there are also things said in manufacturer forums to different parties as well. This is the difficulty with the issue in terms of exposing the extent to which the intimidation goes on. It can be very subtle, I am sure.

Senator BARNETT—You can understand that, as members of parliament, we have to make decisions based on all, and the best, information which is factually available and we cannot do it based on other suppositions. That is an issue.

Mr McKenzie—I understand.

Prof. Zumbo—We agree entirely. It is a question of evidence. We provide anecdotal evidence in the sense of our experience. We have not named suppliers. You may recall that there was a reference to the ACCC two or three years ago in which the ACCC was asked by the Senate to inquire into the issue of pricing and whether it is price discrimination, how trading terms are determined and what have you. The ACCC undertook that inquiry. It was a voluntary inquiry. The ACCC does not have any coercive powers. Unfortunately only 19 out of the 50 suppliers provided evidence. Even from that evidence there were suggestions that there was discrimination occurring.

Senator BARNETT—That was what I was about to ask about: your response to the ACCC findings in that report. You have indicated, Professor Zumbo, the lack of contribution from various suppliers. What is your response to the ACCC report?

Mr McKenzie—The ACCC report, by its very nature, was limited because of the information it received. It acknowledged the limitations of the information. We can only speculate why only 19 of the 50 suppliers came forward. But, on the basis of the 19 who did come forward, there was evidence that the chains were favoured most of the time on price. The fact that the independent sector was able to get the best price sometimes suggests that the sector can perform to the requirements set by suppliers. But you would think that, if it was an even-handed approach, we would be getting those best prices at least half the time rather than much below half the time. But the commission ultimately deemed that, on the basis of the evidence given to them, there was no suggestion of anticompetitive conduct.

Senator BOSWELL—This committee is investigating section 46. Are you saying that a revised section 46 will give you the ability to get the same prices as Woolworths or Coles?

Mr McKenzie—No, we are saying that, if section 46 was reformed to be consistent with what parliament had intended by addressing the critical threshold test of ‘substantial degree of market power’ and ‘take advantage’, we would then be able to look at the conduct that is going on. At the present time we do not get into the conduct. Price discrimination is one of the forms of conduct that was intended to be addressed by the parliament when section 46 was introduced in its current form. Certainly it was intended, when section 49 was abolished, that section 46 would pick up issues of anticompetitive price discrimination.

Senator MURRAY—I have one question, which is also to assist in this matter. You have put the proposition that transparency of pricing is a key—perhaps the key—consideration. I read somewhere the other day that the greatest aid to honesty is the electric light bulb. As you know, the committee is considering whether it should make a recommendation to include in section 46 the criteria that the courts should have regard to—a non-exhaustive list, I would suggest. Is it your proposition that transparency of pricing should be in those criteria as a matter that the courts should have regard to in considering any litigation under section 46?

Prof. Zumbo—You are absolutely correct in saying that transparency is a key, if not the key, principle. In terms of principles, our comment on guidelines and what have you is that they implement the parliamentary intention. We have a concern that certain guidelines may—

Senator MURRAY—I am sorry to interrupt, but can you come back to my specific question, which is: if we were to recommend putting criteria in the legislation, is that a criterion you would want in there?

Prof. Zumbo—Yes, absolutely.

Mr McKenzie—It would come down to making available to bona fide customers the prices at which the supplier is prepared to deal. That does not necessarily mean that you would get the best price, but you would have an opportunity to get that price because the supplier would lay down the terms and conditions at which he is prepared to offer his best price.

Senator MURRAY—Let me help you by helping you to understand my thinking, which has drawn upon the experience in other fields, particularly with ASIC. What I would hope is that, if the committee took that route, they would then suggest, as a consequence of legislative clarification, that the ACCC in the same sense as ASIC inform the market in a fuller sense about the Corporations Law intent and about the section 46 intent. In other words, it would produce practice notes, guidance notes and things of that sort. That is the kind of framework in which I am thinking about these matters.

Prof. Zumbo—If the guidelines restore the parliamentary intention, that would be excellent. Having restored the parliamentary intention, whatever mechanism was chosen, if the ACCC explained that in more fulsome detail, that would be a very good thing too.

Senator BARNETT—I have a quick question in terms of the ACCC and your response to their submission. Do you have an official response?

Mr McKenzie—We support what the regulator is saying. The regulator is advocating restoring the parliamentary intention by clarifying the key concepts that underpin section 46 and that is exactly our proposition. The only thing we have done is put in a proposal, whereas they have declared their principles, which we totally support.

Senator BARNETT—And you have fleshed it out a bit more. I just want to ask you about recommendation 17 and creeping acquisitions. It has been a big issue all around Australia, but specifically in Tasmania over the last couple of decades—Woolworths now is the major retail grocer down there. I just wanted to flesh that out. You say that you propose that the impact of previous acquisitions on the level of competition be inserted as an additional factor in section 50(3). Can you tell us why that is necessary and is there nothing we can do about it at the moment under the status quo?

Mr McKenzie—I will start off and I will ask Professor Zumbo to add his comments. Section 50 has shown itself to be unable to deal with a series of small acquisitions undertaken by a company with a large market share over a period of time. While each individual acquisition does not have the effect of substantially lessening competition, the overall impact is one that potentially can substantially lessen competition. So, for example, if a major chain were to buy

out 100 stores in one go, that would very much come under the ACCC's spotlight. But, if they make those same acquisitions over a period of years, piecemeal and one by one as part of a strategic plan to acquire that same level of market share, it is very difficult for the commission to find that each acquisition on its own represents a substantial lessening of competition. That is the problem.

The section was designed with a view to preventing any competitive acquisitions on a large scale, not individual small acquisitions. So the commission has been hamstrung in that regard. Because they have been hamstrung, it has contributed to the increasing levels of concentration in key markets such as the retail grocery sector. So our purpose in pushing for reform of this is to try to strike a balance between the need to have a procompetitive environment on the one hand—to protect the competitive process and make sure there is a vigorous independent sector competing with the major players—and, on the other hand, to allow independent retailers to exit their businesses. That, unfortunately, comes in for a bit of debate within our industry. But, at the end of the day, if we allow these acquisitions to continue as they have been for many years—and, more recently, Coles has acquired another 20 of our independent supermarkets since September—

Senator BOSWELL—Were any of those Franklins stores?

