Submission to the

Review of the Trade Practices Act

By

The Department of Agriculture, Fisheries and Forestry – Australia

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EXECUTIVE SUMMARY

The Commonwealth Department of Agriculture, Fisheries and Forestry – Australia's (AFFA) Submission to the review of the competition and authorisation provisions of the *Trade Practices Act 1974* ('the Act') focuses on a number of issues of particular relevance to AFFA's portfolio industries including: imbalance in market power; authorisation of anti-competitive conduct; misuse of market power; and the regulation of mergers.

Given the broad nature of AFFA's portfolio responsibilities which cover agriculture, food, fishing and forestry, there is a divergence of views within stakeholder industries regarding the appropriateness of the provisions of the Act that are subject to review.

Many primary producers are faced with an imbalance of market power in their vertical commercial relationships. Factors contributing to this include deregulation, the concentrated nature of the markets into which primary producers sell produce and from which inputs are bought, the decrease in significance of collective price discovery mechanisms such as auctions and the increasing use by retailers of exclusive supply agreements.

At the same time, the global food product system has undergone significant and accelerating change in recent years. While global economic and trade developments present opportunities for Australian industry, they will increasingly challenge Australia's capacity to compete in globally integrated food markets. Australian domiciled businesses are increasingly under pressure to justify Australia as a strategic location for manufacturing and global product supply. This builds pressure to further rationalise and restructure to: reduce costs; achieve economies of scale; innovate in product development; and enhance process efficiencies, packaging and marketing to compete with large multinationals.

AFFA believes that authorisation of collective bargaining is an important mechanism to address the imbalance in market power that many primary producers face. However, the current authorisation process may be unnecessarily time consuming and costly and may place an unnecessarily onerous burden on applicants. AFFA believes that the Committee should consider a number of reform options specifically in relation to authorisation of collective bargaining by small businesses to address an imbalance of market power. Options that the Committee should consider include the extension of the notification process and/or the incorporation of concentration and market share thresholds into authorisation approval processes, below which the hurdles for endorsement would be lowered.

In addition to the options outlined above, AFFA also believes that the Committee should examine opportunities to more generally streamline the current authorisation process. Options that the Committee should consider include: reducing timeframes in relation to Australian Competition and Consumer Commission (ACCC) determinations; reducing the fee for applications that are very similar to, or are continuations of, existing authorisations; and imposing the same time limit which currently applies to Australian Competition Tribunal decisions regarding reviews of merger determinations to reviews of all other determinations.

AFFA advocates that the ACCC continue to foster an understanding of the authorisation process, and trade practices matters generally, throughout Australia's primary industries

and food processing sector. In this regard, AFFA is aware of the ACCC's Rural and Regional Program established in 2001 to enable the Commission to ensure that rural and regional communities are aware of their rights and obligations under the Act. AFFA believes that such a program performs a valuable role and strongly supports its retention.

Through maintaining regular informal contact with producer and processor bodies, the ACCC could better identify potential areas in which breaches of the Act may be occurring and target its enforcement activities accordingly. Provision of education material for inclusion in industry journals, particularly in relation to the myriad of smaller horticultural associations, may enable the ACCC to improve producers' and processors' understanding of the Act and its administration. AFFA is available to assist the ACCC in identifying relevant industry associations to contact in conducting its education campaigns.

AFFA understands that the unconscionable conduct provisions in Part IVA of the Act (which this review is not considering) and Sections 46 (misuse of market power) and 47 (exclusive dealing) are likely to be relevant, in certain circumstances, to primary producers' concerns regarding their vertical commercial relationships. In addition, AFFA notes that Section 45 (contracts, arrangements or understandings that restrict dealings or affect competition) may also be relevant. The Committee should carefully consider the appropriateness of the existing competition provisions of the Act to address these concerns. This Submission illustrates the nature of competitive interactions within portfolio industries that should be considered by the Committee in their deliberations.

As a general principle, AFFA supports the concept of offence penalties being commensurate with the consumer and business detriment resulting from illegal conduct. These penalties should serve as a sufficient deterrent to illegal market behaviour.

Many of Australia's leading food companies contend that industry rationalisation via mergers and acquisitions is necessary to achieve critical mass in production, innovation and marketing relative to other competitors in global markets. The Committee should ensure that the current merger arrangements are appropriate for globalised markets. The Committee should be mindful, however, that any moves to loosen the current merger arrangements may have detrimental implications for primary producers given the imbalance of market power in vertical commercial relationships underpinning the supply of primary produce.

AFFA believes the Committee should examine opportunities to improve the process of considering merger proposals and, subject to commercial in-confidence issues, enhance the transparency of merger decisions in the pursuit of greater certainty for Australian business. However, AFFA is not advocating the move to a formal mergers notification system.

AFFA notes that issues surrounding the possible introduction of oversight arrangements for the competition regulator have featured prominently in debate of matters associated with the review. Information on the governance arrangements applying to the regulatory functions of the Australian Quarantine Inspection Service (AQIS) (within AFFA's portfolio) has been included as way of general information for the Committee.

1. INTRODUCTION

1.1 AFFA's Interest in the Review

The Commonwealth Department of Agriculture, Fisheries and Forestry – Australia (AFFA) welcomes the opportunity to provide comment on the appropriateness of the current competition and authorisation provisions of the *Trade Practices Act 1974* ('the Act'). As a public sector entity, AFFA has only limited direct exposure to the provisions of the Act. However Australia's framework for regulation of competitive business conduct is highly relevant to all commercial entities in Australia, including those in the agricultural, food, fisheries and forestry industries. Accordingly, AFFA has a sizable stake in the maintenance of the Act's relevance and effectiveness.

