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Submission of John Danks and Son Pty Ltd
to the
Dawson Committee of Inquiry into the *Trade Practices Act 1974* (Cth)

June/July 2002

Executive summary

Terms of reference

John Danks & Son Pty Ltd ('**Danks**') wishes to make submissions in respect of the following terms of reference of the Committee:

- Is Part IV of the Trade Practices Act (**'TPA'**) effective in promoting competitive trading, in terms of services and price?
- Does Part IV of the TPA allow business to readily exercise their rights and obligations under the TPA, consistent with certainty, transparency and accountability?
- Does Part IVA inappropriately impede the ability of the Australian industry to compete?

Operative issues

Danks believes that Part IV severely inhibits the ability of franchised retail groups to compete with retailers operating under wholly-owned or co-operative corporate structures. Our concerns primarily relate to the *per se* prohibitions against price fixing (section 45/45A) and exclusionary provisions (section 45/4D), *viz*:

- the broad interpretation of 'competitors' in relation to the *per se* prohibitions;
- the ambiguity surrounding the interpretation and application of the collective acquisition / joint advertising exception to the price fixing prohibition; and
- the lack of exceptions to the exclusionary provision prohibition.

In its application to our business, and to those of our franchised retailers, the TPA is counter competitive. On its present construction, Part IV prevents our franchisees from leveraging their membership in a common retail brand to both effectively:

- promote competitive trading in terms of services and price;
- readily exercise rights and obligations under the TPA, consistent with certainty and transparency; and
- compete with other retail chains operating under wholly-owned or co-operative structures.

This is inconsistent with the objective of Part IV of the Act to procure and maintain competition in trade and commerce.

Recommendations

Danks submits that Part IV should be amended as follows:

- Franchised retail groups should comprise an exception to the prohibitions on exclusionary provisions and price fixing: ideally in relation to their participation in supply and acquisition markets, but at least in relation to acquisition markets. This may be achieved by either qualifying the definition of competitors in sub-sections 4D(2) and 45A(8), or by provision of a separate exception to these prohibitions.
- Alternatively, the scope of the section 45A(4) collective acquisition / joint advertising exception to the price fixing prohibition should be clarified to apply to individual acquisitions at a price secured via collective negotiation - whether the ultimate acquisition occurs directly with the supplier, or indirectly through a re-seller. This amended form of exemption should also be adapted to apply to arrangements between franchised group members re the supply or acquisition of goods or services under section 4D.

Neither of these proposals would result in competitive detriment in any market, as the franchised groups would remain subject to the general section 45 prohibition against contracts, arrangements or understandings that substantially lessen competition.

We would welcome the opportunity to discuss any of the issues raised in this submission in further detail with the Committee.

Mr John Tregaskis
General Manager

Mr Steven Johnston
National Sales & Marketing Manager

1. Company background of John Danks & Son Pty Ltd

John Danks & Son is a 142 year-old company, whose primary business is the distribution of hardware and garden products to our independent retail franchisees. We currently supply and manage the Home Timber & Hardware, Thrifty-Link Hardware and Plants Plus Garden Centres groups, which have 220, 385 and 110 stores, respectively. We have three distribution centres (located in Melbourne, Sydney and Perth), each stocking approximately 25,000 line items.

2. Our business

One of the major services that we offer to our franchisees is collective strength, *viz* the ability for independent retailers to amass a collective economy of scale. This enables our group members to access the benefits of a uniform brand, purchase stock and market their businesses in a more efficient, professional and cost-effective manner than could be achieved as single proprietors. These economies and efficiencies in turn allow our group stores to offer more competitively priced products in competition with the buying power of large retail chains, and to provide a better range and level of customer service to consumers.

- The retailers are not constrained to purchase product through Danks as they are free to deal direct with any suppliers that they choose.
- Unlike the Food or Pharmacy channels the retailers are not restricted to purchase their product requirements through wholesaler/distributors
- Danks is 'caught ' under the Franchising code because our Group retailers operate under Trade Marks owned by Danks and Danks in the main Manages their Advertising and Marketing spends.
- There is no Franchise or share purchase fee to be in our Marketing Groups.