Mr McKenzie—I am not sure if any of them were former Franklins stores. These are independently owned supermarkets trading under IGA or FoodWorks.

Senator BARNETT—I understand that, but were they all around the country or just in a certain area?

Mr McKenzie—They were predominantly in Victoria, but they are in the four eastern states.

Senator BARNETT—So you are saying that this sort of thing goes on pretty consistently.

Mr McKenzie—Since 1995 there have been about 100 independent stores that have been bought by either Coles or Woolworths. In the process, something in excess of \$1 billion worth of retail sales has changed hands from the independent sector to Coles and Woolworths.

Senator BARNETT—And you have evidence to support that?

Mr McKenzie—Of course. If you would like, I can provide that to you.

Senator BARNETT—That would be helpful.

CHAIR—Could you take that on notice please, Mr McKenzie?

Mr McKenzie—I can, yes.

Prof. Zumbo—I would follow on from Mr McKenzie's comments by saying that, once again, it is a question of whether parliamentary intention has been given effect to. In relation to the prohibition against anticompetitive mergers, section 50 prohibits mergers that substantially lessen competition. The key point from Mr McKenzie's comments was that if 100 stores were

bought in one go, that would clearly be within the parliamentary intention of section 50 to deal with. However, if they were done one by one over a period of one or two years then it would be much more difficult to capture those under section 50, even though the parliamentary intention is to deal with acquisitions that substantially lessen competition, and whether they are done in one hit or individually over a period of time should not detract from that intention.

Senator BOSWELL—This is a very hard decision to make because, on the one hand, you have got the lessening of competition, as you have alluded to, and, on the other hand, you have got the grocers, who say, ‘I want to sell out to the highest bidder.’ Is there another course where you could, say, ask that the price a grocer wants be notified? That would allow the independents in. Is that an option: to declare the price before the sale?

Mr McKenzie—The other avenue is to have a more transparent bidding process.

Senator BOSWELL—That is what I am trying to get to.

Mr McKenzie—Currently what happens is that either the independent will approach Coles or Woolworths or they will approach the independent. They will begin negotiations, they will lock the independent into a confidentiality agreement and that is the last we hear of it until such time as it has been confirmed that there has been a sale price agreed. At that point, possibly even after the exchange of contracts, Coles or Woolworths would notify the ACCC of the acquisition.

Senator BOSWELL—This is what I am trying to get to: is there a point where we can open it up?

Mr McKenzie—If we could open it up—for example, at the point where they were to reach agreement in principle but before they had actually exchanged contracts—and allow other bidders to come into the process then that would certainly be a great step forward. We know that, on a number of occasions, either the wholesaler or other independent retailers would have happily bid on those stores but were denied the opportunity. If they were given the opportunity, there would be a possibility that those stores could remain in independent hands.

Senator BOSWELL—Would you not just get into a bidding war where Coles or Woolworths would outbid you anyway?

Mr McKenzie—They have got deeper pockets than the independents or the wholesalers have, and that is ultimately what would possibly happen. The end result could be, if Coles or Woolworths was determined to get the store at any price, a bidding war that only they could win. That is the difficulty. You need more than transparency really; you need a fair opportunity to keep those stores in independent hands. If it comes down to a bidding war, the major chains are always going to win.

Prof. Zumbo—There are dangers in that also in the sense that if the price reaches astronomical levels and the chain succeeds in buying that store then they have to make that store pay at some point in time. We heard earlier that some of institutions have paid a lot of money for electricity generators and cannot service the debt. There comes a point where, if you pay a high price, you have to make that investment work. So if one of the chains were to win at a huge price and that has to be made to work, does that mean driving out the competition in that area to raise

prices? Does it mean cross-subsidising? Does paying top dollar for this store mean that you have to raise your prices across the state to cover that? How is that acquisition made to work?

Senator BOSWELL—I would have thought that, if section 46 were enacted and your competition decided to sell butter at \$1 per 500 grams but in one particular area they tried to sell it at 80c, that would be predatory pricing. I am assured that that will not happen.

Prof. Zumbo—If it does happen, it is not covered by the Trade Practices Act.

Senator BOSWELL—At the moment it is not.

Prof. Zumbo—Yes, that is exactly right.

Senator BOSWELL—But it would be if the amendment went through, because that would then be predatory pricing.

Prof. Zumbo—If section 46 were restored to its parliamentary intention, yes, that would deal with that issue.

Senator BARNETT—Can I just quickly ask: to your knowledge, has that happened before? Is there evidence of the type of behaviour that Senator Boswell is talking about?

Senator BOSWELL—It did happen once and I got an assurance that it would never happen again, and it never has happened again. I was assured that so many gates had to be gone through, and somehow it got through the gates—

Senator BARNETT—But can NARGA advise us as to whether that has happened before?

Mr McKenzie—I am not too sure of the specific incident that you are referring to. Can you clarify that?

Senator BOSWELL—In some southern New South Wales towns butter was at a different price—and I think you even gave me the bulletin—than butter right across the state. I challenged the stores and they said that it could not happen. I showed them the brochure and they said that it did happen. They gave me an assurance that it would never happen again, and it never has, as far as I am aware.

Mr McKenzie—We know that, from time to time, the chains will put out special handbills in different locations which show lower prices than on their statewide handbill. The question then becomes: why are they doing that? Could it be that there are vigorous independent stores in that area? That is one of the areas that we have brought to the attention of the ACCC from time to time.

Prof. Zumbo—Or are they matching competition, which would be perfectly legitimate?

Mr McKenzie—Yes, if they are matching competition, but this is a pre-printed handbill for that locality, which is organised a week or so in advance. It may be more than that. During the Dawson process, we brought the committee's attention to a pattern of conduct in Victoria where

about 20-odd stores were operating with special handbills below the particular chain's standard statewide handbill. We also know that in certain locations Woolworths have ran petrol discounts of up to 10c a litre off, whereas statewide discounts were 4c a litre off. Why were they doing that in certain locations? Again, we brought that to the attention of the ACCC. We regard those sorts of activities as, *prima facie*, predatory in nature, but of course they can never be tested because of the problems with section 46.