1.2 Scope of the Review

The Terms of Reference require the Committee to review the operation of the competition and authorisation provisions of the Act, specifically Parts IV (and associated penalty provisions) and VII. Broadly speaking, Part IV prohibits the following anti-competitive trade practices:

- anti-competitive agreements and exclusionary provisions, (Sections 45-45EB) [it should be noted that the Terms of Reference specifically exclude Sections 45D-45EB which deal with secondary boycotts];
- misuse of market power (Sections 46-46B);
- exclusive dealing (Section 47);
- resale price maintenance (Section 48); and
- mergers which would have the effect of substantially lessening competition in a substantial market (Sections 50 & 50A).

Part VII of the Act deals with authorisations and notifications in respect of anti-competitive trade practices. Under the provisions in Part VII, the Australian Competition and Consumer Commission (ACCC) has the power to provide exemption from legal action for some mergers and certain anti-competitive conduct that might otherwise breach the Act.

1.3 Contents of Submission

This Submission discusses some of the more prominent issues associated with the competition and authorisation provisions of the Act and their implications for AFFA portfolio industries. Section 2 provides background information on the role of AFFA and the contribution of the agricultural, food, fisheries and forestry industries to the Australian economy. This section also highlights the changing composition of world food trade as well as the globalisation of food industries and its implications for Australian food companies.

Section 3 discusses the changing operating environment for many primary producers, focussing on the issue of imbalance of market power faced by producers in their vertical commercial relationships. Discussion of the authorisation process and possible reform options to address its shortfalls are also explored. Consideration of the applicability of the competition provisions in relation to primary producers' concerns is also provided.

Section 4 provides an overview of the different views of primary producers and the food industry in regard to the merger provisions and their administration. The Submission concludes with some information on existing governance arrangements applying to the regulatory functions of the Australian Quarantine Inspection Service (AQIS) which lies within AFFA's portfolio.

2. BACKGROUND

2.1 Overview of AFFA

AFFA serves the Australian community by promoting the profitability, competitiveness and sustainability of Australia's agricultural, food, fisheries and forestry industries and enhancing Australia's natural resource base to achieve greater national wealth and stronger rural and regional communities.

The Department's responsibilities include:

- assisting Australian agricultural, food, fisheries and forestry industries become more competitive, profitable and sustainable;
- enhancing the natural resource base that supports Australia's agricultural, food, fisheries and forestry industries;
- delivering scientific and economic research, policy advice, programs and services to assist portfolio industries overcome challenges and capitalise on the opportunities of a dynamic and globally-integrated operating environment;
- addressing issues relating to the integrity of Australia's food supply chain, from producer to processor to the consumer;
- safeguarding the integrity of Australia's animal, plant and fish health status;
- undertaking quarantine, export inspection and certification, and food safety standards activities and ensuring their consistency with international regulations governing trade between nations; and
- optimising opportunities for Australian animal, plant, fish, food and forestry products to access overseas markets.

AFFA includes businesses that provide specialist services to portfolio industries such as AQIS, the Australian Bureau of Agricultural and Resource Economics (ABARE), and the Bureau of Rural Sciences (BRS). The Department also oversights a number of statutory marketing authorities, regulatory authorities, Research and Development Corporations, and advisory bodies.

In 2001-02, AFFA received an estimated $242 million in Commonwealth revenue to deliver portfolio outputs in addition to receiving around $182 million from external customers and clients for specific services. The Department also administers about $1,085 million of additional Government funds directed towards programs for Australia's agricultural, fisheries, forestry and food industries and to support improved natural resource management.

2.2 Rural Commodity Overview

The agricultural, fisheries and forestry industries play an important role in the economic health of Australia. The gross value added to the Australian economy by the agricultural sector amounted to $18.4 billion in 2000-01, representing 2.9 per cent of Gross Domestic Product (GDP). The forestry and fishing industries together contributed $1.6 billion of gross value added, or one quarter of a GDP percentage point.

In 2001-02 there were 429,000 people employed in the agriculture, forestry and fishing industries. This figure comprised: 369,000 people engaged in agriculture; 28,000 in rural service industries; 13,000 in forestry and logging; and 19,000 in commercial fishing.

Farm, forest and fisheries products represented around 21 per cent of Australian exports of goods and services on a balance of payments basis in 2000-01. Mineral resources (36 per cent), other merchandise (22 per cent) and services (21 per cent) constituted the remaining export categories.

2.2.1 Agriculture

Australia's gross value of agricultural production was estimated at $37.8 billion in 2001-02, a 34 per cent increase over the $28.3 billion recorded in 1996-97. Farm exports contributed $30.5 billion to the Australian economy in 2001-02, representing more than 80 per cent of total agricultural output. The total value of farm exports has risen by an estimated 40 per cent over the past five years.

The pattern of rapidly declining numbers of agricultural establishments in the early 1990s has slowed, with the number of establishments remaining at around 145,000 between 1995 and 2000. The number of agricultural enterprises in Australia increased slightly from 145,226 in 1999 to 146,371 as at 30 June 2000. The number of establishments by agricultural activity is detailed in Table 1.

In 2001-02, the relatively low value of the Australian dollar, relatively buoyant international prices for agricultural commodities and good seasonal conditions in most parts of Australia contributed to significant increases in both the total value of agricultural production and the value of agricultural exports. However, the gross value of farm production and the value of farm exports for 2002-03 are both forecast to decline by nine per cent due to an appreciating Australian currency, lower commodity prices and less favourable climactic conditions.

While the net value of farm production is forecast to decline by 40 per cent to around $5.8 billion in 2002-03, following a 51 per cent rise in 2001-02, it is still likely to be higher than for any year in the 1990s.

2.2.2 Fisheries and Forestry

The gross value of Australian fisheries production was estimated at $2.5 billion in 2001-02, having increased by around 41 per cent over the previous five years. Australian exports of fisheries products have increased by 70 per cent since 1996-97 and realised an estimated $2.1 billion in 2001-02.

The gross value of forestry production amounted to an estimated $1.3 billion in 1999-2000, a 27 per cent rise over the four-year period since 1996-97. The value of Australian forest product exports, including paper and paperboard products, was estimated at $1.7 billion in 2001-02. The total value of forest product exports has risen by 46 per cent since 1996-97.