3. Operative issues relevant to the terms of reference

In the process of refreshing our Trade Practices Compliance program, we have become aware of issues under Part IV of the TPA that may have the potential to severely inhibit the ability of our franchisees to compete with larger retailers operating under different corporate structures. These issues relate to the *per se* prohibitions against price fixing (section 45/45A) and exclusionary provisions (section 45/4D). We hold particular concerns in relation to:

- the broad conception of 'competitors' applicable in relation to the *per se* prohibitions;
- the ambiguity surrounding the interpretation and application of the collective acquisition / joint advertising exception to the price fixing prohibition (section 45A(4)); and
- the lack of exceptions to the exclusionary provision prohibition (section 4D).

3.1 'Competitors'

We understand that our geographically-proximate group retailers are potential competitors in the hardware / nursery supplies markets. However, we have also been advised that there is also a risk that each member may also be a competitor in the market for the wholesale acquisition of their hardware / nursery stock.

The conception of our group members as 'competitors' potentially exposes us to liability under both sections 45/45A and 45/4D. This restricts our ability to bring our retailers together to discuss commercial issues that are vital to their group's ability to effectively compete against other large hardware and nursery chains, and in which they have a vested interest as independent businesses. These issues include:

- the suppliers that we support;
- the selection of products, and the retail price points, to be advertised in group catalogues and on television;
- the development of localised advertising initiatives; and
- the establishment of fees to be charged for group advertising programs.

As a consequence, we have disbanded a number of our franchisee committees.

Wholly-owned retail chains (such as Bunnings and BBC / Hardwarehouse) and co-operatives (such as Mitre 10 nationally and Cooperative Purchasing Services who operate in WA) are not necessarily faced with the same restrictions. These organisations are fundamentally similar to us in the way that they go to market. The only difference is their corporate structure.

We understand that the theory behind the application of the *per se* prohibitions to acquisition markets is to avoid monopsonistic activity that has the potential to cause competitive detriment in markets along the vertical supply chain. Any such agreement between large buyers would, of course, fall foul of the general section 45 prohibitions against contracts, arrangements or understandings that substantially lessen competition in a market. However, the failure of the per se prohibitions to adequately account for small 'competitors' seeking to act in a pro-competitive manner by aggregating their buying power in a competitive market means that the per se prohibitions are actually harming the competitive processes they seek to promote.

Whilst some allowance is made for the pro-competitive activities of aggregated buying groups through the collective acquisition exception to the price fixing prohibition, we believe that the operation of this aspect of Part IV remains deficient due to:

- the ambiguity surrounding the scope and interpretation of that exception, which is ineffective in its application to franchised retail groups; and
- the lack of any form of collective acquisition exception to the exclusionary provision prohibition under section 4D. This operates to constrain the ability of buying groups to agree on such matters as preferred suppliers.

3.2 Collective advertising exception

Section 45A(4) of the TPA expressly exempts '*collective acquisitions*', and the '*joint advertising*' of the goods collectively acquired, from the scope of the price fixing prohibition. In particular, it exempts arrangements or understandings:

> *(a) in relation to the price of goods or services to be collectively acquired, whether directly or indirectly, by parties to the contract, arrangement or understanding ...; or*
>
> *(b) for the joint advertising of the price for the re-supply of goods or services so acquired.*

This statutory exemption has not yet been subject of judicial interpretation. Accordingly, its scope is unclear. We understand that the original intention of the exception was directed at buying groups (like the members of the Danks retail groups) that aim to achieve lower prices through scale economies in acquiring goods and services. However, we have been advised that that reliance on this exception is not without risk, due to the lack of judicial guidance on the section and, in particular, on the scope of the terms 'collective acquisition' and 'joint advertising'.