Senator BARNETT—Exactly.

Senator BOSWELL—Getting back to my original question, I do think we have a pretty serious problem with acquiring acquisitions and we are caught between a rock and hard place. If you had some sort of open bidding—and I do not know whether it is possible legally, whether we have the power to do it or whether the government would try to do it—would that be a solution to the problem?

Mr McKenzie—It is a step forward in that it opens up the process but, as I said, if the chain in question are committed to get that store at any price, their deep pockets will always win out.

Prof. Zumbo—The other thing to remember is that they do not just buy any independent stores; they buy independent stores of strategic value to their plans. Having researched the matter and having chosen that store as adding to their strategic value or their portfolio, they will go to enormous lengths to secure that site. If they really want that site, they will just throw any money at it. They simply have the deeper pockets.

Mr McKenzie—To answer your question, it is a step forward but it may not be the ultimate answer.

Prof. Zumbo—We would need to look at the actual details of the proposal to see whether it is transparent and open, giving everyone a fair opportunity to put in a bid.

Senator BOSWELL—Have you put in a submission on that?

Mr McKenzie—No, not specifically on that issue.

Senator BOSWELL—I suppose this committee is not really looking at that.

Mr McKenzie—No.

CHAIR—No, unless you wanted to consider it under the banner of 'creeping acquisitions' and make a submission.

Mr McKenzie—Yes, that is another solution. We have gone the particular route that we have and we have offered a number of different proposals which would take into account the cumulative impact. But we have also put forward other proposals whereby any competitive acquisitions could be authorised, based on public interest grounds, and also could be subject to enforceable undertakings, such as the divestiture of an existing store—

Prof. Zumbo—An existing chain store.

Mr McKenzie—which would allow the chain to buy the independent but, at the same time, they would have to divest one of their own stores. That may not be all that palatable, but we did see it in the Franklins sell-down where Woolworths agreed to divest several of their stores. I believe that we need to explore all avenues, but we are sensitive to the fact that it is a sensitive issue.

Senator BOSWELL—How about you make a submission on that? It may be an option that the government might consider. I read a speech by Graeme Samuel the other day in which he was concerned about it, but he left it up in the air as to what should be done about it. He said that it was a problem but he did not come down one way or the other on it.

Mr McKenzie—Certainly the previous chairman identified it as a priority area for the commission to look at. Professor Fels was at times quoted as saying that he saw it as an issue in terms of undermining competition.

Senator BOSWELL—Mr Samuels—

Mr McKenzie—Professor Fels said that, prior to his departure from the commission.

Senator BARNETT—But Graeme Samuel has said that too; it is on the public record.

Mr McKenzie—Yes. I think everyone understands the issue. It is a very complex issue and it requires sophisticated approaches to deal with it. It is a sensitive area. We would be happy to apply our minds to it and try to give you some guidance on it.

Senator BARNETT—That would be appreciated.

CHAIR—So you have taken two issues on notice.

Mr McKenzie—Yes, we have.

Senator BARNETT—I want to go to the issue of section 46 more generally and I would like to get your response on whether, the higher the market share held by a company, it is more likely or less likely that there could be a breach of section 46—misuse of market power?

Prof. Zumbo—Market share is only one element.

Senator BARNETT—I know, but is it more likely or less likely?

Prof. Zumbo—The higher the market share the greater the propensity to be tempted to engage in certain conduct.

Senator BARNETT—Thank you. The state Labor government in Tasmania has recently implemented total deregulation of trading hours. I think everyone agrees that that will hand more market share to Coles and Woolworths, the major chains in that state. The state government has recently completed what was a secret deal with Woolworths in which it provided stamp duty forgoing of \$1.4 million for restructuring purposes. On the other hand, the state government receives \$18 million in national competition policy payments this financial year but has not

provided any of those funds to the small businesses that have been impacted adversely by the total deregulation. Do you have a view on whether any of those funds—the \$18 million—should be used for restructuring or for providing assistance to small businesses in terms of the impact of total deregulation and on the appropriateness of the \$1.4 million stamp duty holiday?

CHAIR—Senator Barnett, I consider that to be a fairly cheeky question but I will allow Mr McKenzie to respond to it.

Senator BARNETT—Thank you.

Mr McKenzie—We believe very strongly that, when there is a deregulation, the loser should gain some form of compensation. It is easy to identify the winners, the people who gain from deregulation, but the losers have so far gained very little from national competition policy—certainly not in the case of the deregulation of shop trading hours. There are models around. For example, the deregulation or phasing out of liquor licensing laws in Victoria provides a model whereby funds were set aside—albeit by Coles and Woolworths, not by the government—which were contributed towards training and financial advice and in other ways to assist the small businesses directly affected by deregulation, or who wanted to exit the industry, to make those judgments. As a principle, we entirely support some consideration being given to some of these dividends being set aside to help those parties that have been directly impacted by the consequences of that deregulation. Of course, it is a question of how much.

CHAIR—Gentlemen, that concludes our questions. Thank you very much for your evidence, for your submission, for your supplementary submission and for the things that you have taken on notice.

Mr McKenzie—What sort of time frame would you like us to get back to you within on those things? Give me a ballpark figure.

CHAIR—Tomorrow?

Mr McKenzie—I know that you have deadlines!

CHAIR—We do have deadlines. Perhaps you could liaise with the secretariat, but one week to 10 days would be appreciated, if you could manage it.

Proceedings suspended from 12.50 p.m. to 1.38 p.m.

HUNTER, Mr John, General Counsel, Metcash Trading Ltd

REITZER, Mr Andrew, Chief Executive Officer, Metcash Trading Ltd

TEMPANY, Mr Gary, National Group Manager, Merchandise and Marketing, Metcash Trading Ltd

CHAIR—Welcome. I now invite you to make an opening statement and at the conclusion of that we will ask some questions.