Table 1: Establishments with agricultural activity, as at 30 June 2000

Enterprise	No. of Establishments
Beef cattle farming	35,236
Grain-sheep/beef cattle farming	18,232
Grain growing	16,463
Sheep farming	14,302
Dairy cattle farming	13,820
Sheep-beef cattle farming	9,253
Other fruit growing	8,300
Grape growing	6,522
Vegetable growing	5,313
Sugar cane growing	5,029
Plant nurseries, cut flower and flower seed growing	3,630
Horse farming	2,021
Crop and plant growing n.e.c.	1,614
Other livestock farming n.e.c.	1,158
Pig farming	1,145
Cotton growing	974
Poultry farming (meat)	845
Poultry farming (eggs)	508
Deer farming	196
Other industries	1,811
Total all industries	146,371

n.e.c – not elsewhere classified
Source: Australian Bureau of Statistics; *Agriculture (Catalogue 7113.0*) (October 2001)

2.3 The Australian Food Industry[1]

The food industry is a vital component of the Australian economy. Food products, incorporating fresh horticultural produce and processed goods (i.e. meat, dairy, processed seafood, beverages and ingredients), account for about 43 per cent of total retailing turnover in Australia and around 20 per cent of Australia's merchandise exports. Exports of these food products have averaged annualised growth of nine per cent over the past decade and realised $16.9 billion in 2000-01. In the same financial year, Australia imported $4.3 billion of processed food and beverages.

The food industry directly employs over 225,000 people throughout Australia in around 25,000 horticultural establishments and other food businesses. Australia's food product system makes a significant contribution to the economies of regional areas through employment, business and service opportunities.

The processed food industry is Australia's largest manufacturing sector (with a turnover in excess of $55 billion in 2000-01) adding value to Australia's agricultural commodities sold in both domestic and export markets. The industry contributes around $14.3 billion or 2.2% to Australia's GDP. The industry comprises around 3,400 firms employing over

[1] Information on the Australian food industry and world food trade presented in sections 2.3, 2.4 and 2.5 has been extracted from an AFFA publication *National Food Industry Strategy* (June 2002).

163,000 people. Around 22 per cent of processed food and beverage sales are to international markets.

Changing consumer tastes; preferences for healthy eating; improvements in handling, storage and distribution systems; enhanced plant breeding techniques; improved management practices; and more targeted marketing in the Australian domestic market, has resulted in a 15 per cent increase in the consumption of fruit and vegetables over the last decade and an increase of more than 40 per cent in the past 50 years. This trend has provided significant growth opportunities for Australian horticulture.

Fresh horticultural products contribute around five per cent of the value of Australia's food exports and have doubled in value over the 1990s to around $680 million in 2000-01. The horticultural industry makes a significant contribution to rural and regional economies with over 60,000 employees located in these areas.

2.4 The Changing Nature of International Food Trade

While agricultural commodities and processed food products have long been internationally traded, the composition of world food trade has changed significantly in recent years. The four major components of world food trade include: bulk commodities; processed intermediate products (such as skim milk powder, bulk cheese and boned meat); fresh horticultural products; and processed consumer goods (such as beverages, smallgoods, biscuits, and confectionery). Recent figures show that trade in processed food products has increased to an estimate of 75 per cent of global food trade, from 50 per cent in 1985, and is growing at twice the rate of trade in primary products.

However, Australia has a relatively small share of the international food market with around three per cent of global trade in processed food. While this figure has remained steady over the last few years, Australia's major competitors have been steadily increasing their global market share.

2.5 Globalisation of the Food Industry

The global food product system has undergone significant and accelerating change in recent years. This has been fuelled by the removal of barriers to the flow of information, capital services and goods. Rapid technological advancements in transport, financial services, telecommunications and computer technology have also been responsible for driving change. While global economic and trade developments present opportunities for Australian industry, they will increasingly challenge Australia's capacity to compete in globally integrated food markets.

Globalisation allows firms to treat whole regions, or indeed the whole world, as a single market. This supports the global sourcing of inputs and the manufacturing and marketing of products on a very large scale and at highly competitive prices. In addition to cost savings, international expansion through greenfields investments, mergers and acquisitions provides new growth opportunities for food processors faced with mature and low-growth domestic markets. The trend to global mega-mergers is accelerating with the value of mergers and acquisitions in the food industry in 2000 representing around 12 times the historical norm.

International businesses are restructuring and extending their operations along international lines, siting their operations globally to centralise operational functions, such as marketing, R&D or procurement, in locations that leverage competitive advantage.

Australian domiciled businesses are increasingly under pressure to justify Australia as a strategic location for corporate production and global supply. This builds pressure to further rationalise and restructure to: reduce costs; achieve economies of scale; innovate in product development; and enhance process efficiencies, packaging and marketing to compete with the large multinationals. These efforts need to be supported by Government policies conducive to international competitiveness in meeting import competition and forging export markets.

3. IMBALANCE OF MARKET POWER, AUTHORISATION & MISUSE OF MARKET POWER

Key Points

- The Committee should be aware that many primary producers are faced with an imbalance of market power in their vertical commercial relationships. Factors contributing to this include deregulation, the concentrated nature of the markets into which primary producers sell produce and from which inputs are bought, the decrease in significance of collective price discovery mechanisms such as auctions and the increasing use by retailers of exclusive supply agreements.

- AFFA believes that authorisation of collective bargaining is an important mechanism to address the imbalance of market power that many primary producers face. However, the current authorisation process may be unduly time consuming and costly and may place an unnecessarily onerous burden on applicants. AFFA believes that the Committee should consider a number of reform options specifically in relation to authorisation of collective bargaining by small businesses to address an imbalance of market power. Options that the Committee should consider include the extension of the notification process and/or the incorporation of concentration and market share thresholds into authorisation approval processes, below which the hurdles for endorsement would be lowered.