For example, it is not clear whether to satisfy the 'collective' element of the exemption it is necessary for our group members to:

> (b) collectively contract for the purchase of goods or services;
>
> (c) collectively negotiate, but separately contract, for the purchase of the goods or services (as suggested by the ACCC, below); or
>
> (d) collectively acquire the goods or services, in the sense of receiving or taking possession of the goods or services in a collective manner (eg a collective warehouse).

In both the Rural Guidelines in the Trade Practices Act (December 1997) and A Guide to the Trade Practices Act for the Health Sector (November 1995), the ACCC stated:

'*Collective acquisition generally requires collective negotiation (or negotiation by a collectively appointed negotiator) and individual acquisition at the price negotiated*'.

In making this comment, the ACCC was contrasting the situation of a collective acquirer who acquires title to goods and services and then re-sells the goods and services to members of a buying group.

We are concerned that, if the ACCC's interpretation of the exception is to be preferred, the franchised retail group structure employed by Danks may potentially fall outside the scope of the collective acquisition exception. This is because:

- there is no collective negotiation by the group members with the manufacturers /suppliers of their stock - either directly, or indirectly through a collectively-appointed negotiator. Rather, Danks negotiates and transacts with suppliers in its own capacity as a re-seller to, and not an acquisition agent of, its franchisee group members; and

- there is no acquisition by the retail group members from the manufacturers / suppliers - individually or otherwise - at the wholesale prices negotiated by Danks. Rather, the retail group members acquire their stock from Danks as an interposed entity.

Therefore, in its application to buying groups operated within a franchised structure, we submit that the collective acquisition / joint advertising exception may apply counter to its original intention to promote scale economies achieved by the aggregation of small businesses purchasing power.

3.3 Exceptions to the exclusionary provision prohibition

Deficient though the collective acquisition exception to the price fixing prohibition may be, it remains superior to the operation of the exceptions to the exclusionary provision prohibition (or, more accurately, the lack thereof). This prohibition strictly prohibits arrangements between competitors that have the purpose of preventing, restricting or limiting the supply of goods or services to, or acquisition of goods or services from, particular persons or classes of persons (in general, or on particular conditions). To the extent that a franchised buying group purports to agree on stock lines or preferred suppliers et cetera, it may potentially be deemed to have engaged in collective conduct in breach of the exclusionary provision prohibition.

3.4 Conclusion – operative issues relevant to the terms of reference

We submit that the results described above are inconsistent with the objective of Part IV of the Act to procure and maintain competition in trade and commerce. In its application to our business, and to those of our franchised retailers, the Act is counter competitive. On its present construction, Part IV prevents our franchisees from leveraging their membership in a common retail brand to both effectively:

- promote competitive trading in terms of services and price;

- readily exercise rights and obligations under the TPA, consistent with certainty and transparency; and

- compete with other retail chains operating under wholly-owned or co-operative structures.

This, in turn, negates the economies and efficiencies that allow our members to offer more competitively priced products in competition with the buying power of large retail chains, and to provide better range and customer service to consumers. It is the consumer that ultimately loses.

4. Suggested revisions to Part IV

In light of the anomalous application of Part IV discussed above, we submit that:

- franchised retail groups should comprise an exception to the prohibitions on exclusionary provisions and price fixing: ideally in relation to their participation in supply and acquisition markets,

but at least in relation to acquisition markets. This may be achieved by either qualifying the definition of competitors in sub-sections 4D(2) and 45A(8), or by provision of a separate exception to these prohibitions; and

- the scope of the section 45A(4) collective acquisition / joint advertising exception to the price fixing prohibition should be clarified to apply to individual acquisitions at a price secured via collective negotiation - whether the ultimate acquisition on the collectively-negotiated terms is direct from the supplier, or indirectly through a re-seller. This amended form of exemption for franchises should also be adapted to apply to arrangements between franchises group members in relation to the supply or acquisition of goods or services under section 4D.

Neither of these proposals will result in competitive detriment in any market, as such groups would remain subject to the general section 45 prohibition against contracts, arrangements or understandings that substantially lessen competition.

John Danks & Son Pty Ltd
12 July 2002