Mr Hunter—I would like to thank the Senate Economics References Committee for inviting Metcash to appear today. The purpose of Metcash's submission is to supplement the submission presented to the inquiry by the National Association of Retail Grocers of Australia. Metcash fully supports the NARGA submission. This support reflects Metcash's dependence on the success of its small business customers who, in turn, depend on the efficacy of Metcash's buying strength. In this respect, Metcash's position differs substantially from the position of market participants representing the big end of town. Metcash works very closely with its customers, both on an individual level and through banner groups. Metcash does not compete with its customers but, rather, it facilitates their ability to compete with the chains. A vibrant Metcash means greater support for individual retailers, and the greater that support the more vigorously they can compete in the interests of consumers.

With respect to the effectiveness of the Trade Practices Act in protecting small business, Metcash specifically supports the NARGA submission in relation to clarifying section 46, dealing with abuse of market power, and section 51AC, dealing with unconscionable conduct in business transactions, and changing section 50, dealing with acquisitions resulting in a substantial lessening of competition to address creeping acquisitions.

Metcash's submission particularly addresses the creeping acquisition issue. Metcash has commissioned extensive research to detail the economic effects likely to result from a continuation of recent trends. The results of this research are set out in a report to the ACCC prepared on behalf of Metcash titled *Creeping acquisitions in the Australian grocery industry* and dated August 2003, compiled by NECG, a copy of which is attached to Metcash's submission. I will summarise the key findings shortly.

In the absence of anticompetitive conduct by the chains and/or suppliers, Metcash can be a vibrant third force providing wholesale supply and also a full range of marketing and merchandising services to its customers. It is not just a box mover; it is an efficient operation benchmarked against world's best practice. The existence of this third force has been under threat for several years from the creeping acquisition of independent supermarkets by the chains. Metcash is not seeking protection of its position. However, it would like the inquiry to understand that the ongoing duopolisation of the grocery sector does have the following negative competition consequences: choice and price competition for the end consumer that flows from having a third full service player is under threat; the competitiveness and value of the remaining independent grocery retailers is under threat; the competitive ability of wholesalers who supply independent grocery retailers and the interests of their shareholders, employees and other

stakeholders is under threat; and the viability and efficiency of suppliers is under threat from an emerging monopsonist marketplace where dominant market power is exercised by buyers.

I turn to the NECG report. The thesis of the report is that a resurgence in creeping acquisitions threatens to undermine the competitive constraint both by directly removing retailers from particular local retail markets and by undermining the customer and cost base of Metcash's wholesaling operations, thereby loosening, or potentially loosening, the price constraint which the independents can impose on the chains.

The NECG report analyses the impact or potential impact of creeping acquisitions on competition. With creeping acquisitions there is no discrete point at which the substantial lessening of competition occurs, but once the point of no return is reached, the erosion of competition cannot be reversed. Preserving a competitive market structure from being undone by acquisitions is the essence of merger control, which in turn is an indispensable element of an effective competition policy. Consumers who depend on grocery retailing for many of the goods central to quality of life have every right to expect that the Trade Practices Act will deter all forms of anticompetitive conduct and promote vigorous competition for the benefit of Australia's consumers. This is not about industry policy; it is about an effective Trade Practices Act restraining abuses of market power. I am happy to take questions.

CHAIR—Thank you. I think you have been here for most of the morning, haven't you, Mr Hunter?

Mr Hunter—Yes, that is right.

CHAIR—Were you here when I asked NARGA about their relationship with Metcash?

Mr Hunter—Yes.

CHAIR—I see from your submission that you are strongly supportive and in fact describe it as a symbiotic relationship with the independent retailers. I understand the point that you are making in your submission, but you have not had the benefit of NARGA's experience in terms of hearing the witnesses, including Mr Corbett from Woolworths, so I will read from the transcript of Mr Corbett's evidence. He made mention of your support for NARGA's campaign on section 46. He said:

If there is any dominance of the Australian market, it is in the wholesale market where, if you are on the east or west coast of Australia you have only one supplier, and that is Metcash or FAL—and if any of the independents are at a disadvantage it is that they have only one source of supply.

Would you care to comment on that view?

Mr Reitzer—Retail is where the real level of competition occurs in our industry. That is where the level of competition is when you finally face a consumer and try to sell a product for X price; that is really where competitive pressures apply. The reason there is only one wholesaler left on the east coast and in Western Australia is that there is just not enough volume to support further wholesalers. Because of the creeping acquisitions of the chains over the last 15 to 20 years, there is not enough volume. Woolworths themselves were in the wholesale business up

until a year ago. They owned a business called Australian Independent Wholesalers, made no money and, after a number of years, when their biggest customer left they decided to close it.

We are very mindful—and I think there is even a schedule in our submission on this—of the profit that Woolworths would make, because Woolworths, and Coles, do the wholesale job as they own distribution centres, just like us. But they also own a retail piece, just like our customers, and there is a certain profit that they make at wholesale level and at retail level, although when you look at their numbers it is all rolled up; that is the profit that is available for us.

You say independent retailers have no choice. Of course they have a choice as there are a number of wholesalers. I think just in the confectionery market there are 1,000 wholesalers that they can buy from. Independent retailers can buy from a number of manufacturers directly, not having to go through a wholesaler. The threat that is always there is that the barriers to entry to open a wholesale business are very low—you only have to go and rent a warehouse; that is it and you are in—and if we were to charge too much or not do a good job for our independent retailers they would just band together and open a warehouse and do their own distribution. So those are the competitive strands at the wholesale level, but the real competition in this industry is at retail.

CHAIR—Fair enough.

Mr Hunter—I would add that the High Court had a look at this, in the Trade Practices Tribunal's decision in the Davids-Composite Buyers case, and that was the result: that competition is at retail level.

CHAIR—Your substantive submission does focus on creeping acquisitions and you use the NECG report to substantiate much of your argument. Can you take us through the major findings of that report—and you touched on them in your introductory comments—as to the effect of creeping acquisitions?

Mr Reitzer—Five years ago, when the company that I work for became involved in the industry in Australia, the independent sector was in really bad shape. The market share of our customers was down to 11 per cent. The prices we got from manufacturers did not allow us to compete. We were a very ill-disciplined sector. We had 29 brands and everyone was doing their own thing. Over time we have created a lot of discipline and an effective force of independents. We have joined them primarily under one brand and we are getting a lot of support from manufacturers to be an effective third force. We are out there and we add a competitive tension. We do not play on a level playing field because we do not buy at the same prices that the chains do—and we can have a long debate as to whether or not that is justified. We do not buy at the same prices but I suppose our costs are less, we are more innovative, we are a lot more flexible and we have always got speed on our side. So we are able to compete and we have proven that.