- In addition to the options outlined above, AFFA also believes that the Committee should examine opportunities to more generally streamline the current authorisation process. Options that the Committee should consider include reducing timeframes in relation to ACCC determinations; reducing the fee for applications that are very similar to, or are continuations of existing authorisations; and imposing the same time limit which currently applies to Australian Competition Tribunal (ACT) decisions regarding reviews of merger determinations to reviews of all other determinations.

- AFFA advocates that the ACCC should continue to foster an understanding of the authorisation process, and trade practices matters generally, throughout Australia's primary industries and food processing sector.

- AFFA understands that the unconscionable conduct provisions in Part IVA of the Act (which this review is not considering) and Sections 46 (misuse of market power) and 47 (exclusive dealing) are likely to be relevant, in certain circumstances, to primary producers' concerns regarding their vertical commercial relationships. In addition, AFFA notes that Section 45 (contracts, arrangements or understandings that restrict dealings or affect competition) may also be relevant. The Committee should carefully consider the appropriateness of the existing competition provisions of the Act to address these concerns.

- As a general principle, AFFA supports the concept of offence penalties being commensurate with the consumer and business detriment resulting from illegal conduct. These penalties should serve as a sufficient deterrent to illegal market behaviour.

3.1 Imbalance of Market Power

Many of the agricultural industries that were formerly regulated by statutory marketing legislation have been deregulated. In some cases this has meant the removal of vesting and/or price setting arrangements. As a result most rural producers in these industries are now facing the task of negotiating their own prices and conditions of sale rather than being subject to those prescribed by the Statutory Marketing Authorities[2]. At the same time, price discovery mechanisms for agricultural products are declining in significance as direct contract negotiations replace traditional auction systems.

In a deregulated marketing environment, most primary producers are faced with the situation of doing business both as a buyer of inputs and supplier of outputs in highly concentrated markets

The combination of deregulation, concentrated markets and lack of price discovery mechanisms has increased the exposure of primary producers to commercial price negotiations in which larger agribusiness companies and food retailers can leverage considerable market power in negotiating contractual arrangements for the supply of produce.

It is also important to note that the major retailers are building long-term global supply relationships with a limited number of preferred suppliers. These large retailers, by enforcing adherence to 'proprietary' food safety and quality systems, are discouraging the 'sharing' of suppliers. Gaining exclusive supply agreements is a form of vertical integration that allows retailers to maximise their returns from efficiency improvements along the chain.

With some agricultural commodities, opportunities for spacial and temporal arbitrage improve the bargaining power of producers. The prevalence of derivatives instruments, including new products such as weather futures, allows farmers to price risk and make fully informed business decisions reflective of actual costs of production. However, risk management instruments are yet to evolve in many newly deregulated markets and perishability of products means that some farmers have limited opportunity to benefit from arbitrage opportunities.

In certain industries such as dairying, the widespread prevalence of co-operatives serves to provide pricing transparency and disciplines the terms and conditions of confidential negotiations between proprietary companies and their suppliers in other parts of the industry.

Most agricultural co-operatives essentially control product at both the primary and secondary levels of production resulting in vertical supply-chain integration. Hence co-operative benefits to members accrue from a combination of factors: prices received for supply of produce; returns on capital in the form of dividends; the increasing value of equity stakes in the co-operative; and any farm services and other benefits that may be accessed by virtue of membership.

[2] Some rural industries retain statutory marketing legislation. An example is the single desk wheat export marketing arrangements. These arrangements are specifically exempted from Part IV of the Act by subsection 57(6) of the *Wheat Marketing Act 1989*. The Wheat Export Authority will review the single desk arrangements in 2004.

As competitive pressures increase, some of these co-operative structures are likely to be involved in some form of corporate consolidation whereby business ownership may revert to proprietary companies. In such instances, the price-discovery benefits of co-operatives to all farmers, irrespective of co-operative membership or otherwise, are likely to be lost. This may further weaken producer bargaining power in industries such as dairying.

Appendix A contains information on developments relevant to primary producers' concerns regarding their vertical commercial relationships, including some of the recommendations of the Joint Select Committee on the Retailing Sector and a Senate Order to the ACCC on the prices paid to suppliers by Australian grocery retailers.

3.2 Authorisation

Authorisation of collective bargaining is seen by many primary producers as an important mechanism to address the imbalance of market power in vertical commercial relationships.

Authorisation provides protection from action by the ACCC or any other party for potential breaches of certain anti-competitive trade practices provisions of the Act. In its publication *Authorisations and Notifications* (May 1999) the ACCC points out the five steps to authorisation:

- lodging an application for authorisation;
- the statutory test;
- draft determination;
- requesting a conference; and
- final determination.

A fee of $7,500 is payable upon applying for authorisation ($15,000 in the case of merger authorisations) and $1,500 for each additional related applications (other than for mergers) lodged within 14 days of the first application.

The ACCC states that when lodging an application for authorisation the application should clearly identify the conduct or arrangement for which authorisation is being sought, and the parties to it; include all relevant documentation; and be accompanied by a submission identifying in detail claims of public benefits arising from the conduct and addressing any anti-competitive detriment. Interim authorisations can be requested either at the time the application is lodged, or later.

In assessing applications for authorisation the ACCC must assess the public benefits and anti-competitive aspects of the arrangements or conduct. For arrangements and conduct that may substantially lessen competition, the applicant must satisfy the ACCC that the arrangements or conduct results in a benefit to the public that outweighs any anti-competitive effect. For primary and secondary boycotts, third line forcing, resale price maintenance and mergers, the applicant must satisfy the ACCC that the conduct results in a benefit to the public significant to justify its endorsement.

After considering the application the ACCC prepares a draft determination, normally within four months of receipt of the application. The applicant or any other interested party dissatisfied with the draft determination can request a conference. Such requests must be made in writing, generally within 14 days of the draft's publication. The

conference must be held within 30 days of that 14-day period. After the conference the Commission reconsiders the application and publishes its final determination, usually within 30 days. In the absence of a request for a conference or submissions opposing the draft determination, the ACCC promptly publishes its final determination.

The ACCC's final determination is subject to appeal to the ACT. Applications for review of ACCC determinations must be lodged within 21 days of the date of the final determination. In the case of mergers, the ACT must make a decision within 60 days except in special or complex circumstances. It is understood that there is no equivalent time period in which the ACT must make a decision regarding a review of non-merger determinations.

3.3 Concerns with the Authorisation Process

A number of concerns have been raised about the authorisation process, including its timeliness, cost and the onerous burden it places on applicants. A lack of understanding of the process and the types of issues that need to be addressed when applying for authorisation would also appear to be a problem.

Many agricultural industries are geographically fragmented and are not always effectively represented by industry associations. In addition, most industry associations do not have a great deal of money and resources, nor the skills necessary to put together a thorough authorisation application.

The dairy industry is an example of an industry that has been recently deregulated and exhibits characteristics that suggest an imbalance of market power. The market is characterised by a large number of individual farming enterprises (currently around 12,000) and a small number of milk processors (3 major) in addition to a number of facilities producing manufactured milk products such as cheese, skim milk powder, butter and yoghurt.

The ACCC has recognised the weak bargaining position of farmers by granting collective bargaining authorisation to Premium Milk in Queensland in 2001 and, in its 2002 decision handed down to Australian Dairy Farmers' Federation (ADFF), authorising all farmers across Australia to form bargaining groups subject to specified criteria. The costs of applying for exemption on an individual group-by-group basis were a factor in the ADFF applying for some form of umbrella authorisation covering all dairy farmers in Australia.

However, the ACCC decision granting authorisation has attracted an appeal to the ACT that will significantly delay the formation of bargaining groups and may also entail significant legal costs that will affect the ability of ADFF to defend the ACCC decision. If the ACT overturns the original ACCC decision, the cost of re-applying for exemptions on an individual regional basis may well become a major issue for dairy farmers.

3.4 Options for Reform of the Authorisation Process

3.4.1 Streamlining the Current Authorisation Process

To address some of these concerns, AFFA is of the view that the Committee should examine opportunities to more generally streamline the current authorisation process. Options that the Committee should consider include:

- reducing the timeframe in which the ACCC must make a determination in relation to an authorisation application;
- reducing the application fee for applications that are very similar to, or are continuations of, existing authorisations; and
- imposing the same time limit which currently applies to ACT decisions regarding reviews of merger determinations to reviews of all other determinations.

3.4.2 Increasing Producers' Understanding of Trade Practices Matters

The ACCC should explore opportunities to build ongoing relationships with agricultural industry associations as a means of facilitating the dissemination of information on trade practices matters generally, and authorisation specifically. This should also extend to the food industry, particularly those in rural and regional areas.

In this regard, AFFA is aware of the ACCC's Rural and Regional Program established in 2001 to enable the Commission to ensure that rural and regional communities are aware of their rights and obligations under the Act. AFFA believes that such a program performs a valuable role and strongly supports its retention.

Through maintaining regular informal contact with producer and processor bodies, the ACCC could better identify potential areas in which breaches of the Act may be occurring and target its enforcement activities accordingly. Provision of education material for inclusion in industry journals, particularly in relation to the myriad of smaller horticultural associations, may enable the ACCC to improve producers' and processors' understanding of the Act and its administration. AFFA is available to assist the ACCC in identifying relevant industry associations to contact in conducting its education campaigns.

3.4.3 Extension of the Notification Process

In addition to streamlining the authorisation process, AFFA believes that the Committee should consider additional reform options exclusively in relation to authorisation applications by small businesses seeking to address an imbalance of market power. One option would involve extending the current notification process used for exclusive dealing to replace the authorisation process.

Notification provides protection from action for potential breaches of the exclusive dealing provisions of the Act. It differs from the authorisation process in that parties do not have to await a decision from the ACCC. The immunity given by notification operates from the date of lodgement (or 14 days after in the case of third line forcing) and remains in place unless revoked by the Commission.

In its publication *Authorisations and Notifications* (May 1999), the ACCC states "If [in the case of third line forcing] within the 14-day period after lodgement, the Commission issues a draft notice stating that it intends to revoke the notification, immunity will not commence unless the Commission makes a final decision not to revoke the notification…

"The Commission will revoke immunity for exclusive dealing (other than third line forcing) only if it considers the conduct substantially lessens competition and that in all the circumstances there appears to be no countervailing public benefit; or any public benefit does not outweigh the detriment to the public resulting from the lessening of competition.

"To deny or revoke immunity in respect of notified third line forcing the Commission must be satisfied that the likely benefit to the public will not outweigh the likely detriment to the public."

It is likely that, similar to notifications for third line forcing, immunity in relation to collective bargaining by small businesses would not be automatic, but rather commence after a sufficient period for the ACCC to consider the proposed conduct and indicate whether it will revoke the notification. This is because the type of conduct likely to be considered may have significant competition issues.

3.4.4 Application of Concentration and Market Share Thresholds

Another reform option could involve introducing something similar to the current concentration and market share thresholds that are applied by the ACCC in its consideration of merger proposals. Provided the collective group does not breach the thresholds (or alternatively the party they wish to negotiate with operates in a highly concentrated market or has a substantial market share), it should be much easier and cheaper for small businesses to receive authorisation. This option could be an alternate to the notification proposal just discussed, or it could be a component of the notification proposal (thus the ACCC would allow the collective group to use the notification process rather than authorisation if the thresholds were not breached).

Making it easier for those primary producers faced with an imbalance of market power to collectively negotiate may lead to skilled bargaining agents entering newly deregulated industries. This may encourage innovation in contract bargaining and enhance vertical risk sharing in agricultural supply chains. However, if these arrangements did lead to the use of bargaining agents, there would be a need to impose certain conditions relating to information disclosure and other issues fundamental to the preservation of competitive market structures. These conditions may need to be prescribed in legislation.