Over five years we have lifted the market share of the independents from 11 per cent to over 16 per cent, and we do add a competitive tension to the market with that 16 per cent. You must believe me that we are not the ones that make waves, but we do add a competitive tension. The one Achilles heel that we have is that these are very low margins: our profit after five years of hard work is 1.4c for every dollar of goods that get sold, so our profit margins are razor thin and we need lots of volume to make it work. Over five years we have managed to get to that 16 per

cent but the Achilles heel is that, if the chains cherry-pick our bigger customers and buy them out without us getting an opportunity to buy them—so if they just buy them out—that volume would then start falling and, because this is a volume margin game, we would not be able to support the independents.

The NECG report was conclusive on two fronts. The first front, which is the most important, is the supermarket chain's so-called retail section. We did a massive survey of prices in the market at one particular time at all the chains and all the independents. We chose one state and spent a lot of money shopping in every single store and buying exactly the same basket on exactly the same day. We proved conclusively that in each micromarket—that is, in each town or in each suburb—as the number of competitors in that market increases, the number of the special price promotions and the number of cheapest prices at the chains increases. For example, if there was only one player in the market, the chains were only cheapest on 23 prices in a basket of 600 items. The moment there were two players, they were cheaper on 54 prices. The moment there were three players, they were cheaper on 71 prices. The moment there were four players, they were cheaper on 65. What we proved conclusively was that the more players there are in that market—and the other players are only the independents; IGA and FoodWorks in Victoria—the cheaper the prices are at the chains.

The chains pay the same price for a can of coffee, so why would they sell it at different prices in different towns and suburbs of Victoria? The only reason is competition in the local area. They pay the same, they get the same deals and they get the same discounts. Why would they sell it at different prices in 400 outlets in Victoria if they had one management, one computer and one system? The reason is local competition. By taking out strategic local competition in certain towns and suburbs, the intent is obviously to reduce the number of players. Instead of a town having three players, you then go to two players or one player; because whilst BI-LO and Coles are two brands, there is one management.

Either immediately or over time you obviously have fewer specials and less attractive prices in the chain. That is what the NECG report proved. That would then obviously damage wholesale volumes and the ability for independents to compete. Therefore, part of our submission is that we believe that the Trade Practices Act should be changed where it refers to 'an acquisition'. As has been said previously, if someone were to buy a chain of 100 supermarkets in Australia—it does not exist, but if someone were to do it—that would obviously go to the ACCC. The ACCC would look at it and say that it was an acquisition that would lead to a substantially lessening of opposition—but what if it were done over time?

What we would really recommend, what we are looking for and what we think is good for Australia because it would stop the competitive tension being removed is, for example, putting in a phrase like 'a tendency to reduce competition'. If the law said that, the ACCC could not approve what would amount to a series of single strategic acquisitions of independent stores to reduce the number of players in a town.

CHAIR—You heard the evidence from NARGA on this issue before lunch. Would you support their suggestion about having a notification before the sale was complete? I cannot remember at which point they were saying now—at the agreement in principle, I think was the term. Do you think that that could work?

Mr Reitzer—We do not believe it would work, because the chains have financial power and buy cheaper than independents do. We are not competing on a level playing field. Just by having some sort of transparent process or allowing my customers to also bid for an independent store will mean they get beaten every time. My honest belief is that it will actually make it worse, because the two chains will think they have got the approval of relevant authorities to go and do creeping acquisitions—because it is all sort of transparent now, that means it is okay to do it. We think that it will make it worse. We believe—specifically for our industry, and I can perhaps draw a parallel to petrol stations—that acquisitions should be looked at in terms of the tendency or the pattern of what is being done. We are just formalising the process by making it transparent, because, if supermarket chains have got financial power and independents do not have financial power, they will win anyway.

CHAIR—You support the idea of transparency in creeping acquisitions. What about the issue raised by NARGA about terms and fees charged by independent customers?

Mr Reitzer—Let me go back a little. Perhaps I misunderstood. We feel that transparency on buying independent retail stores will not help. If that comes in, it will be a bit better than now, but it will not help much. I can give you some practical examples on trading terms, and that is Gary's job, so he can chip in as well. In Australia, when we deal with the major grocery manufacturers and services, we do not ever see, other than from one supplier, what the actual published trading terms of the suppliers are. When we negotiate with a supplier we would say, 'We would like to buy a whole truck load of coffee in one size with all pallets the same'—as that is the most efficient way of ordering it from the manufacturer—'so what is the discount, please?' He would say, 'Five per cent.' We would then ask, 'Is that the standard discount that Woolworths and Coles get for buying a truck load of coffee at once?' He does not answer that question. We can only assume—and at times we get some evidence—that when they buy one truck load, exactly the same, they get more than five per cent. Another example is that if we were to say, 'If we pay you in 50 days, what is the cash discount?' they would say, 'Two per cent.' We would then ask: 'So two per cent for 50 days is your published, standard term? If Woolworths or Coles pay in 50 days, do they get two per cent?' They do not answer the question.

There is only one manufacturer in Australia—and this is because their parent company is American and they have decided that all their subsidiaries across the world will comply with the Robinson-Patman act—that has a published, laminated piece of paper with all the terms, all the buckets and all the moneys. They show that to us, and it is like a menu in a restaurant. For each piece, we can see that if we buy 100,000 cases we will get this, or if we pay like that we will get this, or if we only buy in pallets we will get that. We can see exactly. There are many things on that menu from that supplier we cannot do, but we know and that is fine. We know the chains can do that half a per cent, one per cent or quarter per cent, but we cannot do it.

When we ask for transparency, that is what we are asking for. We are not asking for a level playing field, and we are not asking that if I buy 10,000 cases and the chains buy 20,000 cases I get the same price. That is not it. We would like to know, in an open, transparent form—just like they have in the United States and Canada, for example—what is available and what we have to do to earn those terms. That is not available, but that is what we would like from transparency.