3.5 Misuse of Market Power and Other Provisions

The terms imbalance of market power and misuse of market power have separate and distinct interpretations. A primary producer facing an imbalance of market power in their vertical commercial relationships whereby that imbalance is used to their disadvantage, may simply represent a situation indicative of the normal dynamics of market behaviour. However, in certain instances, the relevant conduct may raise concerns under the Act.

In its publication *National Farmers' Federation 2001 Election Priorities* (2001), the National Farmers' Federation list the areas of concern that farmers raise regarding their commercial supply arrangements. These include:

- "unfair negotiating practices;
- the absolute refusal to issue documented supply contracts for fresh produce suppliers;
- breaches of contract;
- the 'flexible' use of quality standards as grounds for product rejection;
- the enforcement of additional costs irrespective of contract terms;
- the imposition of onerous financial terms on contract suppliers; and
- the absolute refusal to issue documented supply contracts for fresh produce suppliers."

Section 46 of the Act deals with misuse of market power. Subsection 46(1) states:

> A corporation that has a substantial degree of power in a market shall not take advantage of that power for the purpose of:
>
> (a) eliminating or substantially damaging a competitor of the corporation or of a body corporate that is related to the corporation in that or any other market;
> (b) preventing the entry of a person into that or any other market; or
> (c) deterring or preventing a person from engaging in competitive conduct in that or any other market.

AFFA is aware of possible options for reform to Section 46 that are likely to be considered by the Committee. Some of these include: reversal of onus of proof; introduction of an 'effects test' either in addition to, or in place of, the 'purpose test'; introduction of 'cease and desist orders'; and amendment to subsection 46(7) to make it explicit that purpose can be inferred from the effect of any conduct.

These options have generated considerable public debate and received substantial media coverage in recent months. These issues are likely to be canvassed in detail in other submissions and should be carefully considered by the Committee.

The focus of Section 46 is on conduct between business competitors and thus primarily relates to horizontal commercial relationships. AFFA understands that Section 46 is only likely to be relevant to vertical commercial relationships where misuse of market power is manifested in vertical constraints (i.e. insistence on exclusive terms).

Section 47 (exclusive dealing) and the unconscionable conduct provisions in Part IVA of the Act are also likely to be relevant, in certain circumstances, to primary producers' concerns. More generally (i.e. not necessarily related to an imbalance of market power), Section 45 (contracts, arrangements or understandings that restrict dealings or affect competition) may also be relevant. For example, price fixing, market sharing and primary boycotts are types of conduct in which buyers of agricultural produce or suppliers of inputs may engage that could potentially have detrimental outcomes for primary producers.

In relation to Section 47, subsections 47(2), (3), (6) and (7) focus on exclusive dealing behaviour by suppliers and subsections 47(4) and (5) focus on exclusive dealing behaviour by buyers. With the exception of matters relevant to subsections 47(6) and (7) which deal with third line forcing, conduct must substantially lessen competition before a possible

breach has occurred. Notification and authorisation can be sought in relation to conduct that is believed to breach Section 47.

It would appear that the unconscionable conduct provisions in Part IVA of the Act (which this review is not considering) are relevant to some of the concerns of primary producers relating to their vertical commercial relationships that are not addressed by the competition provisions. Sections 51AA and 51AC deal with unconscionable conduct in commercial transactions. Section 51AA provides a statutory basis for the existing common law/equitable action of unconscionable conduct, and Section 51AC provides a new statutory case of action for unconscionable conduct, primarily aimed at assisting small businesses.

In the context of these matters, the Committee should carefully consider the appropriateness of the existing competition provisions of the Act to address primary producers' concerns relating to their vertical commercial relationships. The Committee should draw on the information on markets for rural commodities and associated products provided in earlier sections of this Submission to ensure that the interests of primary producers are given adequate consideration.

As a general principle, AFFA supports the concept of offence penalties being commensurate with the consumer and business detriment resulting from illegal conduct. These penalties should serve as a sufficient deterrent to illegal market behaviour.

4. MERGERS

Key Points

- AFFA notes many of Australia's leading food companies contend that industry rationalisation via mergers and acquisitions is necessary to achieve critical mass in production, innovation and marketing relative to other competitors in global markets. The Committee should ensure that the current merger arrangements are appropriate for globalised markets.

- The Committee should be mindful that any moves to loosen the current merger arrangements may have detrimental implications for primary producers given the imbalance of market power in vertical commercial relationships underpinning the supply of primary produce.

- AFFA believes the Committee should examine opportunities to improve the process of considering merger proposals and, subject to commercial in-confidence issues, enhance the transparency of merger decisions in the pursuit of greater certainty for Australian business. However, AFFA is not advocating the move to a formal mergers notification system.

4.1 Relevant Provisions

The Act provides the ACCC with two tiers of regulation in relation to mergers and acquisitions:

- Section 50 of the Act prohibits acquisitions which would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia, or in a State, Territory or region of Australia; and

- Part VII of the Act allows the ACCC to authorise, or grant legal immunity to mergers that would be likely to result in such a benefit to the public that the acquisition should be allowed to take place. Moreover, Section 87B of the Act is available for undertakings to overcome the anti-competitive effect of mergers where appropriate.

The ACCC's approach to administering and enforcing the competition test is outlined in its publication *Merger Guidelines* (updated June 1999). The Merger Guidelines use a series of 'thresholds' to determine whether a merger is likely to lessen competition. These relate to: the market share of the merged entity and levels of concentration in the market; whether imports are effective in constraining the entity (generally if they are at least 10% of the market); if barriers to entry are low; and other factors such as countervailing power.

Authorisation applications for mergers are covered by additional specific legislative requirements. In making its assessment, the ACCC considers all potential public benefits from the proposed merger. The Act specifically requires that a significant increase in the real value of exports or significant import substitution be regarded as public benefits. It must also take into account all other relevant matters that relate to the international competitiveness of Australian industry.

The ACCC must make a decision on a merger authorisation application within 30 days, although it has the ability to extend the time should additional information be required and the applicant has been notified. Authorisation is deemed to be granted if the ACCC does not make a decision within the applicable timeframe.

4.2 Merger Debate

4.2.1 Appropriateness of Current Merger Provisions

AFFA is aware of the current debate regarding the merger provisions and their administration by the ACCC and the extent to which Australian companies are permitted to achieve sufficient economies of scale to compete internationally.

The test for a merger was changed to substantial lessening of competition in 1993 because it was considered at the time that international competitiveness was achieved not by encouraging industries to increase scale through mergers, but rather by encouraging them to compete.

The ACCC claims that most mergers do not raise competition concerns and are not challenged by the Commission. On average, approximately 5% of mergers considered by the ACCC annually raise competition concerns. The majority of these are subsequently approved with court-enforceable undertakings. Industry argues that these figures are distorted as they do not include informal approaches to the ACCC that result in the businesses involved not pursuing the matter or instances in which businesses are deterred from even discussing the prospect of potential mergers with the Commission due to perceptions of limited chances of success.

Definition of the relevant market is fundamental to the application of the merger guidelines. The guidelines provide for the consideration, under the definition of market, of all sources of closely substitutable products, including imports, which are available to consumers. Mergers are assessed on a case-by-case basis, taking into account supply and demand-side substitutability at the time of the merger.

The ACCC maintains that the framework of the Act is not an obstacle to allowing Australian firms to merge to achieve the scale necessary for international competitiveness (where this is necessary) provided there is sufficient public benefit.

It is also worth noting that there may be other ways of achieving enhanced capacity to compete internationally if this is the central concern of business. In its publication *Exports and the Trade Practices Act* (October 1997), the ACCC states “Apart from mergers and joint ventures there are other vehicles in which firms may organise themselves that can be used to enhance international competitiveness. Firms may choose to form a consortium in respect of export operations, or make an export agreement which can be registered with the Commission”.

Subsection 51(2)(g) of the Act provides an exemption to the competition provisions in Part IV (except for secondary boycotts and resale price maintenance) for a provision of a contract, arrangement or understanding that relates exclusively to the export of goods from Australia, or to the supply of services outside Australia, provided relevant details are

submitted to the ACCC within 14 days of arrival at the contract, arrangement or understanding.

When evaluating the current provisions and their administration, and deciding whether these need to be amended, the Committee needs to be aware of the divergent concerns of the food industry and primary producers.

4.2.2 Concerns of Primary Producers

Any proposal to loosen the current mergers test is likely to result in further rationalisation of some of the key markets to which primary producers supply. This is likely to further increase the existing imbalance in market that many producers face in their vertical commercial relationships.

For example, the domestic dairy processing sector is already highly concentrated and pressure for further rationalisation has increased since deregulation, particularly given the competition for house brand milk contracts to support milk-flow volumes and reduce the fixed costs of operating milk processing facilities. This is despite the low margins associated with supply of generic milk products. In considering whether further amalgamations or acquisitions should be approved, AFFA believes that careful consideration should be given to the bargaining position of farmer-suppliers and the preservation of price gains to consumers following deregulation.

The situation is complicated by developments in New Zealand where the industry has effectively amalgamated into one major player that owns equity in several Australian domestic processors. Should the current mergers test be relaxed, a situation could emerge where control over domestic processors is increasingly held by a single entity. Developments in New Zealand also mean that competition from imported milk and yoghurt products is reduced.

4.2.3 Concerns of the Food Industry

Food industry concerns differ from those raised by primary producers for a number of reasons including:

- food processing companies are generally larger than individual agricultural producers and global rationalisation of food processors is well-advanced;
- the food processing sector does not have an R&D infrastructure similar to the R&D corporations that support rural commodity producers. Hence, food businesses often need to have the scale to commission their own R&D activities;
- food companies largely trade in differentiated, branded products where there is less potential for co-operation in activities such as marketing; and
- food companies are generally competing against large global companies.

There are concerns among manufacturing industries about merger regulation. These concerns generally encompass the following themes:

- Australia's current merger regulation is too restrictive and mergers which would foster efficiency and not hinder competition have been inhibited on occasions. The economic

costs of deterring efficiency-enhancing mergers can be large as firms may be prevented from competing in global markets where scale economies are important;
- problems with mergers are partly due to shortcomings in the provisions (i.e. what is allowed under the legislation), and partly due to the manner in which the regulations are administered;
- the ability of Australian companies to compete effectively on an international scale has suffered due to merger regulation, resulting in Australian companies being relatively easy targets for foreign takeovers – leading to a "branch office" status for the economy; and
- more and more Australian companies are looking offshore as domestic opportunities for mergers shrink. The merger regulations in Australia are claimed to be more onerous than in other countries.

Larger companies in the food industry commonly express these sentiments. The food industry is concerned that the risk of ACCC opposition and resulting legal expense is sufficient in some cases to end preliminary merger negotiations at an early stage. To encourage multinational corporations to operate in Australia (and to bring added benefits such as R&D, technology and sharing of a skilled international workforce), some food companies argue that Australia needs to have competition laws that are comparable to other leading countries. The ACCC contends that the Export Guidelines address these concerns. However the provisions of the Export Guidelines are not always relevant because multinationals tend to set up franchises in Australia rather than export.

Concerns have been expressed in a number of studies over the lack of anti-trust enforcement in some international markets relative to Australia. The Asian region is renowned for the weakness of its enforcement, and for allowing cartels to operate in many sectors including the food industry. If local firms are inhibited by mergers regulation from rationalising in Australia while their competitors are not, Australian firms could be placed at a disadvantage in competing in offshore markets.