Mr Tempany—The trade refers to above the line and below the line discounts. If you talk about price being above the line, there is generally a published price list which is available to

everybody. Then there may be certain efficiency discounts which are called above the line, and they are also published across the trade. Below that are what are called below the line discounts. These are the hidden discounts which come by way of the trading terms—for example, for buying in efficient load sizes, for using electronic transfer of information for ordering and inventory management, and for those types of things. There are various levels of discounts which apply. As well, there are promotional discounts. There are significant percentages involved in promotional discounts, and all of that is hidden. It is below the line, and none of that is transparent. The criteria the manufacturers are seeking for everyone to qualify for those hidden discounts are not available for the trade to see. On top of that, there are promotional discounts which, tactically, are to get the prices decreased in the marketplace on promotional activity. Again, those various levels of discounts are hidden.

CHAIR—NARGA referred to that as calling for like terms for like customers. Do you give like terms for like customers to the independent customers who purchase from you?

Mr Reitzer—Yes. I will explain exactly how we work. We take the price that we pay for the goods, less all the discounts that, as Gary said, are on the invoice—all the case discounts, all the efficiency allowances and even the cash discounts—and we arrive at a net net stripped cost. It is a field in our computer and it is totally transparent—any customer can go into any one of our systems anywhere and see the exact list of discounts—and that is the net net price that we pay the manufacturer. That is the price we charge every single customer. Every single customer of IGA pays that price. If you look at my financial accounts, my sales and my cost of sales are identical: what I get from my customers I give to the manufacturers.

So we get to a net stripped cost which we charge every single supplier and then we charge them a service fee for what they do. The service fee depends upon how much they buy. To pick every order, we walk an average of seven kilometres in a warehouse. So if a small customer gave me an order for two pallets and a big customer gave me an order for eight pallets, they would pay different prices. Those prices are published—they are in a manual and they are available to every single one of our customers—but like customers would pay exactly the same terms.

CHAIR—I think that is very clear. Just going to the issue of substantial market power, do you believe Metcash has substantial market power?

Mr Reitzer—No, not at all. As we said, the real competition is at retail. Our customers, collectively, have 16 per cent market share and I am up against two competitors that have 76 per cent between them, so we definitely do not have substantial market power.

Mr Tempany—When the manufacturers or the suppliers are putting their deals in place—for example, if they are looking to launch a new product into the marketplace—clearly, with our market share at 16 per cent, we do not dictate market power, whereas the combined market share of the chains would mean that, if the manufacturer does not get listed and ranged within at least one of the chains, and probably two, the viability of launching that new line into the marketplace would not be possible.

CHAIR—Mr Hunter, you said that you provided the NECG report to the ACCC.

Mr Hunter—It was commissioned for them.

CHAIR—Have you had any formal response from the commission?

Mr Reitzer—Yes. Firstly, we had a series of meetings where they questioned the arithmetic. There were a whole lot of things that I did not understand—about regression analysis and so on—but they were confirmed and ticked, and the matter is under consideration. Nothing further has happened.

CHAIR—And the NECG report makes a very strong argument that creeping acquisitions are affecting the viability of your business?

Mr Reitzer—That is correct. The NECG report had a look at all our numbers, at the volumes and margins relationships, and drew a graph that showed at what point we would no longer be able to compete. So it is a question of how long creeping acquisition goes until the independent sector will no longer be able to add a competitive tension in the market.

CHAIR—So the fact that your share price has gone up by 20 per cent since April is not an indication that things are strong for you, that you have a strong market share?

Mr Reitzer—No. I cannot answer the question as to why my share price goes up or down, because I do not know. All I can say is that Metcash has done very well over the last five years in taking a company that lost \$250 million four or five years ago to one making \$80 million this year.

But you must please understand that it would be impossible to do that if my independent retailers were not also making good margins and profits. So my sales can only be up if my customer sales are. As a result of all the things we have done in terms of branding, pricing, good retailing, coming out with petrol deals and things like that, we—my independent retail customers and I as the wholesaler—are all benefiting. People in the share market then buy my shares because they think they are good shares. We do not hide that.

The biggest compliment we had was when the NECG report proved that independently owned supermarkets do add a competitive tension. If we had done this report five years ago—we did not—they definitely would not have arrived at the same conclusion. We have done that by being cheaper, giving our customers great service and doing the right things. We are not shy of that and we are not hiding that. What we are saying is that, from an Australian point of view, we believe it would be wrong if that all disappeared and there really were only two players. We believe it is bad enough now. If you are a manufacturer, a farmer or a grower or you want to launch a new product, if two customers say no, that is the end of it. You have no opportunity to do that. None of them will come to give evidence here, but that is very much the case. We think that, if independents—my customers—were not kept there as an effective third force, it would be bad. Therefore there is an obligation on the government to do something. That is why we made the submission.

CHAIR—I have no further questions.

Senator BRANDIS—I have just one question. I think you have made your position reasonably clear, but I just want to make this perfectly clear for the record. It is no part of your

argument, is it, that there is not room for below-cost discounting in certain circumstances; you do not say that that is necessarily wrong or per se ought to be prohibited by the act, do you?

Mr Reitzer—No. At the moment all the players in the market are at times forced by market forces to sell things below cost.

Senator BRANDIS—Not just that, but on occasions there will be strategic behaviour which involves discounting to below cost which would not necessarily be unlawful; would you accept that?

Mr Reitzer—Yes, we accept that. Below-cost selling is, to my mind—and it is something we do, Coles do and Woolworths do—part of the normal trends and the normal competitive activities. It is actually procompetitive—

Senator BRANDIS—Absolutely.

Mr Reitzer—because the consumer wins. The point I would like to make is that I have an associate who owns 50 stores—they do not buy from us or anything—in Queensland. A certain competitor targeted just those 50 stores and was selling below cost purely against those 50 stores. One then has to ask oneself why. To my mind, that is bordering on anticompetitive behaviour because you are trying—

Senator BRANDIS—Of course it may be. But there are some people who take what I think is a fairly superficial view of this debate. They say that if you amend section 46 the effect of that may be to make it impossible for firms to engage in aggressive price discounting whenever that means they are selling a good or service below cost. I do not think that follows at all, because in a sense it avoids the question of in what circumstances that conduct is predatory and in what circumstances it is merely aggressive competition. Our task is to draw that line. I want to make this point because your firm is one of the submitters to this inquiry that is calling for fairly extensive reform of section 46. You do not say that section 46 should be amended to in all circumstances prevent below-cost price discounting, do you?