4.3 Informal Mergers Approval Process

Besides the central merger debate, there are also concerns relating to the timeliness and uncertainty associated with the consideration of merger proposals and the lack of transparency of ACCC merger decisions.

AFFA notes, however, that:

- Australia is unlike many other countries in that notification of mergers is not compulsory (and thus regulatory burden on businesses wishing to merge is reduced) and the ACCC is understood to be world's best practice in respect of timelines for its informal consideration of merger proposals; and
- time periods for clearance of merger proposals and the associated information requirements are set out in the *Merger Guidelines*.

Although not advocating the move to a formal mergers notification system, AFFA believes that the Committee should examine any opportunities to improve the current process of considering merger proposals and, subject to commercial in-confidence issues, enhance the transparency of merger decisions in the pursuit of greater certainty for Australian business. In this respect, AFFA notes that in its Submission to this review the ACCC states "The

Commission is open to any constructive suggestions to help overcome procedural delays flowing from its processes or the way that parties and their advisers bring matters to the Commission for consideration within the context of the informal notification system."

5. GOVERNANCE ISSUES

AFFA notes the debate about whether the current governance arrangements for the ACCC are sufficient to ensure the appropriate enforcement of the Act. Information on the governance arrangements applying to the regulatory functions of AQIS, as well as associated industry consultative mechanisms, has been included as way of general information for the Committee.

The Quarantine and Exports Advisory Council (QEAC) is a non-statutory independent advisory council to the Minister for Agriculture, Fisheries and Forestry and the Director of Quarantine. The Council's terms of reference incorporate all functions performed by AQIS and include:

- provision of advice to the Minister and the Director of Quarantine on major quarantine and export certification policy issues and strategic directions for AQIS;
- inquiry into and provision of advice to the Minister on matters referred to it by the Minister;
- acting as a focal point to ensure broad ranging, effective consultation between AQIS/AFFA, industry and stakeholders;
- provision of advice on the effectiveness of AQIS's program delivery;
- oversighting implementation of the Government's decision on the Quarantine Review Fish Task Force and Meat Inspection Reform reports; and
- assisting AQIS/AFFA in evaluating its performance.

QEAC is a skills-based Committee with strong academic background and industry experience. Members are appointed for 2-3 year terms. All appointments are ratified by Cabinet and the Prime Minister once a decision has been made by the Minister.

Industry Consultative Committees have been established as a consultative mechanism between QEAC and various industry groups with an interest in quarantine and export matters. Committees established include Biologicals, Grain Industry, Dairy Export, Export Meat Industry, Organic Produce Export, Seafood Export, Post Entry Plant Industry, Horticultural Export, Imported Foods, Cargo and Airline Industry. The scope of the committees is reflected in their Terms of Reference and each Committee meets on a regular basis e.g. quarterly, bi-annually or annually. The consultative process has a degree of inherent informality and flexibility, that is seen as a great strength by industry groups, QEAC and AQIS and is considered integral to the continuing success and evolution of the consultative process.

Further information on these arrangements can be obtained from AFFA.

Department of Agriculture, Fisheries and Forestry – Australia

Date: 19 July 2002

APPENDIX 1

DEVELOPMENTS RELEVANT TO PRIMARY PRODUCERS' CONCERNS WITH THEIR VERTICAL COMMERCIAL RELATIONSHIPS

Joint Select Committee on the Retailing Sector

To address concerns about the impact of market concentration in the Australian retail sector, the Government set up the Joint Select Committee on the Retailing Sector on 10 December 1998. The Committee presented its report, *Fair Market or Market Failure*, on 30 August 1999 which contained 10 recommendations. The Government implemented a number of these recommendations (either in part or full), including the introduction of a voluntary Retail Grocery Industry Code of Conduct ('the Code') and a Retail Industry Ombudsman, as well as amendments to the Act.

The Code came into effect on 13 September 2000 and represents a set of voluntary guidelines promoting fair trading practices in the retail grocery industry and a simple resolution mechanism in the event of a dispute. The Code addresses: produce standards and specifications; contracts; labelling, packaging and preparation; and voluntary notification of retail business acquisitions. The Code applies to industry participants in their vertical commercial relationships.

Notwithstanding the introduction of the Code, primary producers are still expressing concern with the practices of the major buyers of their produce. Anecdotal evidence suggests growers fear commercial ramifications if they pursue with the Ombudsman a case of unfair commercial practice against the major supermarkets.

The *Trade Practices Amendment Act (No 1) 2001* (enacted in July 2001) implemented a number of the recommendations of the Joint Select Committee as well as other amendments stemming from the Australian Law Reform Commission's 1994 report *Compliance with the Trade Practices Act*.

Amendments that were made to the Act stemming from the Joint Select Committee included:

- giving the ACCC the power to undertake representative actions and to seek damages on behalf of third parties under Part IV of the Act;
- extending the definition of a market (for mergers and acquisitions) from a substantial market in Australia, a State or a Territory to also include a region of Australia; and
- increasing the $1 million transactional limit applying to Section 51AC (unconscionable conduct) to $3 million.

Senate Order to the Australian Competition and Consumer Commission

On 8 February 2001 the Australian Senate agreed to an order that a report be presented to the Senate, as soon as practicable after 30 June 2001, by the ACCC on the prices paid to suppliers by Australian grocery retailers and associated terms relating to resold goods. The order also dealt with related matters concerning price differences and market conduct.

The ACCC's inquiry is examining the relationships between major suppliers, wholesalers and grocery retailers (i.e. those at the front-end of the supply chain). The inquiry will exclude consideration of the price of fresh fruit and vegetables and fresh meat. In its publication *Senate Order to the Australian Competition and Consumer Commission on Prices Paid to Suppliers by Retailers and Wholesalers in the Australian Grocery Industry - Discussion Paper* (August 2001) the ACCC states "The Commission notes that the comparison of prices paid at the farm gate to the price paid by consumers at the end of the supply chain is an important issue but a detailed analysis of that issue is beyond the scope of this inquiry".