Mr Reitzer—No, where it is procompetitive. Where it is anticompetitive, it should be addressed by the law.

CHAIR—Thank you very much, gentlemen. That concludes our discussion this afternoon. We appreciate your submission. I found the report that you provided was fascinating as well and very useful for our deliberations. Thank you for your time.

[2.14 p.m.]

BURKE, Mr Charles, Chair, Farm Business and Economics Committee, National Farmers Federation

POTTER, Mr Michael James, Policy Manager, Economics, National Farmers Federation

CHAIR—Welcome. I invite you to make an opening statement and, at the conclusion of that, we will ask some questions.

Mr Burke—Thank you for the opportunity to provide a submission to the Senate Economics References Committee on the Trade Practices Act. Many farmers are affected by concentrated markets. Some farm inputs have only a few sellers—for example, fuel and chemicals. Similarly, many farm outputs have a limited number of buyers—for example, fruit, vegetables, chickens and dairy products. The Trade Practices Act provides two mechanisms to address concentration of market power. Firstly, the Trade Practices Act restricts the ability of firms to abuse market power and, secondly, it allows companies with limited market power to collectively bargain. It is important for both these mechanisms to work correctly and we therefore welcome the Dawson inquiry into competition provisions of the Trade Practices Act.

To both the Dawson inquiry and this Senate inquiry, NFF has emphasised that the collective-bargaining provisions are vital in ensuring farmers are able to deal with concentrated markets. We do not consider that concentrated markets should be dealt with through widespread changes to the provisions preventing abuse of market power. NFF therefore was supportive of Dawson's recommendations to make collective bargaining simpler, quicker and cheaper and to reject an effects test in section 46 of the Trade Practices Act.

However, NFF does have some suggestions to improve the details of Dawson's recommendations, and these are largely to address some issues that Dawson did not address. We should re-emphasise that NFF is overwhelmingly supportive of Dawson's recommendations. This Senate inquiry has enabled NFF to present its suggested improvements to Dawson's recommendations and to discuss some issues that were not considered in the Dawson inquiry. First, it is important to state that NFF is keen to ensure that any debate over sections 46 and 51AC does not detract from the more important issue for us, which is to ensure that collective bargaining is made simpler, quicker and cheaper. NFF considers that collective bargaining is the best way of addressing market power, rather than having much tougher restrictions on businesses with market power. Collective bargaining is less intrusive for businesses, is more certain to provide public benefits—whereas some of the other proposals may have little or no public benefit—and is generally accepted by all business groups, whereas some of the other proposals are supported by a narrower range of business groups.

NFF has greatest concern with the proposals to put an effects test in section 46 and to prohibit certain conduct under section 51AC. Our submission explores at great length the problems with an effects test in section 46, and I will not go over that territory at the moment. NFF has just put in a supplementary submission to the inquiry addressing the ACCC's new suggested amendments to section 46. I regret that we were not able to put in this submission earlier, but we

thought these issues were important enough to go through NFF's internal clearance process in detail. In NFF's estimation, these new proposals from the ACCC are much better than the previous proposal to insert an effects test. They are less invasive changes, which ensure that section 46 operates as intended, particularly after the 1986 amendments to the Trade Practices Act.

Senator BRANDIS—I am sorry, Mr Burke. Are you now referring to the proposals in your supplementary submission?

Mr Burke—Yes.

Senator BRANDIS—Thank you.

Mr Burke—A number of commentators have argued that recent court cases, particularly *Boral*, have reduced the effect of the 1986 amendments to the Trade Practices Act. NFF does not wish to enter this debate. A key aspect of the ACCC's new proposals is that they will have little or no effect if the courts are interpreting section 46 correctly. This should be seen in contrast to the effects test proposal, which would have changed the character of section 46 completely. We are especially concerned that an effects test will have anticompetitive results—exactly the opposite of what is intended.

Our supplementary submission also considers the Fair Trading Coalition's proposals relating to section 51AC, which prohibits unconscionable conduct. NFF has chosen not to comment on the first two proposals—that is, to add 'unfair' and 'harsh' to the definition of unconscionable conduct and to include misuse of market power as an indicator of unconscionable conduct. These proposals may raise some legal issues which NFF does not have any expertise in addressing.

However, we have significant concerns with the proposals to ban certain conduct—specifically, unilateral variation, termination without due process, varying a contract after it is signed and presentation of take-it-or-leave-it contracts. NFF agrees that the conduct is, in most cases, detrimental to competition. In fact, some of our members have raised concerns about this type of conduct. However, NFF does not consider that this warrants an outright ban on misconduct. There are occasions when this conduct is reasonable, and it may be difficult to carve out these occasions: for example, where a bank, with many banking products, can unilaterally vary the appropriate interest rate. Another concern is that the definition of prohibited conduct is vague: for example, banning unilateral variation means negotiation is required; how would 'negotiation' be defined? In addition, NFF is concerned with any significant proposal for amending the Trade Practices Act that is not being actively supported by the ACCC.

In summary, NFF is very supportive of measures to address market power by increasing the access to collective bargaining. We are not supportive of major changes to the rules prohibiting misuse of market power, although some smaller changes may be warranted. In any case, NFF does not want the collective bargaining proposals to be held up by an extended debate over the prohibitions. That concludes my opening address. Thank you.

CHAIR—Mr Potter did you want to add anything?

Mr Potter—I have just one quick thing to add: in the inquiry's terms of reference you wanted to consider codes of conduct. We have said in our submission that, overall, we are supportive of codes of conduct. However, we indicated that the retail grocery industry code of conduct has not reached an adequate standard at the moment. Significant improvements are needed to that and we are seeking for those concerns to be addressed through a separate government review of the retail grocery code.

CHAIR—Thank you. We had a long discussion about codes this morning with the ACCC and several other witnesses, and the ACCC certainly seemed to have a process in place for considering a whole range of codes.

Mr Potter—That is right. We have engaged with them on their draft process for looking to set a bar for voluntary codes of conduct. In order to get ACCC endorsement, the code should be above a certain quality. We have suggested that the retail grocery industry code of conduct could be a useful code to trial that process on.

Senator BOSWELL—As far as fruit and vegetables are concerned, is the code of conduct you are looking at going to establish who owns what? For example, when a farmer sends a product down to an agent, the agent may on-sell three or four times; from my observations from talking with growers, growers want to know who they are selling to. They do not want to have their product sold on up to four times and then get it back five days later. They want to know that if they send it to an agent he will operate as an agent and sell it and take his commission out, or he will ring them up and say, 'I can get you \$60 a box for this,' and they can take it or not. Is that what you want in the code of conduct?

Mr Burke—I think one of the difficulties has been in the definition of what an agent does and what a merchant does. What you have just said goes to where the simple answer is. People are concerned that they do not know whether a person who is trading is an agent and on-selling it and when they are going to get paid—

Senator BOSWELL—What is the NFF's view on that? Do they think this code should include a provision saying that a person must advise the farmer whether he is an agent or a merchant?

Mr Burke—Are you talking about the retail grocery industry code of conduct?

Senator BOSWELL—I am talking about a voluntary code of conduct for farmers and horticulturalists who send a product down to an agent. The agent may sell it on and on, and then they do not know where it goes. But they want to know that once it is sold it is not their problem. They do not want to get it back after it has been around five times. Is this what the NFF are looking at?

Mr Potter—Yes. That certainly is what we are trying to do. We made a submission to the government's review of the retail grocery code of conduct, which was quite detailed. It is not a public document. But one of the things that we said in that submission was that we wanted agents or traders, or whatever you call them, to make it completely clear at the start of the transaction which capacity they are operating in—whether they are actually taking ownership of

the produce; whether they are not taking ownership of the produce. Also, these people should provide contracts in writing unless the farmer specifically asks for it not to be put in writing.

Senator BOSWELL—I understand where you are coming from.

CHAIR—Thank you for your supplementary submission, which actually addressed those proposals from the ACCC. I want to talk to you a little bit about your proposals about collective bargaining, which you addressed initially in your remarks. One of the things that you have proposed is that the ACCC be required to respond to notifications within 21 day to allow extra time beyond the 14 days that was recommended by the Dawson report. Can you tell me what merit there is in that seven-day additional time frame? How did you come to that time frame?

Mr Burke—I guess within the confines of it we are trying to get the process to become quicker. With the recommendation that it be 14 days initially, we would rather that under a notification process—whether it takes the 21 days or not—all the information be considered properly rather than have provided an answer, for the sake of an answer, which did not address the issues properly.

CHAIR—Fair enough.

Mr Burke—What we are trying to do is to set some guidelines so that a speedy notification process can be resolved.

Mr Potter—Basically, we said the current process is really long. Fourteen days is much shorter but 21 days is still much shorter. Twenty-one days will be an improvement over the current process. But the difference between 14 days and 21 days is that 21 days may allow other businesses to provide adequate comment on it and may allow the ACCC to give a fairer consideration of it. We would rather, as Charles said, see the correct decision made within 21 days than an incorrect decision made within 14 days.

CHAIR—I appreciate that. Can you tell me under what circumstances you would envisage farmers using the boycott provisions in the course of collective bargaining?

Mr Burke—I guess there are a whole host of them. I do not necessarily have any specific examples at this stage. But I guess if we talk about misuse of market power and if there were a case where producers were being taken advantage of then that would be provision to have some sort of a collective boycott. As I said, we do not necessarily have specific examples or evidence of what would represent an example of that. It was more a general coverage of what has happened in the past, where groups or a small collection of farmers have felt compelled or almost trapped by having to deal with certain processes, agents or whatever.

Mr Potter—A key thing that we have said is if there is a proposal for a collective boycott it has to go through the normal provisions for there to be a public benefit, and we are not certain that there will be too many cases where a proposal for boycott would meet that test. So it is entirely possible that you could have lots of people applying for collective boycotts but none of them getting approved. That is not our area of expertise—determining whether that is the right decision or not—but we think it is appropriate that the public benefit test be used on everything, including boycotts.

CHAIR—Okay. Thank you very much. Senator Brandis?

Senator BRANDIS—I am lost for words, Madam Chair. I think I agree with everything in the submission practically. In particular, I might say, Mr Burke, I strenuously agree with you about the effects test, and I think that we have had that debate and that debate is over. So, no, I will not delay proceedings with questions.

Senator BOSWELL—This is only peripheral to the section 46 issue, but you said you were not entirely happy with the grocery code of conduct. How do you believe that needs to be strengthened?

Mr Burke—I do not know that it is appropriate for us to answer that question in this forum. We would be happy to explain that further. We have made submissions on how we perceive that that code has—

Senator BOSWELL—You do not have a submission with you here at the moment?

Mr Burke—No.

CHAIR—Senator Boswell, it was made to the government's inquiry; it is not a public document.

Senator BOSWELL—I know.

Mr Burke—So we would be able to go through that with you. We have made some very succinct suggestions about how it could be solved and, as I said, we would be more than happy to meet with you at any stage and work through those, because we see that there is plenty of room for improvement and progress.

Senator BOSWELL—That is okay. We might do that next week when parliament comes back.

Mr Potter—The overall context to the Senate inquiry is that codes of conduct are a great way of addressing concerns about market power, and we have been involved in quite a number of them outside of the retail grocery code—for example, the banking code and the insurance code. They are of mixed quality. One of the things we have come up with is that the banking code is really very good at a lot of the administrative provisions. When it comes to things like the non-core provisions—for example, relating to reviews of the code, how you handle disputes under the code and that sort of thing—the banking code is very good and the retail grocery code is not. And, of course, the ACCC have put out their guidelines for what a code should have. We would like to see the retail grocery code come up to the higher standards which have been set by others.

CHAIR—As there are no further questions, thank you very much for your time and for your submission and supplementary submission. The committee will be considering that in its report, which is due 4 December—so, not too long.

Mr Burke—We look forward to it. Thanks again for your time.

CHAIR—Thank you very much.

Committee adjourned at 2.32 p.m.